

PATRIOT NATIONAL BANCORP INC

Form 10-Q

August 08, 2014

Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended June 30, 2014

Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut

06-1559137

(State of incorporation)

(I.R.S. Employer Identification Number)

900 Bedford Street, Stamford, Connecticut 06901

(Address of principal executive offices)

(203) 324-7500

(Registrant's telephone number)

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

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

Yes No

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date.

Common stock, \$0.01 par value per share, 39,160,627 shares outstanding as of the close of business July 31, 2014.

Table Of Contents

Table of Contents

| | |
|--|----|
| <u>PART I - FINANCIAL INFORMATION</u> | 3 |
| Item 1: <u>Consolidated Financial Statements</u> | 3 |
| Item 2: <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 45 |
| Item 3: <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 58 |
| Item 4: <u>Controls and Procedures</u> | 60 |
| <u>PART II - OTHER INFORMATION</u> | 61 |
| Item 1: <u>Legal Proceedings</u> | 61 |
| Item 1A: <u>Risk Factors</u> | 61 |
| Item 6: <u>Exhibits</u> | 61 |

Table Of Contents**PART I - FINANCIAL INFORMATION****Item 1: Consolidated Financial Statements****PATRIOT NATIONAL BANCORP, INC.****CONSOLIDATED BALANCE SHEETS**

| | <i>(in thousands, except shares)</i> | |
|---|--|----------------------|
| | June 30, 2014 | December 31, 2013 |
| | (Unaudited) | |
| ASSETS | | |
| Cash and due from banks: | | |
| Noninterest bearing deposits and cash | \$1,584 | \$1,570 |
| Interest bearing deposits | 58,345 | 33,296 |
| Total cash and cash equivalents | 59,929 | 34,866 |
| Securities: | | |
| Available for sale securities, at fair value (Note 2) | 35,686 | 37,701 |
| Other Investments | 4,450 | 4,450 |
| Federal Reserve Bank stock, at cost | 1,517 | 1,444 |
| Federal Home Loan Bank stock, at cost | 4,143 | 4,143 |
| Total securities | 45,796 | 47,738 |
| Loans receivable (net of allowance for loan losses: 2014: \$5,214 2013: \$5,681) (Note 3) | 402,786 | 418,148 |
| Accrued interest and dividends receivable | 1,555 | 1,566 |
| Premises and equipment, net | 18,227 | 15,061 |
| Cash surrender value of life insurance | 22,262 | 22,025 |
| Deferred tax asset (Note 6) | - | - |
| Other assets | 1,498 | 1,844 |
| Total assets | \$552,053 | \$541,248 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits (Note 4): | | |
| Noninterest bearing deposits | \$61,685 | \$55,358 |
| Interest bearing deposits | 364,747 | 374,846 |
| Total deposits | 426,432 | 430,204 |
| Federal Home Loan Bank borrowings | 72,000 | 57,000 |
| Junior subordinated debt owed to unconsolidated trust | 8,248 | 8,248 |
| Accrued expenses and other liabilities | 2,057 | 3,955 |
| Total liabilities | 508,737 | 499,407 |

Commitments and Contingencies (Note 9)

Shareholders' equity (Notes 5 and 10)

| | | |
|--|------------------|------------------|
| Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding | - | - |
| Common stock, \$.01 par value, 100,000,000 shares authorized; 2014: 39,172,332 shares issued; 39,160,627 shares outstanding. 2013 :38,786,680 shares issued; 38,774,975 shares outstanding | 392 | 388 |
| Additional paid-in capital | 105,610 | 105,484 |
| Accumulated deficit | (61,840) | (62,684) |
| Less: Treasury stock, at cost: 2014 and 2013, 11,705 shares | (160) | (160) |
| Accumulated other comprehensive income | (686) | (1,187) |
| Total shareholders' equity | 43,316 | 41,841 |
| Total liabilities and shareholders' equity | \$552,053 | \$541,248 |

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents**PATRIOT NATIONAL BANCORP, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)***(in thousands, except per share amounts)*

| Three Months Ended | | Six Months Ended | |
|--------------------|----------|------------------|----------|
| June 30, | June 30, | June 30, | June 30, |
| 2014 | 2013 | 2014 | 2013 |

Interest and Dividend Income

| | | | | |
|---|--------------|--------------|--------------|---------------|
| Interest and fees on loans | \$4,667 | \$ 5,045 | \$ 9,358 | \$ 10,241 |
| Interest on investment securities | 133 | 226 | 268 | 474 |
| Dividends on investment securities | 42 | 29 | 83 | 58 |
| Other interest income | 14 | 9 | 26 | 37 |
| Total interest and dividend income | 4,856 | 5,309 | 9,735 | 10,810 |

Interest Expense

| | | | | |
|--|--------------|--------------|--------------|--------------|
| Interest on deposits | 607 | 1,032 | 1,244 | 2,161 |
| Interest on Federal Home Loan Bank borrowings | 33 | 167 | 66 | 518 |
| Interest on subordinated debt | 82 | 71 | 282 | 142 |
| Interest on other borrowings | - | 6 | - | 82 |
| Total interest expense | 722 | 1,276 | 1,592 | 2,903 |
| Net interest income | 4,134 | 4,033 | 8,143 | 7,907 |
| Provision for Loan Losses | - | - | - | (30) |
| Net interest income after provision for loan losses | 4,134 | 4,033 | 8,143 | 7,937 |

Non-Interest Income

| | | | | |
|--|------------|------------|--------------|--------------|
| Mortgage banking activity | 17 | 119 | 17 | 165 |
| Loan application, inspection & processing fees | 83 | 116 | 149 | 154 |
| Fees and service charges | 233 | 212 | 452 | 383 |
| Gains on sale of loans | - | 28 | - | 28 |
| Gain on sale branch assets and deposits | - | 51 | - | 51 |
| Earnings on cash surrender value of life insurance | 116 | 142 | 237 | 269 |
| Other income | 174 | 101 | 361 | 206 |
| Total non-interest income | 623 | 769 | 1,216 | 1,256 |

Non-Interest Expense

| | | | | |
|--------------------------------------|-------|-------|-------|-------|
| Salaries and benefits | 1,976 | 2,577 | 3,947 | 5,582 |
| Occupancy and equipment expense | 865 | 936 | 1,787 | 1,975 |
| Data processing expense | 279 | 289 | 529 | 660 |
| Advertising and promotional expenses | 73 | 76 | 124 | 118 |

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

| | | | | |
|---|---------------|-------------------|----------------|--------------------|
| Professional and other outside services | 457 | 770 | 928 | 1,659 |
| Loan administration and processing expenses | 19 | 74 | 36 | 151 |
| Regulatory assessments | 237 | 304 | 467 | 678 |
| Insurance expense | 78 | 83 | 175 | 162 |
| Other real estate operations | (4) | 55 | 12 | 57 |
| Material and communications | 84 | 102 | 177 | 208 |
| Restructuring charges and asset disposals (Note 12) | - | 394 | - | 394 |
| Prepayment penalty on borrowings | - | 2,711 | - | 2,711 |
| Other operating expenses | 168 | 343 | 333 | 728 |
| Total non-interest expense | 4,232 | 8,714 | 8,515 | 15,083 |
| Income (loss) before income taxes | 525 | (3,912) | 844 | (5,890) |
| Benefit for Income Taxes | - | - | - | (21) |
| Net income (loss) | \$525 | \$ (3,912) | \$ 844 | \$ (5,869) |
| Basic and diluted income (loss) per share | \$0.01 | \$ (0.10) | \$ 0.02 | \$ (0.15) |

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents**PATRIOT NATIONAL BANCORP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

| | <i>(in thousands)</i> | | | |
|------------------------------------|-----------------------|------------------|----------------|------------------|
| | Three Months | | Six Months | |
| | Ended | | Ended | |
| | June 30, | | June 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Net income (loss) | \$525 | \$(3,912) | \$844 | \$(5,869) |
| Other comprehensive income: | | | | |
| Unrealized holding gains | | | | |
| (losses) arising during the | 108 | (629) | 501 | (574) |
| period | | | | |
| Total | 108 | (629) | 501 | (574) |
| Comprehensive income (loss) | \$633 | \$(4,541) | \$1,345 | \$(6,443) |

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents**PATRIOT NATIONAL BANCORP, INC.****CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY****(Unaudited)***(in thousands, except shares)*

| | Number of Shares | Common Stock | Additional Paid-In Capital | Accumulated Deficit | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---------------------|-----------------|----------------------------------|------------------------|-------------------|---|-----------|
| Six months ended June 30, 2014 | | | | | | | |
| Balance at December 31, 2013 | 38,774,975 | \$ 388 | \$ 105,484 | \$ (62,684) | \$ (160) | \$ (1,187) | \$ 41,841 |
| Comprehensive income | | | | | | | |
| Net income | - | - | - | 844 | - | - | 844 |
| Unrealized holding gain on available for sale securities | - | - | - | - | - | 501 | 501 |
| Total comprehensive income | | | | | | | 1,345 |
| Share-based compensation | | | | | | | |
| expense | - | - | 130 | - | - | - | 130 |
| Issuance of restricted stock | 385,652 | 4 | (4) | | | | - |
| Balance, June 30, 2014 | 39,160,627 | \$ 392 | \$ 105,610 | \$ (61,840) | \$ (160) | \$ (686) | \$ 43,316 |
| Six months ended June 30, 2013 | | | | | | | |
| Balance at December 31, 2012 | 38,480,114 | \$ 385 | \$ 105,356 | \$ (55,395) | \$ (160) | \$ (618) | \$ 49,568 |
| Comprehensive loss | | | | | | | |
| Net loss | - | - | - | (5,869) | - | - | (5,869) |
| Unrealized holding loss on available for sale securities | - | - | - | - | - | (574) | \$(574) |
| Total comprehensive loss | | | | | | | (6,443) |
| Share-based compensation | | | | | | | |
| expense | - | - | 15 | - | - | - | 15 |
| Redemption of restricted stock | (34,788) | - | | | | | - |
| Balance, June 30, 2013 | 38,445,326 | \$ 385 | \$ 105,371 | \$ (61,264) | \$ (160) | \$ (1,192) | \$ 43,140 |

Table Of Contents**PATRIOT NATIONAL BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

| | <i>(in thousands)</i> | |
|--|-----------------------|-----------------|
| | Six Months Ended | |
| | June 30, | |
| | 2014 | 2013 |
| Cash Flows from Operating Activities: | | |
| Net income (loss): | \$844 | \$(5,869) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Restructuring charges and asset disposals | - | 303 |
| Amortization of investment premiums, net | 128 | 87 |
| Amortization and accretion of purchase loan premiums and discounts, net | 40 | 16 |
| Provision for loan losses | - | (30) |
| Gain on sale of loans | - | (28) |
| Gain on sale of mortgage loans | - | (161) |
| Originations of mortgage loans held for sale | - | (28,975) |
| Proceeds from sales of mortgage loans held for sale | - | 19,111 |
| Earnings on cash surrender value of life insurance | (237) | (269) |
| Depreciation and amortization | 573 | 588 |
| Loss (gain) on sale of other real estate owned | 4 | (200) |
| Proceeds from sale of branch assets and deposits | - | 127 |
| Gain on sale of branch assets and deposits | - | (51) |
| Share-based compensation | 130 | 15 |
| Changes in assets and liabilities: | | |
| Decrease (Increase) in net deferred loan costs | 76 | (110) |
| Decrease in accrued interest and dividends receivable | 11 | 184 |
| Decrease in other assets | 346 | 795 |
| Decrease in accrued expenses and other liabilities | (1,898) | (1,286) |
| Net cash provided by (used in) operating activities | 17 | (15,753) |
| Cash Flows from Investing Activities: | | |
| Principal repayments on available for sale securities | 2,388 | 1,514 |
| Purchases of Federal Reserve Bank stock | (73) | - |
| Proceeds from repurchase of excess stock by Federal Reserve Bank | - | 96 |
| Proceeds from repurchase of excess stock by Federal Home Loan Bank | - | 201 |
| Proceeds from sale of loans | - | 10,655 |
| Net decrease in loans | 15,246 | 477 |
| Purchase of other real estate owned | (264) | - |
| Proceeds from sale of other real estate owned | 260 | 1,310 |

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

| | | |
|---|---------------|-----------------|
| Capital improvements of other real estate owned | - | (80) |
| Purchase of bank premises and equipment, net | (3,739) | (2,708) |
| Net cash provided by investing activities | 13,818 | 11,465 |
| Cash Flows from Financing Activities: | | |
| Net increase in demand, savings and money market deposits | 9,640 | 17,103 |
| Net decrease in time certificates of deposits | (13,412) | (22,205) |
| Decrease in deposits held for sale | - | (14,538) |
| Increase (decrease) in FHLB borrowings | 15,000 | (15,000) |
| Decrease in repurchase agreements | - | (7,000) |
| Net cash provided by (used in) financing activities | 11,228 | (41,640) |
| Net increase (decrease) in cash and cash equivalents | 25,063 | (45,928) |
| Cash and Cash Equivalents: | | |
| Beginning | 34,866 | 71,014 |
| Ending | \$59,929 | \$25,086 |

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued

(Unaudited)

| | Six Months Ended June 30, | |
|---|---------------------------------|----------|
| | 2014 | 2013 |
| Supplemental Disclosures of Cash Flow Information | | |
| Interest paid | \$2,965 | \$2,866 |
| Income taxes paid | \$3 | \$3 |
| Supplemental disclosures of noncash operating, investing and financing activities: | | |
| Unrealized holding gain (loss) on available for sale securities arising during the period | \$501 | \$(574) |
| Reduction in deposits held for sale | \$- | \$10,167 |
| Reduction in branch assets held for sale | \$- | \$12 |

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Financial Statement Presentation

The Consolidated Balance Sheet at December 31, 2013 has been derived from the audited financial statements of Patriot National Bancorp, Inc. (“Bancorp” or “the Company”) at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the previously filed audited financial statements of Bancorp and notes thereto for the year ended December 31, 2013.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the six months ended June 30, 2014 are not necessarily indicative of the results of operations that may be expected for the remainder of 2014.

Table Of Contents**Note 2: Investment Securities**

The amortized cost, gross unrealized losses and approximate fair values of available-for-sale securities at June 30, 2014 and December 31, 2013 are as follows:

| <i>(in thousands)</i> | Amortized Cost | Gross Unrealized Losses | Fair Value |
|--|-------------------|-------------------------------|---------------|
| June 30, 2014: | | | |
| U. S. Government agency bonds | \$ 7,500 | \$ (156) | \$7,344 |
| U. S. Government agency mortgage-backed securities | 19,872 | (374) | 19,498 |
| Corporate bonds | 9,000 | (156) | 8,844 |
| | \$ 36,372 | \$ (686) | \$35,686 |
| December 31, 2013: | | | |
| U. S. Government agency bonds | \$ 7,500 | \$ (421) | \$7,079 |
| U. S. Government agency mortgage-backed securities | 22,388 | (636) | 21,752 |
| Corporate bonds | 9,000 | (130) | 8,870 |
| | \$ 38,888 | \$ (1,187) | \$37,701 |

Table Of Contents

The following table presents the gross unrealized loss and fair value of Bancorp's available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at June 30, 2014 and December 31, 2013:

| <i>(in thousands)</i> | Less Than 12 Months | | 12 Months or More | | Total | |
|---|----------------------------|------------------------|--------------------------|------------------------|-------------------|------------------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| <u>June 30, 2014:</u> | | | | | | |
| U. S. Government agency bonds | \$- | \$ - | \$7,344 | \$ (156) | \$7,344 | \$ (156) |
| U. S. Government agency mortgage -backed securities | - | - | 19,484 | (374) | 19,484 | (374) |
| Corporate bonds | - | - | 8,844 | (156) | 8,844 | (156) |
| Totals | \$- | \$ - | \$35,672 | \$ (686) | \$35,672 | \$ (686) |
| <u>December 31, 2013:</u> | | | | | | |
| U. S. Government agency bonds | \$7,079 | \$ (421) | \$- | \$ - | \$7,079 | \$ (421) |
| U. S. Government agency mortgage -backed securities | 8,871 | (291) | 12,856 | (345) | 21,727 | (636) |
| Corporate bonds | - | - | 8,870 | (130) | 8,870 | (130) |
| Totals | \$15,950 | \$ (712) | \$21,726 | \$ (475) | \$37,676 | \$ (1,187) |

At June 30, 2014, all eleven available-for-sale securities had unrealized holding losses with aggregate depreciation of 1.9% from the amortized cost. At December 31, 2013, eleven securities had unrealized losses with aggregate depreciation of 3.2% from the amortized cost.

Bancorp performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, when the loss position is due to a deterioration in credit quality, management's plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management believes that none of the unrealized losses on available-for-sale securities noted above are other than temporary due to the fact that they relate to market interest rate changes on U.S. Government agency debt, corporate debt and mortgage-backed securities issued by U.S. Government agencies. Management considers the issuers of the securities to be financially sound, the corporate bonds are investment grade and the Company expects to receive all contractual principal and interest related to these investments. Because the Company does not intend to sell the investments, and it is not more-likely-than-not that the Company will be required to sell the investments before

recovery of their amortized cost basis, which may be at maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2014.

Table Of Contents

The amortized cost and fair value of available-for-sale debt securities at June 30, 2014 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be prepaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following summary:

| <i>(in thousands)</i> | Amortized Cost | Fair Value |
|---|-------------------|---------------|
| Maturity: | | |
| Corporate bonds 5 to 10 years | \$ 9,000 | \$8,844 |
| U.S. Government agency bonds < 5 years | 2,500 | 2,491 |
| U.S. Government agency bonds 5 to 10 years | 5,000 | 4,853 |
| U.S. Government agency mortgage-backed securities | 19,872 | 19,498 |
| Total | \$ 36,372 | \$35,686 |

Note 3: Loans Receivable and Allowance for Loan Losses

A summary of the Company's loan portfolio at June 30, 2014 and December 31, 2013 is as follows:

| <i>(in thousands)</i> | June 30, 2014 | December 31, 2013 |
|-----------------------------|------------------|-------------------------|
| Real Estate | | |
| Commercial | \$219,762 | \$223,165 |
| Residential | 89,517 | 106,198 |
| Construction | - | 260 |
| Construction to permanent | 14,436 | 11,303 |
| Commercial | 37,849 | 35,061 |
| Consumer home equity | 42,384 | 44,081 |
| Consumer installment | 3,397 | 2,990 |
| Total Loans | 407,345 | 423,058 |
| Premiums on purchased loans | 160 | 200 |
| Net deferred costs | 495 | 571 |
| Allowance for loan losses | (5,214) | (5,681) |
| Loans receivable, net | \$402,786 | \$418,148 |

Table Of Contents

The changes in the allowance for loan losses for the periods shown are as follows:

| <i>(in thousands)</i> | Three months ended June 30, 2014 | | Six months ended June 30, 2013 | |
|--|---|---------|---|---------|
| | 2014 | 2013 | 2014 | 2013 |
| Balance, beginning of period | \$5,480 | \$5,717 | \$5,681 | \$6,016 |
| Provision for loan losses | - | - | - | (30) |
| Loans charged-off | (285) | (412) | (502) | (717) |
| Recoveries of loans previously charged-off | 19 | 17 | 35 | 53 |
| Balance, end of period | \$5,214 | \$5,322 | \$5,214 | \$5,322 |

The unpaid principal balances of loans on nonaccrual status and considered impaired were \$13.9 million at June 30, 2014 and \$12.3 million at December 31, 2013. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately \$51,000 of additional income during the quarter ended June 30, 2014 and \$373,000 during the quarter ended June 30, 2013. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately \$84,000 of additional income for the six months ended June 30, 2014 and \$679,000 for the six month ended June 30, 2013.

For the three months ended June 30, 2014 and 2013, the interest collected and recognized as income on impaired loans, which includes non-accrual loans, trouble debt restructurings ("TDRs") and loans that were previously classified as TDRs that have been upgraded, was approximately \$184,000 and \$96,000 respectively. For the six months ended June 30, 2014 and 2013, the interest collected on impaired loans was approximately \$419,000 and \$220,000 respectively. The average recorded investment in impaired loans for the three and six months ended June 30, 2014 was \$22.1 million and \$21.7 million respectively.

At June 30, 2014, there were 3 loans totaling \$3.4 million that were considered "TDRs", as compared to December 31, 2013 when there were 2 loans totaling \$2.2 million, all of which were included in impaired loans. At June 30, 2014, 2 of the 3 loans aggregating \$2.1 million were accruing loans and 1 loan of \$1.3 million was a non-accruing loan. The non-accruing loan was an existing TDR at December 31, 2013 which was restructured again in the quarter ended March 31, 2014.

The Company's lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County in New York. The Company originates commercial real estate loans, commercial business loans, and a variety of other consumer loans. In addition, the Company previously had originated loans for residential real estate, the construction of residential homes, residential developments and for land development projects. A moratorium on all new speculative construction loans was instituted by management in July 2008. All residential and

commercial mortgage loans are collateralized primarily by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent to some degree on the status of the regional economy as well as upon the regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

Table Of Contents

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral for commercial real estate at the date of the credit extension depending on the Company's evaluation of the borrowers' creditworthiness and type of collateral. In the case of construction loans, the maximum loan-to-value was 65% of the "as completed" market value. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when deemed necessary. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower's ability to generate continuing cash flows on all loans not related to construction.

Risk characteristics of the Company's portfolio classes include the following:

Commercial Real Estate Loans – In underwriting commercial real estate loans, the Company evaluates both the prospective borrower's ability to make timely payments on the loan and the value of the property securing the loans. Repayment of such loans may be negatively impacted should the borrower default or should there be a substantial decline in the value of the property securing the loan or a decline in the general economic conditions. Where the owner occupies the property, the Company also evaluates the business's ability to repay the loan on a timely basis. In addition, the Company may require personal guarantees, lease assignments and/or the guarantee of the operating company when the property is owner occupied.

Commercial and Industrial Loans – The Company's commercial and industrial loan portfolio consists primarily of commercial business loans and lines of credit to businesses and professionals. These loans are usually made to finance the purchase of inventory or new or used equipment and for other short or long-term working capital purposes. These loans are generally secured by business assets, but are also occasionally offered on an unsecured basis. In granting this type of loan, the Company primarily looks to the borrower's cash flow as the source of repayment with collateral and personal guarantees as a secondary source. Payments on such loans are often dependent upon the successful operation of the underlying business involved. Repayment of such loans may therefore be negatively impacted by adverse changes in economic conditions, management's inability to effectively manage the business, claims of others against the borrower's assets which may take priority over the Company's claims against assets, death or disability of the borrower or loss of market for the borrower's products or services.

Residential Real Estate Loans – Home equity loans secured by residential real estate properties are offered by the Company. The company no longer offers residential loans, having exited this business in 2013. Repayment of residential real estate loans may be negatively impacted should the borrower have financial difficulties, should there be a significant decline in the value of the property securing the loan or should there be decline in general economic conditions.

Construction Loans – Construction loans are short-term loans (generally up to 18 months) secured by land for either residential or commercial development. The loans are generally made for acquisition and improvements. Funds are disbursed as phases of construction are completed. Included in this category are loans to construct single family homes where no contract of sale exists, based upon the experience and the financial strength of the builder, the type and location of the property and other factors. Construction loans are generally personally guaranteed by the principal(s). Repayment of such loans may be negatively impacted by the builders' inability to complete construction, by a downturn in the new construction market, by a significant increase in interest rates or by a decline in general economic condition.

Table Of Contents

Other Loans – The Company also offers installments loans and reserve lines of credit to individuals. Repayments of such loans are often dependent on the personal income of the borrower which may be negatively impacted by adverse changes in economic conditions. The Company does not place an emphasis on originating these types of loans.

The Company does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burdened ratios.

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the three months ended June 30, 2014. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

| Three months ended June 30, 2014 | Commercial | Commercial Real Estate | Construction | Construction Permanent | Residential | Consumer | Unallocated | Total |
|---|-------------------|---------------------------------------|---------------------|-----------------------------------|--------------------|-----------------|--------------------|--------------|
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | \$ 2,371 | \$ 1,320 | \$ 260 | \$ 34 | \$ 704 | \$ 539 | \$ 252 | \$ 5,480 |
| Charge-offs | (2) | - | (260) | - | (18) | (5) | - | (285) |
| Recoveries | 4 | 15 | - | - | - | - | - | 19 |
| Provision | 105 | (210) | - | 115 | (56) | 160 | (114) | - |
| Ending Balance | \$ 2,478 | \$ 1,125 | \$ - | \$ 149 | \$ 630 | \$ 694 | \$ 138 | \$ 5,214 |
| Ending balance: individually evaluated for impairment | \$ 1,750 | \$ 307 | \$ - | \$ - | \$ - | \$ 5 | \$ - | \$ 2,062 |
| Ending balance: collectively evaluated for impairment | 728 | 818 | - | 149 | 630 | 689 | 138 | 3,152 |
| Total Allowance for Loan Losses | \$ 2,478 | \$ 1,125 | \$ - | \$ 149 | \$ 630 | \$ 694 | \$ 138 | \$ 5,214 |
| Total Loans ending balance | \$ 37,849 | \$ 219,762 | \$ - | \$ 14,436 | \$ 89,517 | \$ 45,781 | \$ - | \$ 407,345 |
| Ending balance: individually evaluated for impairment | \$ 7,291 | \$ 11,610 | \$ - | \$ - | \$ 5,115 | \$ 588 | \$ - | \$ 24,604 |
| Ending balance: collectively evaluated for impairment | \$ 30,558 | \$ 208,152 | \$ - | \$ 14,436 | \$ 84,402 | \$ 45,193 | \$ - | \$ 382,741 |

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the six months ended June 30, 2014. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

| Six months ended June 30, 2014 | Commercial | | Construction | | Residential | Consumer | Unallocated | Total |
|---------------------------------------|------------|-------------|--------------|-----------|-------------|-----------|-------------|------------|
| | Commercial | Real Estate | Construction | Permanent | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | \$ 2,285 | \$ 1,585 | \$ 260 | \$ 25 | \$ 795 | \$ 534 | \$ 197 | \$ 5,681 |
| Charge-offs | (11) | - | (260) | - | (195) | (36) | - | (502) |
| Recoveries | 4 | 30 | - | - | - | 1 | - | 35 |
| Provision | 200 | (490) | - | 124 | 30 | 195 | (59) | - |
| Ending Balance | \$ 2,478 | \$ 1,125 | \$ - | \$ 149 | \$ 630 | \$ 694 | \$ 138 | \$ 5,214 |
| Ending balance: | | | | | | | | |
| individually evaluated for impairment | \$ 1,750 | \$ 307 | \$ - | \$ - | \$ - | \$ 5 | \$ - | \$ 2,062 |
| Ending balance: | | | | | | | | |
| collectively evaluated for impairment | 728 | 818 | - | 149 | 630 | 689 | 138 | 3,152 |
| Total Allowance for Loan Losses | \$ 2,478 | \$ 1,125 | \$ - | \$ 149 | \$ 630 | \$ 694 | \$ 138 | \$ 5,214 |
| Total Loans ending balance | \$ 37,849 | \$ 219,762 | \$ - | \$ 14,436 | \$ 89,517 | \$ 45,781 | \$ - | \$ 407,345 |
| Ending balance: | | | | | | | | |
| individually evaluated for impairment | \$ 7,291 | \$ 11,610 | \$ - | \$ - | \$ 5,115 | \$ 588 | \$ - | \$ 24,604 |
| Ending balance: | | | | | | | | |
| collectively evaluated for impairment | \$ 30,558 | \$ 208,152 | \$ - | \$ 14,436 | \$ 84,402 | \$ 45,193 | \$ - | \$ 382,741 |

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the three months ended June 30, 2013. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

| Three months ended June 30, 2013 | Commercial | | Construction | | Residential | Consumer | Unallocated | Total |
|--|----------------------|----------------|---------------------------|---------------------------|-------------|-----------|-------------|------------|
| | Commercial Estate | Real Estate | Construction Permanent | Construction Permanent | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | \$ 1,847 | \$ 2,492 | \$ 307 | \$ 31 | \$ 746 | \$ 118 | \$ 176 | \$ 5,717 |
| Charge-offs | - | (275) | (23) | - | (95) | (19) | - | (412) |
| Recoveries | 1 | 15 | - | - | 1 | - | - | 17 |
| Provision | (126) | (279) | (48) | (7) | 282 | 145 | 33 | - |
| Ending Balance | \$ 1,722 | \$ 1,953 | \$ 236 | \$ 24 | \$ 934 | \$ 244 | \$ 209 | \$ 5,322 |
| Ending balance: individually evaluated for impairment | \$ 1,251 | \$ 539 | \$ 236 | \$ - | \$ 158 | \$ 2 | \$ - | \$ 2,186 |
| Ending balance: collectively evaluated for impairment | 471 | 1,414 | - | 24 | 776 | 242 | 209 | 3,136 |
| Total Allowance for Loan Losses | \$ 1,722 | \$ 1,953 | \$ 236 | \$ 24 | \$ 934 | \$ 244 | \$ 209 | \$ 5,322 |
| | | | | | | | | |
| Total Loans ending balance | \$ 36,278 | \$ 236,224 | \$ 3,471 | \$ 9,904 | \$ 117,416 | \$ 49,090 | \$ - | \$ 452,383 |
| | | | | | | | | |
| Ending balance: individually evaluated for impairment | \$ 6,349 | \$ 15,615 | \$ 3,471 | \$ 1,228 | \$ 8,754 | \$ 600 | \$ - | \$ 36,017 |
| | | | | | | | | |
| Ending balance: collectively evaluated for impairment | \$ 29,929 | \$ 220,609 | \$ - | \$ 8,676 | \$ 108,662 | \$ 48,490 | \$ - | \$ 416,366 |

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the six months ended June 30, 2013. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

| Six months ended June 30, 2013 | Commercial | | Construction | | Residential | Consumer | Unallocated | Total |
|--|----------------------|----------------|---------------------------|---------------------------|-------------|-----------|-------------|------------|
| | Commercial Estate | Real Estate | Construction Permanent | Construction Permanent | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | \$ 942 | \$ 3,509 | \$ 311 | \$ 19 | \$ 897 | \$ 217 | \$ 121 | \$ 6,016 |
| Charge-offs | - | (290) | (23) | - | (385) | (19) | - | (717) |
| Recoveries | 2 | 30 | 20 | - | 1 | - | - | 53 |
| Provision | 778 | (1,296) | (72) | 5 | 421 | 46 | 88 | (30) |
| Ending Balance | \$ 1,722 | \$ 1,953 | \$ 236 | \$ 24 | \$ 934 | \$ 244 | \$ 209 | \$ 5,322 |
| Ending balance: individually evaluated for impairment | \$ 1,251 | \$ 539 | \$ 236 | \$ - | \$ 158 | \$ 2 | \$ - | \$ 2,186 |
| Ending balance: collectively evaluated for impairment | 471 | 1,414 | - | 24 | 776 | 242 | 209 | 3,136 |
| Total Allowance for Loan Losses | \$ 1,722 | \$ 1,953 | \$ 236 | \$ 24 | \$ 934 | \$ 244 | \$ 209 | \$ 5,322 |
| Total Loans ending balance | \$ 36,278 | \$ 236,224 | \$ 3,471 | \$ 9,904 | \$ 117,416 | \$ 49,090 | \$ - | \$ 452,383 |
| Ending balance: individually evaluated for impairment | \$ 6,349 | \$ 15,615 | \$ 3,471 | \$ 1,228 | \$ 8,754 | \$ 600 | \$ - | \$ 36,017 |
| Ending balance: collectively evaluated for impairment | \$ 29,929 | \$ 220,609 | \$ - | \$ 8,676 | \$ 108,662 | \$ 48,490 | \$ - | \$ 416,366 |

Table Of Contents

The following table details for the year ended December 31, 2013 the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

| 2013 | Commercial | Commercial | Construction | Construction | Residential | Consumer | Unallocated | Total |
|---|-------------------|--------------------|---------------------|---------------------|--------------------|-----------------|--------------------|--------------|
| | | Real Estate | | Permanent | | | | |
| Total Loans ending balance | \$ 35,061 | \$ 223,165 | \$ 260 | \$ 11,303 | \$ 106,198 | \$ 47,071 | \$ - | \$ 423,058 |
| Ending balance: individually evaluated for impairment | 6,152 | 7,767 | 260 | 1,197 | 6,024 | 593 | - | 21,993 |
| Ending balance: collectively evaluated for impairment | \$ 28,909 | \$ 215,398 | \$ - | \$ 10,106 | \$ 100,174 | \$ 46,478 | \$ - | \$ 401,065 |

Table Of Contents

The Company monitors the credit quality of its loans receivable on an ongoing manner. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that internally assigned risk ratings and loan-to-value ratios (LTVs), at period end, are the key credit quality indicators that best help management monitor the credit quality of the Company's loans receivable. Loan-to-value ratios used by management in monitoring credit quality are based on current period loan balances and original values at time of origination (unless a current appraisal has been obtained as a result of the loan being deemed impaired or the loan is a maturing construction loan).

Appraisals on properties securing non-performing loans and Other Real Estate Owned ("OREO") are updated annually. We update our impairment analysis monthly based on the most recent appraisal as well as other factors (such as senior lien positions, i.e. property taxes).

The majority of the Company's impaired loans have been resolved through courses of action other than through foreclosure. These include normal loan payoffs, the traditional workout process, triggering personal guarantee obligations, and troubled debt restructurings. However, as loan workout efforts progress to a point where the bank's liquidation of real estate collateral is the likely outcome, the impairment analysis is updated to reflect actual recent experience with bank sales of OREO properties.

Included in the allowance for loan losses are disposition discount adjustments made to real estate appraisals on collateral dependent impaired loans anticipated to become OREO in the coming quarter. The appraisal adjustments percentage is reviewed quarterly and modified based on an analysis of actual variances between appraised values as of the date prior loans were transferred into OREO and the actual average sales prices of these loans. The difference is the disposition discount.

The Company has a risk rating system as part of the risk assessment of its loan portfolio. The Company's lending officers are required to assign an Obligor and a Facility risk rating to each loan in their portfolio at origination, which is ratified or modified by the Committee to which the loan is submitted for approval. When the lender learns of important financial developments, the risk rating is reviewed accordingly, and adjusted if necessary. Similarly, the Loan Committee can adjust a risk rating.

In addition, the Company engages a third party independent loan reviewer that performs quarterly reviews of a sample of loans, validating the Bank's risk ratings assigned to such loans. The risk ratings play an important role in the establishment of the loan loss provision and to confirm the adequacy of the allowance for loan losses. Any upgrades to classified loans must be approved by the Board Loan Committee.

When assigning a risk rating to a loan, management utilizes the Bank's internal ten-point risk rating system. An asset is considered "special mention" when it has a potential weakness based on objective evidence, but does not currently expose the Company to sufficient risk to warrant classification as in one of the following categories: An asset is considered "substandard" if it is not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have well defined weaknesses based on objective evidence, and are characterized by the "distinct possibility" that the Company will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable."

Charge-off generally commences after the loan is classified "doubtful" to reduce the loan to its recoverable balance. If the account is classified as "loss", the full balance is charged off regardless of the potential recovery from the sale of the collateral. This amount is recognized as a recovery once the collateral is sold.

In accordance with FFIEC ("Federal Financial Institutions Examination Council") published policies establishing uniform criteria for the classification of retail credit based on delinquency status, "Open-end" credits are charged-off when 180 days delinquent and "Closed-end" credits are charged-off when 120 days delinquent. In lieu of charging off the entire loan balance, loans with collateral may be written down to the value of the collateral less the cost to sell.

Table Of Contents

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at June 30, 2014:

CREDIT RISK PROFILE BY CREDIT WORTHINESS CATEGORY

| <i>(in thousands)</i> | Commercial | | Commercial Real Estate | | Construction to Permanent | | | | Residential Real Estate | | Consumer | | Other |
|-----------------------|------------|---------|------------------------|----------|---------------------------|--------|----------|---------|-------------------------|----------|----------|---------|-------|
| | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | |
| Internal Risk Rating | | | | | | | | | | | | | |
| Pass | \$26,290 | \$3,944 | \$199,352 | \$6,471 | \$- | \$- | \$12,674 | \$1,762 | \$67,516 | \$19,970 | \$43,547 | \$1,543 | \$659 |
| Special Mention | 150 | - | 3,926 | 3,096 | - | - | - | - | - | - | - | - | - |
| Substandard | 7,465 | - | 3,634 | 3,283 | - | - | - | - | 1,549 | 482 | 32 | - | - |
| | \$33,905 | \$3,944 | \$206,912 | \$12,850 | \$- | \$- | \$12,674 | \$1,762 | \$69,065 | \$20,452 | \$43,579 | \$1,543 | \$659 |

CREDIT RISK PROFILE

| <i>(in thousands)</i> | Commercial | Commercial Real Estate | Construction | Construction to Permanent | Residential Real Estate | Consumer Totals |
|-----------------------|------------|------------------------|--------------|---------------------------|-------------------------|-----------------|
| Performing | \$30,558 | \$215,205 | \$- | \$14,436 | \$87,486 | \$45,749 |
| Non Performing | 7,291 | 4,557 | - | - | 2,031 | 32 |
| Total | \$37,849 | \$219,762 | \$- | \$14,436 | \$89,517 | \$45,781 |

Table Of Contents

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at December 31, 2013:

CREDIT RISK PROFILE BY CREDIT WORTHINESS CATEGORY

(in thousands)

| LTVs: | Commercial | | Commercial Real Estate | | Construction | | Construction to Permanent | | Residential Real Estate | | Consumer | | Other |
|----------------------|------------|---------|------------------------|----------|--------------|--------|---------------------------|--------|-------------------------|----------|----------|---------|-------|
| | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | < 75% | >= 75% | |
| Internal Risk Rating | | | | | | | | | | | | | |
| Pass | \$23,493 | \$3,898 | \$199,118 | \$7,951 | \$- | \$- | \$10,106 | \$- | \$82,704 | \$20,592 | \$42,542 | \$3,839 | \$650 |
| Special Mention | 167 | - | 6,573 | 2,502 | - | - | - | - | - | - | - | - | - |
| Substandard | 7,503 | - | 3,690 | 3,331 | 60 | 200 | 1,197 | - | 1,976 | 926 | 9 | 31 | - |
| | \$31,163 | \$3,898 | \$209,381 | \$13,784 | \$60 | \$200 | \$11,303 | \$- | \$84,680 | \$21,518 | \$42,551 | \$3,870 | \$650 |

CREDIT RISK PROFILE

| (in thousands) | Commercial | Commercial Real Estate | Construction | Construction to Permanent | Residential Real Estate | Consumer Totals |
|----------------|------------|------------------------|--------------|---------------------------|-------------------------|-----------------|
| Performing | \$28,909 | \$221,401 | \$- | \$10,106 | \$103,296 | \$47,038 |
| Non Performing | 6,152 | 1,764 | 260 | 1,197 | 2,902 | 33 |
| Total | \$35,061 | \$223,165 | \$260 | \$11,303 | \$106,198 | \$47,071 |

Table Of Contents

The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at June 30, 2014:

| <u>2014</u> | Non-Accrual and Past Due Loans | | | | | | |
|-------------------------------|--|--|-------------------------------------|-------------------------------|----------------|--|---|
| | Non-Accrual Loans | | | | | | |
| | 31-60 Days Past Due | 61-90 Days Past Due | Greater Than 90 Days | Total Past Due | Current | >90 Days Past Due and Accruing | Total Non-Accrual and Past Due Loans |
| Commercial | | | | | | | |
| Substandard | \$ 1,300 | \$ 3 | \$ 5 | \$ 1,308 | \$ 5,983 | \$ - | \$ 7,291 |
| Total Commercial | \$ 1,300 | \$ 3 | \$ 5 | \$ 1,308 | \$ 5,983 | \$ - | \$ 7,291 |
| Commercial Real Estate | | | | | | | |
| Substandard | \$ - | \$ - | \$ 313 | \$ 313 | \$ 4,244 | \$ - | \$ 4,557 |
| Total Commercial Real Estate | \$ - | \$ - | \$ 313 | \$ 313 | \$ 4,244 | \$ - | \$ 4,557 |
| Residential Real Estate | | | | | | | |
| Substandard | \$ - | \$ - | \$ 2,031 | \$ 2,031 | \$ - | \$ - | \$ 2,031 |
| Total Residential Real Estate | \$ - | \$ - | \$ 2,031 | \$ 2,031 | \$ - | \$ - | \$ 2,031 |
| Consumer | | | | | | | |
| Substandard | \$ - | \$ - | \$ 5 | \$ 5 | \$ 27 | \$ - | \$ 32 |
| Total Consumer | \$ - | \$ - | \$ 5 | \$ 5 | \$ 27 | \$ - | \$ 32 |
| Total | \$ 1,300 | \$ 3 | \$ 2,354 | \$ 3,657 | \$ 10,254 | \$ - | \$ 13,911 |

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded balance of these non-accrual loans was \$13.9 million and \$12.3 million at June 30, 2014, and December 31, 2013 respectively. Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accruing status.

At June 30, 2014, \$10.3 million or 74% of the non-accruing loan balance of \$13.9 million was current.

There were no loans past due ninety days or more, and still accruing interest at June 30, 2014. There were two such loans at December 31, 2013, totaling \$866,000. One loan had a balance of \$841,000 and was current and a second loan for \$25,000 was current within 60 days as to interest payments. Both were past the loan's maturity date and in the process of being renewed at December 31, 2013.

Table Of Contents

The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at December 31, 2013:

| <u>2013</u> | Non-Accrual and Past Due Loans | | | | | | |
|---------------------------------|---------------------------------------|----------------------------|-----------------------------|-----------------------|----------------|--|---|
| | Non-Accrual Loans | | Greater Than 90 Days | Total Past Due | Current | >90 Days Past Due and Accruing | Total Non-Accrual and Past Due Loans |
| <i>(in thousands)</i> | 31-60 Days Past Due | 61-90 Days Past Due | | | | | |
| Commercial | | | | | | | |
| Pass | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 25 | \$ 25 |
| Substandard | \$ - | \$ - | \$ 2 | \$ 2 | \$ 6,150 | \$ - | \$ 6,152 |
| Total Commercial | \$ - | \$ - | \$ 2 | \$ 2 | \$ 6,150 | \$ 25 | \$ 6,177 |
| Commercial Real Estate | | | | | | | |
| Substandard | \$ - | \$ - | \$ 1,764 | \$ 1,764 | \$ - | \$ 841 | \$ 2,605 |
| Total Commercial Real Estate | \$ - | \$ - | \$ 1,764 | \$ 1,764 | \$ - | \$ 841 | \$ 2,605 |
| Construction | | | | | | | |
| Substandard | \$ - | \$ - | \$ 260 | \$ 260 | \$ - | \$ - | \$ 260 |
| Total Construction | \$ - | \$ - | \$ 260 | \$ 260 | \$ - | \$ - | \$ 260 |
| Construction to Permanent | | | | | | | |
| Substandard | \$ - | \$ - | \$ - | \$ - | \$ 1,197 | \$ - | \$ 1,197 |
| Total Construction to Permanent | \$ - | \$ - | \$ - | \$ - | \$ 1,197 | \$ - | \$ 1,197 |
| Residential Real Estate | | | | | | | |
| Substandard | \$ - | \$ - | \$ 2,523 | \$ 2,523 | \$ 379 | \$ - | \$ 2,902 |
| Total Residential Real Estate | \$ - | \$ - | \$ 2,523 | \$ 2,523 | \$ 379 | \$ - | \$ 2,902 |
| Consumer | | | | | | | |
| Substandard | \$ - | \$ - | \$ 2 | \$ 2 | \$ 31 | \$ - | \$ 33 |
| Total Consumer | \$ - | \$ - | \$ 2 | \$ 2 | \$ 31 | \$ - | \$ 33 |
| Total | \$ - | \$ - | \$ 4,551 | \$ 4,551 | \$ 7,757 | \$ 866 | \$ 13,174 |

Table Of Contents

The following table sets forth the detail and delinquency status of loans receivable, by performing and non-performing loans at June 30, 2014.

| <i>(in thousands)</i> | Performing (Accruing) Loans | | | | Total Performing Loans | Total Non-Accrual and Past Due Loans | Total Loans |
|--|--|--|-------------------------------|-------------------|---------------------------------------|---|------------------------|
| | 31-60 Days Past Due | 61-90 Days Past Due | Total Past Due | Current | | | |
| 2014 | | | | | | | |
| Commercial | | | | | | | |
| Pass | \$ 1,002 | \$ - | \$ 1,002 | \$ 29,231 | \$ 30,233 | \$ - | \$ 30,233 |
| Special Mention | - | 15 | 15 | 135 | 150 | - | 150 |
| Substandard | - | 25 | 25 | 150 | 175 | 7,291 | 7,466 |
| Total Commercial | \$ 1,002 | \$ 40 | \$ 1,042 | \$ 29,516 | \$ 30,558 | \$ 7,291 | \$ 37,849 |
| Commercial Real Estate | | | | | | | |
| Pass | \$ - | \$ - | \$ - | \$ 205,823 | \$ 205,823 | \$ - | \$ 205,823 |
| Special Mention | 1,816 | - | 1,816 | 5,206 | 7,022 | - | 7,022 |
| Substandard | - | - | - | 2,360 | 2,360 | 4,557 | 6,917 |
| Total Commercial Real Estate | \$ 1,816 | \$ - | \$ 1,816 | \$ 213,389 | \$ 215,205 | \$ 4,557 | \$ 219,762 |
| Construction to Permanent | | | | | | | |
| Pass | \$ - | \$ - | \$ - | \$ 14,436 | \$ 14,436 | \$ - | \$ 14,436 |
| Total Construction to Permanent | \$ - | \$ - | \$ - | \$ 14,436 | \$ 14,436 | \$ - | \$ 14,436 |
| Residential Real Estate | | | | | | | |
| Pass | \$ 155 | \$ - | \$ 155 | \$ 87,331 | \$ 87,486 | \$ - | \$ 87,486 |
| Substandard | - | - | - | - | - | 2,031 | 2,031 |
| Total Residential Real Estate | \$ 155 | \$ - | \$ 155 | \$ 87,331 | \$ 87,486 | \$ 2,031 | \$ 89,517 |
| Consumer | | | | | | | |
| Pass | \$ 11 | \$ 100 | \$ 111 | \$ 45,638 | \$ 45,749 | \$ - | \$ 45,749 |
| Substandard | - | - | - | - | - | 32 | 32 |
| Total Consumer | \$ 11 | \$ 100 | \$ 111 | \$ 45,638 | \$ 45,749 | \$ 32 | \$ 45,781 |
| Total | | | | | | | |
| Pass | \$ 1,168 | \$ 100 | \$ 1,268 | \$ 382,459 | \$ 383,727 | \$ - | \$ 383,727 |
| Special Mention | 1,816 | 15 | 1,831 | 5,341 | 7,172 | - | 7,172 |
| Substandard | - | 25 | 25 | 2,510 | 2,535 | 13,911 | 16,446 |
| Grand Total | \$ 2,984 | \$ 140 | \$ 3,124 | \$ 390,310 | \$ 393,434 | \$ 13,911 | \$ 407,345 |

Table Of Contents

The following table sets forth the detail and delinquency status of loans receivable by performing and non-performing loans at December 31, 2013.

| <i>(in thousands)</i> | Performing (Accruing) Loans | | | | Total Loan Balances | Total Non-Accrual and Past Due Loans | Total Loans Receivable |
|---------------------------------|------------------------------------|----------------------------|-----------------------|------------------|----------------------------|---|-------------------------------|
| | 31-60 Days Past Due | 61-89 Days Past Due | Total Past Due | Current | | | |
| 2013 | | | | | | | |
| Commercial | | | | | | | |
| Pass | \$725 | \$- | \$725 | \$26,641 | \$27,366 | \$ 25 | \$ 27,391 |
| Special Mention | - | - | - | 167 | 167 | - | 167 |
| Substandard | - | - | - | 1,351 | 1,351 | 6,152 | 7,503 |
| Total Commercial | \$725 | \$- | \$725 | \$28,159 | \$28,884 | \$ 6,177 | \$ 35,061 |
| Commercial Real Estate | | | | | | | |
| Pass | \$1,858 | \$266 | \$2,124 | \$204,944 | \$207,068 | \$ - | \$ 207,068 |
| Special Mention | - | - | - | 9,075 | 9,075 | - | 9,075 |
| Substandard | - | - | - | 4,417 | 4,417 | 2,605 | 7,022 |
| Total Commercial Real Estate | \$1,858 | \$266 | \$2,124 | \$218,436 | \$220,560 | \$ 2,605 | \$ 223,165 |
| Construction | | | | | | | |
| Substandard | - | - | - | - | - | 260 | 260 |
| Total Construction | \$- | \$- | \$- | \$- | \$- | \$ 260 | \$ 260 |
| Construction to Permanent | | | | | | | |
| Pass | \$- | \$- | \$- | \$10,106 | \$10,106 | \$ - | \$ 10,106 |
| Substandard | - | - | - | - | - | 1,197 | 1,197 |
| Total Construction to Permanent | \$- | \$- | \$- | \$10,106 | \$10,106 | \$ 1,197 | \$ 11,303 |
| Residential Real Estate | | | | | | | |
| Pass | \$32 | \$- | \$32 | \$103,264 | \$103,296 | \$ - | \$ 103,296 |
| Substandard | - | - | - | - | - | 2,902 | 2,902 |
| Total Residential Real Estate | \$32 | \$- | \$32 | \$103,264 | \$103,296 | \$ 2,902 | \$ 106,198 |
| Consumer | | | | | | | |
| Pass | \$350 | \$560 | \$910 | \$46,121 | \$47,031 | \$ - | \$ 47,031 |
| Substandard | 7 | - | 7 | - | 7 | 33 | 40 |
| Total Consumer | \$357 | \$560 | \$917 | \$46,121 | \$47,038 | \$ 33 | \$ 47,071 |
| Total | | | | | | | |
| Pass | \$2,965 | \$826 | \$3,791 | \$391,076 | \$394,867 | \$ 25 | \$ 394,892 |
| Special Mention | - | - | - | 9,242 | 9,242 | - | 9,242 |
| Substandard | 7 | - | 7 | 5,768 | 5,775 | 13,149 | 18,924 |
| Grand Total | \$2,972 | \$826 | \$3,798 | \$406,086 | \$409,884 | \$ 13,174 | \$ 423,058 |

Table Of Contents

The following table summarizes impaired loans as of June 30, 2014:

| (in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|-------------------------------------|--------------------------------|---|------------------------------|
| With no related allowance recorded: | | | |
| Commercial | \$ 1,308 | \$ 1,374 | \$ - |
| Commercial Real Estate | 8,640 | 9,467 | - |
| Construction | - | 510 | - |
| Construction to Permanent | - | - | - |
| Residential | 4,746 | 7,316 | - |
| Consumer | 583 | 662 | - |
| Total: | \$ 15,277 | \$ 19,329 | \$ - |
| With an allowance recorded: | | | |
| Commercial | \$ 5,983 | \$ 5,983 | \$ 1,750 |
| Commercial Real Estate | 2,970 | 3,013 | 307 |
| Construction | - | - | - |
| Construction to Permanent | - | - | - |
| Residential | 369 | 397 | - |
| Consumer | 5 | 5 | 5 |
| Total: | \$ 9,327 | \$ 9,398 | \$ 2,062 |
| Commercial | \$ 7,291 | \$ 7,357 | \$ 1,750 |
| Commercial Real Estate | 11,610 | 12,480 | 307 |
| Construction | - | 510 | - |
| Construction to Permanent | - | - | - |
| Residential | 5,115 | 7,713 | - |
| Consumer | 588 | 667 | 5 |
| Total: | \$ 24,604 | \$ 28,727 | \$ 2,062 |

Impaired loans consist of non-accrual loans, TDRs and loans that were previously classified as TDRs that have been upgraded from non-accrual.

Table Of Contents

The following table summarizes impaired loans as of December 31, 2013:

| <i>(in thousands)</i> | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|-------------------------------------|--------------------------------|---|------------------------------|
| With no related allowance recorded: | | | |
| Commercial | \$ 2 | \$ 151 | \$ - |
| Commercial Real Estate | 7,597 | 8,316 | - |
| Construction | - | - | - |
| Construction to Permanent | 1,197 | 1,425 | - |
| Residential | 5,098 | 7,632 | - |
| Consumer | 591 | 670 | - |
| Total: | \$ 14,485 | \$ 18,194 | \$ - |
| With an allowance recorded: | | | |
| Commercial | \$ 6,150 | \$ 6,150 | \$ 1,500 |
| Commercial Real Estate | 170 | 215 | 31 |
| Construction | 260 | 487 | 260 |
| Construction to Permanent | - | - | - |
| Residential | 926 | 1,066 | 98 |
| Consumer | 2 | 2 | 2 |
| Total: | \$ 7,508 | \$ 7,920 | \$ 1,891 |
| Commercial | \$ 6,152 | \$ 6,301 | \$ 1,500 |
| Commercial Real Estate | 7,767 | 8,531 | 31 |
| Construction | 260 | 487 | 260 |
| Construction to Permanent | 1,197 | 1,425 | - |
| Residential | 6,024 | 8,698 | 98 |
| Consumer | 593 | 672 | 2 |
| Total: | \$ 21,993 | \$ 26,114 | \$ 1,891 |

The recorded investment of impaired loans at June 30, 2014 and December 31, 2013 was \$24.6 million and \$22.0 million, with related allowances of \$2.1 million and \$1.9 million, respectively.

Included in the tables above at June 30, 2014 and December 31, 2013 are loans with carrying balances of \$15.2 million and \$14.5 million that required no specific reserves in our allowance for loan losses. Loans that did not require specific reserves have sufficient collateral values, less costs to sell, supporting the carrying balances of the loans. In some cases, there may be no specific reserves because the Company already charged-off the specific impairment. Once a borrower is in default, the Company is under no obligation to advance additional funds on unused

commitments.

On a case-by-case basis, the Company may agree to modify the contractual terms of a borrower's loan to remain competitive and assist customers who may be experiencing financial difficulty, as well as to preserve the Company's position in the loan. If the borrower is experiencing financial difficulties and a concession has been made, the loan is classified as a troubled debt restructured loan.

Table Of Contents

The following table presents the total troubled debt restructured loans as of June 30, 2014:

| <i>(Dollars in thousands)</i> | Accrual | Non-accrual | Total |
|------------------------------------|------------|-------------|------------|
| | # | # | # |
| | of | of | of |
| | Loans | Loans | Loans |
| Commercial Real Estate | 2 \$ 2,109 | 1 \$ 1,274 | 3 \$ 3,383 |
| Total Troubled Debt Restructurings | 2 \$ 2,109 | 1 \$ 1,274 | 3 \$ 3,383 |

The following table presents the total troubled debt restructured loans as of December 31, 2013:

| <i>(Dollars in thousands)</i> | Accrual | Non-accrual | Total |
|------------------------------------|----------|-------------|------------|
| | # | # | # |
| | of | of | of |
| | Loans | Loans | Loans |
| Commercial Real Estate | 1 \$ 991 | - \$ - | 1 \$ 991 |
| Construction to Permanent | - - | 1 1,197 | 1 1,197 |
| Total Troubled Debt Restructurings | 1 \$ 991 | 1 \$ 1,197 | 2 \$ 2,188 |

No loans were modified in a troubled debt restructuring during the three months ended June 30, 2014. The following table summarizes loans that were modified in a troubled debt restructuring during the six months ended June 30, 2014.

| <i>(Dollars in thousands)</i> | Six months ended June 30, 2014 | | Investment | |
|------------------------------------|--------------------------------|-----------|------------|-------------------|
| | Pre-Modification | | | Post-Modification |
| | Number of | Number of | | Outstanding |
| | Recorded | Recorded | | Recorded |
| Commercial Real Estate | 2 \$ 2,439 | 2 | \$ 2,430 | |
| Total Troubled Debt Restructurings | 2 \$ 2,439 | 2 | \$ 2,430 | |

Substantially all of our troubled debt restructured loan modifications involve lowering the monthly payments on such loans through either a reduction in interest rate, an extension of the term of the loan, or a combination of these two methods. These modifications rarely result in the forgiveness of principal or accrued interest. In addition, we frequently obtain additional collateral or guarantor support when modifying commercial loans. If the borrower had demonstrated performance under the previous terms and our underwriting process shows the borrower has the capacity to continue to perform under the restructured terms, the loan will continue to accrue interest. Non-accruing

restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible. All troubled debt restructurings are impaired loans, which are individually evaluated for impairment.

Table Of Contents**Note 4: Deposits**

The following table is a summary of the Company's deposits at:

| <i>(in thousands)</i> | June 30, 2014 | December 31, 2013 |
|--|------------------|-------------------------|
| Non-interest bearing | \$61,685 | \$55,358 |
| Interest bearing | | |
| NOW | 30,133 | 28,618 |
| Savings | 85,218 | 80,983 |
| Money market | 26,873 | 29,310 |
| Time certificates, less than \$100,000 | 117,513 | 129,548 |
| Time certificates, \$100,000 or more | 105,010 | 106,387 |
| Total interest bearing | 364,747 | 374,846 |
| Total Deposits | \$426,432 | \$430,204 |

Note 5: Share-Based Compensation

The Company maintains the Patriot National Bancorp, Inc. 2012 Stock Plan to provide an incentive to directors and employees of the Company by the grant of options, restricted stock awards or phantom stock units. The Plan provides for the issuance of up to 3,000,000 shares of the Company's common stock subject to certain Plan limitations. As of June 30, 2014, 2,202,100 shares of stock remain available for issuance under the Plan. The vesting of restricted stock awards and options may be accelerated in accordance with terms of the plan. The Compensation Committee shall make terms and conditions applicable to the vesting of restricted stock awards and stock options. Restricted stock grants are available to directors and employees and generally vest in quarterly or annual installments over a three, four or five year period from the date of grant. The Compensation Committee accelerated the vesting of the initial grant of restricted stock in 2012, whereby the first year of the tranche vested immediately. The Company is expensing the grant date fair value of all share-based compensation over the requisite vesting periods on a straight-line basis.

During the three months ended June 30, 2014 and June 30, 2013, the Company recorded \$72,000 and \$8,000 of total stock-based compensation, respectively. During the six months ended June 30, 2014 and June 30, 2013, the Company recorded \$130,000 and \$15,000 of total stock-based compensation, respectively. During the six months ended June 30, 2014, there were 385,652 awards granted under the 2012 Stock Plan.

Table Of Contents

The following is a summary of the status of the Company's restricted shares as of June 30, 2014, and changes therein during the period then ended.

| | Number of Shares | Weighted Average Grant Date Fair Value |
|---------------------------------|---------------------------------|---|
| Non-vested at December 31, 2013 | 281,835 | \$ 1.26 |
| Granted | 385,652 | 1.04 |
| Vested | (8,874) | 1.73 |
| Non-vested at June 30, 2014 | 658,613 | \$ 1.12 |

Expected future stock award expense related to the non-vested restricted awards as of June 30, 2014, is \$627,000 over an average period of 2.75 years.

The Company had no outstanding stock options at June 30, 2014.

Note 6: Income Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. The deferred tax position has been affected by several significant transactions in prior years. These transactions include provision for loan losses, the levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments, as well as a loss on the bulk sale of loans in 2011. As a result, the Company was in a cumulative net loss position in 2011 and under the applicable accounting guidance, had concluded that it was not more-likely-than-not that the Company would be able to realize its deferred tax assets and, accordingly, had established a full valuation allowance totaling \$14.4 million against the deferred tax asset balance remaining after the IRC 382 write-down (see below).

As measured under the rules of the Tax Reform Act of 1986, the Company has undergone a greater than 50% change of ownership in 2010. Consequently, use of the Company's net operating loss carry forward and certain built in deductions available against future taxable income in any one year are limited. The maximum amount of carry

forwards available in a given year is limited to the product of the Company's fair market value on the date of ownership change and the federal long-term tax-exempt rate, plus any limited carry forward not utilized in prior years.

The Company analyzed the impact of its ownership change in 2010 and calculated the annual limitation under IRC 382 to be \$284,000. Based on the analysis, the Company had determined that the pre-change net operating losses and net unrealized built-in deductions were approximately \$36.2 million. Based on a 20 year carry forward period, the Company could utilize approximately \$5.6 million of the pre-change net operating losses and built-in deductions. Therefore, the Company wrote-off approximately \$10.4 million of deferred tax assets in 2011. Accordingly, the write-off of the deferred tax asset did not affect the consolidated financial statements as there was a full valuation allowance against the deferred tax asset.

Table Of Contents

Management has reviewed the deferred tax position of the Company at June 30, 2014. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. At June 30, 2014, the Company reported taxable income for the third consecutive quarter and is anticipating earnings to be positive in the future. Based on current accounting guidance the Company has not generated taxable income for a sufficient length of time in order to reverse the DTA valuation allowance at June 30, 2014 and, accordingly, had an allowance totaling \$17.6 million. In the future, as the Company continues to generate taxable income on a more sustained basis, the need for a valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

Note 7: Income (loss) per share

The Company is required to present basic income (loss) per share and diluted income (loss) per share in its consolidated statements of operations. Basic income (loss) per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted income (loss) per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and would be determined using the treasury stock method. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income (loss) per share.

Table Of Contents

Non-vested restricted stock awards did not have an impact on the diluted earnings per share. The Company had no outstanding stock options. The following is information about the computation of income (loss) per share for the three and six months ended June 30, 2014 and 2013:

| Three months ended June 30, 2014 | Net Income | Weighted Average | |
|--|-----------------------|-------------------------|---------------|
| | | Common Shares | Amount |
| | | O/S | |
| Basic and Diluted Income Per Share | | | |
| Income attributable to common shareholders | \$525,000 | 38,497,624 | \$ 0.01 |

| Three months ended June 30, 2013 | Net Loss | Weighted Average | |
|--|-----------------|-------------------------|---------------|
| | | Common Shares | Amount |
| | | O/S | |
| Basic and Diluted Loss Per Share | | | |
| Loss attributable to common shareholders | \$(3,912,000) | 38,434,298 | \$ (0.10) |

| Six months ended June 30, 2014 | Net Income | Weighted Average | |
|--|-----------------------|-------------------------|---------------|
| | | Common Shares | Amount |
| | | O/S | |
| Basic and Diluted Income Per Share | | | |
| Income attributable to common shareholders | \$844,000 | 38,495,394 | \$ 0.02 |

| Six months ended June 30, 2013 | Net Loss | Weighted Average | |
|--|-----------------|-------------------------|---------------|
| | | Common Shares | Amount |
| | | O/S | |
| Basic and Diluted Loss Per Share | | | |
| Loss attributable to common shareholders | \$(5,869,000) | 38,434,919 | \$ (0.15) |

Table Of Contents**Note 8: Other Comprehensive Income**

Other comprehensive income, which is comprised solely of the change in unrealized gains and losses on available-for-sale securities, is as follows:

| | Three Months Ended June 30, 2014 | | Six Months Ended June 30, 2014 | | | |
|--|-------------------------------------|---------------|-----------------------------------|---------------|------|--------|
| | Before Tax | Net of Tax | Before Tax | Net of Tax | | |
| | Amount | Tax Effect | Amount | Tax Effect | | |
| (in thousands) | | | | | | |
| Unrealized holding gains arising during the period | \$ 108 | \$ - | \$ 108 | \$ 501 | \$ - | \$ 501 |

| | Three Months Ended June 30, 2013 | | Six Months Ended June 30, 2013 | | | |
|---|-------------------------------------|---------------|-----------------------------------|---------------|------|----------|
| | Before Tax | Net of Tax | Before Tax | Net of Tax | | |
| | Amount | Tax Effect | Amount | Tax Effect | | |
| Unrealized holding (losses) arising during the period | \$(629) | \$ - | \$(629) | \$(574) | \$ - | \$(574) |

Note 9: Financial Instruments with Off-Balance Sheet Risk

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

The contractual amount of commitments to extend credit and standby letters of credit represent the total amount of potential accounting loss should: the contracts be fully drawn upon; the customers default; and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis. Management believes that the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Table Of Contents

Financial instruments whose contractual amounts represent credit risk at June 30, 2014 are as follows:

| | |
|-------------------------------------|---------------------------|
| | <i>(in thousands)</i> |
| Commitments to extend credit: | |
| Future loan commitments | \$ 12,577 |
| Home equity lines of credit | 23,461 |
| Unused lines of credit | 42,331 |
| Undisbursed construction loans | 5,888 |
| Financial standby letters of credit | 1,118 |
| | \$ 85,375 |

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Guarantees that are not derivative contracts are recorded on the Company's consolidated balance sheet at their fair value at inception.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates, or other termination clauses, and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include residential and commercial property, deposits and securities. The bank has established a reserve of \$12,000 as of June 30, 2014.

Note 10: Regulatory and Operational Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). The Bank's capital plan pursuant to the Agreement described below targets a minimum 9% Tier 1 leverage capital ratio.

In February 2009 the Bank entered into a formal written agreement (the "Agreement") with the Office of the Comptroller of the Currency. Under the terms of the Agreement, the Bank has appointed a Compliance Committee of outside directors and the Chief Executive Officer. The Committee must report quarterly to the Board of Directors and to the OCC on the Bank's progress in complying with the Agreement. The Agreement requires the Bank to review, adopt and implement a number of policies and programs related to credit and operational issues. The Agreement further provides for limitations on the acceptance of certain brokered deposits and the extension of credit to borrowers whose loans are criticized. The Bank may pay dividends during the term of the Agreement only with prior written permission from the OCC. The Agreement also requires that the Bank develop and implement a three-year capital plan. The Bank has taken or put into process all of the steps required by the Agreement, and does not anticipate that the restrictions included within the Agreement will impair its current business plan.

In June 2010 the Company entered into a formal written agreement (the "Reserve Bank Agreement") with the Federal Reserve Bank of New York (the "Reserve Bank"). Under the terms of the Reserve Bank Agreement, the Board of Directors of the Company are required to take appropriate steps to fully utilize the Company's financial and managerial resources to serve as a source of strength to the Bank including taking steps to insure that the Bank complies with the Agreement with the OCC. The Reserve Bank Agreement requires the Company to submit, adopt and implement a capital plan that is acceptable to the Reserve Bank. The Company must also report to the Reserve Bank quarterly on the Company's progress in complying with the Reserve Bank Agreement. The Agreement further provides for certain restrictions on the payment or receipt of dividends, distributions of interest or principal on subordinate debentures or trust preferred securities and the Company's ability to incur debt or to purchase or redeem its stock without the prior written approval of the Reserve Bank. The Company has taken or put into process all of the steps required by the Reserve Bank Agreement, and does not anticipate that the restrictions included within the Reserve Bank Agreement will impair its current business plan.

Table Of Contents

The Company's and the Bank's actual capital amounts and ratios at June 30, 2014 and December 31, 2013 were:

| (Dollars in thousands) | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|-----------|---------|-------------------------------|--------|--|---------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| <u>June 30, 2014</u> | | | | | | |
| <u>The Company:</u> | | | | | | |
| Total Capital (to Risk Weighted Assets) | \$ 57,020 | 14.21 % | \$ 32,098 | 8.00 % | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 52,002 | 12.96 % | 16,049 | 4.00 % | N/A | N/A |
| Tier 1 Capital (to Average Assets) | 52,002 | 9.61 % | 21,636 | 4.00 % | N/A | N/A |
| <u>The Bank:</u> | | | | | | |
| Total Capital (to Risk Weighted Assets) | \$ 57,081 | 14.24 % | \$ 32,069 | 8.00 % | \$ 48,103 | 12.00 % |
| Tier 1 Capital (to Risk Weighted Assets) | 52,068 | 12.99 % | 16,034 | 4.00 % | 42,090 | 10.50 % |
| Tier 1 Capital (to Average Assets) | 52,068 | 9.63 % | 21,620 | 4.00 % | 48,646 | 9.00 % |
| <u>December 31, 2013</u> | | | | | | |
| <u>The Company:</u> | | | | | | |
| Total Capital (to Risk Weighted Assets) | \$ 56,060 | 13.95 % | \$ 32,153 | 8.00 % | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 51,027 | 12.70 % | 16,076 | 4.00 % | N/A | N/A |
| Tier 1 Capital (to Average Assets) | 51,027 | 9.33 % | 21,888 | 4.00 % | N/A | N/A |
| <u>The Bank:</u> | | | | | | |

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

| | | | | | | |
|--|-----------|---------|-----------|--------|-----------|---------|
| Total Capital (to Risk Weighted Assets) | \$ 55,758 | 13.86 % | \$ 32,187 | 8.00 % | \$ 48,280 | 12.00 % |
| Tier 1 Capital (to Risk Weighted Assets) | 50,730 | 12.61 % | 16,093 | 4.00 % | 42,245 | 10.50 % |
| Tier 1 Capital (to Average Assets) | 50,730 | 9.28 % | 21,872 | 4.00 % | 49,212 | 9.00 % |

Table Of Contents

Restrictions on dividends, loans and advances

The Company's ability to pay dividends is dependent on the Bank's ability to pay dividends to the Company. Pursuant to the February 9, 2009 Agreement between the Bank and the OCC, the Bank can pay dividends to the Company only pursuant to a dividend policy requiring compliance with the Bank's OCC-approved capital program, in compliance with applicable law and with the prior written determination of no supervisory objection by the Assistant Deputy Comptroller. In addition to the Agreement, certain other restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. The approval of the OCC is required to pay dividends in excess of the Bank's earnings retained in the current year plus retained net earnings for the preceding two years. As of June 30, 2014, the Bank had an accumulated deficit; therefore, dividends may not be paid to the Company. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements.

The Company's ability to pay dividends and incur debt is also restricted by the Reserve Bank Agreement. Under the terms of the Reserve Bank Agreement, the Company has agreed that it shall not declare or pay any dividends or incur, increase or guarantee any debt without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the "Director") of the Board of Governors.

Loans or advances to the Company from the Bank are limited to 10% of the Bank's capital stock and surplus on a secured basis.

Recent Legislative Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") was signed into law on July 21, 2010. The Act is a significant piece of legislation that continues to have a major impact on the financial services industry, including the organization, financial condition and operations of banks and bank holding companies. Management continues to evaluate the impact of the Act; however, uncertainty remains as to its operational impact, which could have a material adverse impact on the Company's business, results of operations and financial condition. Many of the provisions of the Act are aimed at financial institutions that are significantly larger than the Company and the Bank. Notwithstanding this, there are many other provisions that the Company and the Bank are subject to and will have to comply with, including any new rules applicable to the Company and the Bank promulgated by the Bureau of Consumer Financial Protection, a new regulatory body dedicated to consumer protection. As rules and regulations are promulgated by the agencies responsible for implementing and enforcing the Act, the Company and the Bank will have to address each to ensure compliance with applicable provisions of the Act and compliance costs are expected to increase.

The Dodd-Frank Act broadens the base for Federal Deposit Insurance Corporation insurance assessments. Under rules issued by the FDIC in February 2011, the base for insurance assessments changed from domestic deposits to consolidated assets less tangible equity. Assessment rates are calculated using formulas that take into account the risks of the institution being assessed. The rule was effective beginning April 1, 2011. This did not have a material impact on the Company.

On June 28, 2011, the Federal Reserve Board approved a final debit-card interchange rule. This primarily impacts larger banks and has not had a material impact on the Company.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on the Company. The financial reform legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and our ability to conduct business. Management will have to apply resources to ensure compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

Table Of Contents

Note 11: Fair Value and Interest Rate Risk

The Company used fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable: The carrying amount is a reasonable estimate of fair value. These financial instruments are not recorded at fair value on a recurring basis.

Available-for-Sale Securities: These financial instruments are recorded at fair value in the financial statements. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include U.S. government agency bonds and mortgage-backed securities, corporate bonds and money market preferred equity securities. The prices for these instruments are obtained through an independent pricing service or dealer market participants with whom the Company has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricings. The fair value measurements considered observable data may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Management reviews the data and assumptions used in pricing the securities by its third party provider to ensure the highest level of significant inputs are derived from market observable data. Level 3 securities are instruments for which significant unobservable input are utilized. Available-for-sale securities are recorded at fair value on a recurring basis.

Other Investments: The Bank's investment portfolio includes the Solomon Hess SBA Loan Fund totaling \$4.5 million. This investment is utilized for the purposes of the Bank satisfying its CRA lending requirements. As this fund operates as a private fund, shares in the Fund are not publicly traded and therefore have no readily determinable market value. An investment in the Fund is reported in the financial statements at cost, as adjusted for income, losses, and cash distributions attributable to the investment.

Loans: For variable rate loans, which reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using the period end rates, estimated by using local market data, at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a

recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Other Real Estate Owned: The fair value of the Company's OREO properties is based on the estimated current property valuations less estimated selling costs. When the fair value is based on current observable appraised values, OREO is classified within Level 2. The Company classifies the OREO within Level 3 when unobservable adjustments are made to appraised values. The Company does not record other real estate owned at fair value on a recurring basis.

Deposits: The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. The Company does not record deposits at fair value on a recurring basis.

Table Of Contents

Short-term borrowings: The carrying amounts of borrowings under short-term repurchase agreements and other short-term borrowings maturing within 90 days approximate their fair values. The Company does not record short-term borrowings at fair value on a recurring basis.

Junior Subordinated Debt: Junior subordinated debt reprices quarterly and as a result the carrying amount is considered a reasonable estimate of fair value. The Company does not record junior subordinated debt at fair value on a recurring basis.

Federal Home Loan Bank Borrowings: The fair value of the advances is estimated using a discounted cash flow calculation that applies current Federal Home Loan Bank interest rates for advances of similar maturity to a schedule of maturities of such advances. The Company does not record these borrowings at fair value on a recurring basis.

Other Borrowings: The fair values of longer term borrowings are estimated using a discounted cash flow calculation that applies current interest rates for transactions of similar maturity to a schedule of maturities of such transactions. The Company does not record these borrowings at fair value on a recurring basis.

Off-balance sheet instruments: Fair values for the Company's off-balance-sheet instruments (lending commitments) are based on interest rate changes and fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The Company does not record its off-balance-sheet instruments at fair value on a recurring basis.

Table Of Contents

The following table details the financial assets measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine fair value:

(in thousands)

| | Quoted Prices in Active Markets for Identical Assets | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of June 30, 2014 |
|---|--|--|--|---|
| June 30, 2014 | (Level 1) | (Level 2) | (Level 3) | |
| U.S. Government agency mortgage-backed securities | \$ - | \$ 19,498 | \$ - | \$ 19,498 |
| U.S. Government agency bonds | - | 7,344 | - | 7,344 |
| Corporate bonds | - | 8,844 | - | 8,844 |
| Securities available for sale | \$ - | \$ 35,686 | \$ - | \$ 35,686 |

| | Quoted Prices in Active Markets for Identical Assets | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of December 31, 2013 |
|---|--|--|--|--|
| December 31, 2013 | (Level 1) | (Level 2) | (Level 3) | |
| U.S. Government agency mortgage-backed securities | \$ - | \$ 21,752 | \$ - | \$ 21,752 |
| U.S. Government agency bonds | - | 7,079 | - | 7,079 |
| Corporate bonds | - | 8,870 | - | 8,870 |
| Securities available for sale | \$ - | \$ 37,701 | \$ - | \$ 37,701 |

There were no transfers of assets between levels 1, 2 or 3 as of June 30, 2014 or December 31, 2013. Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Table Of Contents

The following tables reflect financial assets measured at fair value on a non-recurring basis as of June 30, 2014 and December 31, 2013, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| <i>(in thousands)</i> | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance |
|--------------------------|---|--|--|-----------------|
| June 30, 2014 | | | | |
| Non-accrual loans | \$ - | \$ - | \$ 11,849 | \$11,849 |
| December 31, 2013 | | | | |
| Non-accrual loans | \$ - | \$ - | \$ 11,283 | \$11,283 |

The Company discloses fair value information about financial instruments, whether or not recognized in the consolidated balance sheet, for which it is practicable to estimate that value. Certain financial instruments are excluded from disclosure requirements and, accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The estimated fair value amounts have been measured as of June 30, 2014 and December 31, 2013 and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair value of these financial instruments subsequent to the respective reporting dates may be different than amounts reported on those dates.

The information presented should not be interpreted as an estimate of the fair value of the Company since a fair value calculation is only required for a limited portion of the Company's assets and liabilities. Due to the 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 bank holding companies may not be meaningful.

Table Of Contents

The following is a summary of the carrying amounts and estimated fair values of the Company's financial instruments not measured and not reported at fair value on the consolidated balance sheets at June 30, 2014 and December 31, 2013:

| <i>(in thousands)</i> | Fair Value Hierarchy | June 30, 2014 | | December 31, 2013 | |
|--|----------------------|-----------------|----------------------|-------------------|----------------------|
| | | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial Assets: | | | | | |
| Cash and noninterest bearing balances due from banks | Level 1 | \$1,584 | \$1,584 | \$1,570 | \$1,570 |
| Interest-bearing deposits due from banks | Level 1 | 58,345 | 58,345 | 33,295 | 33,295 |
| Other investments | Level 2 | 4,450 | 4,450 | 4,450 | 4,450 |
| Federal Reserve Bank stock | Level 1 | 1,517 | 1,517 | 1,444 | 1,444 |
| Federal Home Loan Bank stock | Level 1 | 4,143 | 4,143 | 4,143 | 4,143 |
| Loans receivable, net | Level 3 | 402,786 | 407,430 | 418,148 | 424,831 |
| Accrued interest receivable | Level 1 | 1,555 | 1,555 | 1,566 | 1,566 |
| Financial Liabilities: | | | | | |
| Demand deposits | Level 1 | \$61,685 | \$61,685 | \$55,358 | \$55,358 |
| Savings deposits | Level 1 | 85,218 | 85,218 | 80,983 | 80,983 |
| Money market deposits | Level 1 | 26,873 | 26,873 | 29,310 | 29,310 |
| NOW accounts | Level 1 | 30,133 | 30,133 | 28,618 | 28,618 |
| Time deposits | Level 2 | 222,523 | 223,029 | 235,935 | 236,602 |
| FHLB Borrowings | Level 2 | 72,000 | 72,000 | 57,000 | 57,000 |
| Subordinated debentures | Level 2 | 8,248 | 8,248 | 8,248 | 8,248 |
| Accrued interest payable | Level 1 | 15 | 15 | 1,388 | 1,388 |

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

Off-balance sheet instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at June 30, 2014 and December 31, 2013. The estimated fair value of fee income on letters of credit at June 30, 2014 and December 31, 2013 was insignificant.

Table Of Contents

Note 12: Restructuring Charges and Asset Disposals

The Company recorded no restructuring charges for the six months ended June 30, 2014, compared to \$394,000 in the same period as last year. These costs are included in restructuring charges and asset disposals in the Consolidated Statements of Operations. The \$394,000 of restructuring charges for the six months ended June 2013 consisted of a workforce reduction related charge of \$515,000, partially offset by \$121,000 reduction in existing restructuring reserves related to lease liability costs.

On June 13, 2013, the Company executed a workforce reduction of the residential lending group and retail operations to further reduce operating expenses. There were nineteen employees in total affected by this announcement. Restructuring charges for this initiative resulted in \$515,000 in severance expenses.

On May 29, 2013, the Company purchased a branch location where the cost of the lease exceeded the cost to own. This branch was part of a restructuring initiative in 2011, resulting in a reduction of \$121,000 in lease liability costs.

Restructuring reserves at June 30, 2014 for the restructuring activities taken in connection with prior year initiatives were \$29,000.

Note 13: Recent Accounting Pronouncements

On May 28, 2014, the FASB issued ASU No. 2014-09, “*Revenue from Contracts with Customers*”, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

ASU No. 2013-02, “*Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*,” requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. ASU No. 2013-12 is effective prospectively for reporting

periods beginning after December 15, 2012. The Company adopted this guidance on January 1, 2013 and it did not have a material impact on the consolidated financial statements.

Accounting Standards Update (“ASU”) No. 2011-04, “*Fair Value Measurements (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*,” was issued as a result of the effort to develop common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (“IFRS”). While ASU No. 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands the existing disclosure requirements for fair value measurements and clarifies the existing guidance or wording changes to align with IFRS No. 13. Many of the requirements for the amendments in ASU No. 2011-04 do not result in a change in the application of the requirements in Topic 820. The Company adopted ASU No. 2011-04 on January 1, 2012 and it did not have a material impact on the consolidated financial statements.

ASU No. 2011-05, “*Comprehensive Income (Topic 220) – Presentation of Comprehensive Income*,” requires an entity to present components of comprehensive income either in a single continuous statement of comprehensive income or in two separate consecutive statements. These amendments made the financial statement presentation of other comprehensive income more prominent by eliminating the alternative to present comprehensive income within the statement of equity. As originally issued, ASU No. 2011-05 required entities to present reclassification adjustments out of accumulated other comprehensive income by component in the statement in which net income is presented and the statement in which other comprehensive income is presented (for both interim and annual financial statements). This requirement was deferred by ASU No. 2011-12, “*Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards*”. ASU No. 2011-05 is effective for all interim and annual periods beginning on or after December 15, 2011. The Company adopted this guidance in the first quarter of 2012 and elected to present comprehensive income in a separate consolidated statement of comprehensive income.

Table Of Contents

ASU No. 2014-01 “*Accounting for Investments in Qualified Affordable Housing Projects (Topic 323)*” allows an entity that invests in low income housing projects and meets all the specified conditions to use the proportional amortization method to account for the costs of those investments. The effective date is for annual periods and interim periods within those annual periods beginning after December 15, 2014. The Company is in the process of evaluating the impact of ASU 2014-01 on its financial statement and processes.

In January 2014, the FASB issued ASU No. 2014-04, “*Receivables – Troubled Debt Restructuring by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure*,” to clarify that when an in substance repossession or foreclosure occurs, a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU 2014-04 is effective for annual reporting periods beginning after December 15, 2014. The Company is in the process of evaluating the impact of ASU 2014-04 on its financial statements and processes.

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

"SAFE HARBOR" STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in Bancorp’s public statements, including this one, and in particular in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to; (1) changes in prevailing interest rates which would affect the interest earned on Bancorp’s interest earning assets and the interest paid on its interest bearing liabilities; (2) the timing of repricing of Bancorp’s interest earning assets and interest bearing liabilities; (3) the effect of changes in governmental monetary policy; (4) the effect of changes in regulations applicable to Bancorp and the Bank and the conduct of its business; (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks; (6) the ability of competitors that are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide; (7) the state of the economy and real estate values in Bancorp’s market areas, and the consequent effect on the quality of Bancorp’s loans, (8) recent governmental initiatives that are expected to have a profound effect on the financial services industry and could dramatically change the competitive environment of Company ; (9) other legislative or

regulatory changes, including those related to residential mortgages, changes in accounting standards, and Federal Deposit Insurance Corporation (“FDIC”) premiums that may adversely affect the Company; (10) the application of generally accepted accounting principles, consistently applied, (11) the fact that one period of reported results may not be indicative of future periods, (12) the state of the economy in the greater New York metropolitan area and its particular effect on the Company's customers, vendors and communities and other such factors, including risk factors, as may be described in Bancorp's other filings with the SEC.

Although Bancorp believes that it offers the loan and deposit products and has the resources needed for continued success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

Table Of Contents

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified the accounting for the allowance for loan losses, the analysis of its investment securities and the valuation of deferred income tax assets, as Bancorp's most critical accounting policies and estimates in that they are important to the portrayal of Bancorp's financial condition and results of operations. They require management's most subjective and complex judgment as a result of the need to make an estimate about the effect of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Management's Discussion and Analysis.

Summary

Bancorp reported net income of \$525,000 (\$0.01 basic and diluted income per share) for the quarter ended June 30, 2014; an increase of \$4.4 million, compared to net loss of \$3.9 million (\$0.10 basic and diluted loss per share) for the quarter ended June 30, 2013. For the six months ended June 30, 2014, Bancorp reported net income of \$844,000 (\$0.02 basic and diluted income per share), an increase of \$6.7 million, compared to net loss of \$5.9 million (\$0.15 basic and diluted loss per share) for the six months ended June 30, 2013. Results for the quarter and year ended June 30, 2013 included prepayment penalty fees on borrowings of \$2.7 million and net restructuring charges of \$394,000. Excluding these expenses, net income at June 30, 2014 increased \$1.3 million (\$0.03 per share) and \$3.6 million (\$0.09 per share) from the prior year's quarter and year-to-date net income, respectively.

Bancorp's improved operating performance is primarily the result of profit improvement initiatives implemented during the past 15 months. Some of the more significant initiatives primarily included:

- Prepayment of higher cost borrowings and strategic repricing of deposits resulting in a reduction of the Company's cost of funds
- Asset quality improvement which has helped reduce related expenses and increase loan yields
- Exit from the Residential Mortgage Lending business realizing expense savings in excess of revenue reduction
- Purchasing three properties resulting in reduced occupancy expense and incremental rental income
- Reduction of excess staffing
- Contract renegotiation with major vendors and replacement of some existing vendors resulting in operating expense savings

Total assets increased \$10.9 million from \$541.2 million at December 31, 2013 to \$552.1 million at June 30, 2014. Cash and cash equivalents increased \$25.0 million from \$34.9 million at December 31, 2013 to \$59.9 million at June 30, 2014; reflective of the Bank's actions to increase liquidity. The net loan portfolio decreased \$15.3 million from \$418.1 million at December 31, 2013 to \$402.8 million at June 30, 2014. The decrease was primarily a result of loan payoffs and normal amortization in excess of new origination of loans. Residential loans decreased \$16.7 million as several large loans paid off. The Bank stopped originating Residential loans during 2013. Deposits decreased \$3.8 million from \$430.2 million at December 31, 2013 to \$426.4 million at June 30, 2014. Non-interest bearing deposits increased \$6.3 million. Interest bearing deposits decreased \$10.1 million primarily due to strategic deposit repricing initiatives.

Table Of Contents**FINANCIAL CONDITION*****Cash and Cash Equivalents***

Cash and cash equivalents increased \$25.0 million, or 72%, to \$59.9 million at June 30, 2014 compared to \$34.9 million at December 31, 2013. This increase was primarily the result of a \$15.0 million increase in borrowings, reflecting the Bank's actions to increase liquidity. The liquidity ratio was 15.75% at June 30, 2014 compared to 11.50% at December 31, 2013.

Investments

The following table is a summary of Bancorp's available-for-sale securities portfolio, at fair value, at the dates shown:

| <i>(in thousands)</i> | June 30, 2014 | December 31, 2013 |
|---|------------------|-------------------------|
| U.S. Government Agency bonds | \$7,344 | \$ 7,079 |
| U.S. Government Agency mortgage-backed securities | 19,498 | 21,752 |
| Corporate bonds | 8,844 | 8,870 |
| Total Available-for-Sale Securities | \$35,686 | \$ 37,701 |

Available-for-sale securities decreased \$2.0 million or 5.3%, from \$37.7 million at December 31, 2013 to \$35.7 million at June 30, 2014. This decrease was primarily due to principal pay downs of \$2.4 million on mortgage backed securities partially offset by an increase of \$501,000 in unrealized gains.

Table Of Contents**Loans**

The following table is a summary of Bancorp's loan portfolio at the dates shown:

| <i>(in thousands)</i> | June 30, 2014 | December 31, 2013 |
|-----------------------------|------------------|-------------------------|
| Real Estate | | |
| Commercial | \$219,762 | \$223,165 |
| Residential | 89,517 | 106,198 |
| Construction | - | 260 |
| Construction to permanent | 14,436 | 11,303 |
| Commercial | 37,849 | 35,061 |
| Consumer home equity | 42,384 | 44,081 |
| Consumer installment | 3,397 | 2,990 |
| Total Loans | 407,345 | 423,058 |
| Premiums on purchased loans | 160 | 200 |
| Net deferred costs | 495 | 571 |
| Allowance for loan losses | (5,214) | (5,681) |
| Loans receivable, net | \$402,786 | \$418,148 |

Bancorp's net loan portfolio decreased \$15.4 million, or 3.7%, from \$418.1 million at December 31, 2013 to \$402.8 million at June 30, 2014. The decrease was primarily a result of loan payoffs and normal amortization in excess of new originations. Residential loans decreased \$16.7 million primarily due to several large loan pay-offs. The Bank no longer originates residential loans.

At June 30, 2014, the net loan to deposit ratio was 94% and the net loan to total assets ratio was 73%. At December 31, 2013, these ratios were 97% and 77%, respectively.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a quarterly basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses decreased \$467,000 from December 31, 2013 to June 30, 2014 primarily due to charge-off of construction loans of \$260,000 which were specifically covered in the allowance for loan losses, and also to the partial charge-off of a non-accrual loan, in which the property was transferred to OREO and subsequently sold.

Table Of Contents

The accrual of interest on loans is discontinued at the time the loan is 90 days past due for payment unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off are reversed against interest income. All payments received on non-accrual loans are generally applied to principal only, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, future payments are reasonably assured, and there is 6 months of performance.

Management considers all non-accrual loans and troubled debt restructurings to be impaired. In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered collection delays and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

The changes in the allowance for loan losses for the periods shown are as follows:

| | Three months ended | | Six months ended | |
|---|--------------------|---------------|------------------|---------------|
| | June 30, 2014 | June 30, 2013 | June 30, 2014 | June 30, 2013 |
| <i>(in thousands)</i> | | | | |
| Balance at beginning of period | \$5,480 | \$5,717 | \$5,681 | \$6,016 |
| Charge-offs | (285) | (412) | (502) | (717) |
| Recoveries | 19 | 17 | 35 | 53 |
| Net Charge-offs | (266) | (395) | (467) | (664) |
| Provision charged to operations | - | - | - | (30) |
| Balance at end of period | \$5,214 | \$5,322 | \$5,214 | \$5,322 |
| Annualized net charge-offs during the period to average loans outstanding | 0.26 % | 0.34 % | 0.22 % | 0.29 % |
| Ratio of ALL / Gross Loans | 1.28 % | 1.18 % | 1.28 % | 1.18 % |

Based upon the overall assessment and evaluation of the loan portfolio, management believes the allowance for loan losses of \$5.2 million, at June 30, 2014, which represents 1.28% of gross loans outstanding, is adequate under prevailing economic conditions, to absorb existing losses in the loan portfolio.

Table Of Contents***Non-Accrual, Past Due and Restructured Loans***

The following table presents non-accruing loans and loans past due 90 days or more and still accruing:

| <i>(Dollars in thousands)</i> | June 30, 2014 | December 31, 2013 | | |
|--|------------------|-------------------------|--|--|
| Loans past due over 90 days still accruing | \$- | \$ 866 | | |
| Non accruing loans | 13,911 | 12,308 | | |
| Total | \$13,911 | \$ 13,174 | | |
| % of Total Loans | 3.41 % | 3.11 % | | |
| % of Total Assets | 2.52 % | 2.43 % | | |

Impaired loans are primarily attributable to the lingering effects of the downturn in the economy, which has severely impacted the real estate market and placed unprecedented stress on credit markets. The Bank's customers, many of whom are associated with the financial services industry, have been affected by the impact of the poor economy on employment and real estate values.

The \$13.9 million of non-accrual loans at June 30, 2014 is comprised of 15 loans, for which a specific reserve of \$2.0 million has been established. In all cases, the Bank has obtained appraisal reports from independent licensed appraisal firms and discounted those values for estimated selling costs to determine estimated impairment. Of the \$13.9 million of non-accrual loans at June 30, 2014 borrowers of 11 loans with aggregate balances of \$11.6 million continue to make loan payments and these loans are current within one and two months as to payments.

Potential Problem Loans

In addition to the above, there are \$2.5 million of substandard accruing loans and \$7.2 million of special mention loans. All of the substandard accruing and special mention loans continue to make timely payments and were within 30 days at June 30, 2014 with the exception of three loans totaling \$40,000, of which one loan of \$9,000 was paid off subsequent to June 30, 2014.

Other Real Estate Owned

There was no real estate owned at June 30, 2014 and December 31, 2013. During the six months ended June 30, 2014, one OREO property was obtained and subsequently sold.

Deferred Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of the Company at June 30, 2014. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. At June 30, 2014, the Company reported taxable income for the third consecutive quarter and is anticipating earnings to be positive in the future. Based on current accounting guidance the Company has not generated taxable income for a sufficient length of time in order to reverse the DTA valuation allowance at June 30, 2014 and, accordingly, had an allowance totaling \$17.6 million. In the future, as the Company continues to generate taxable income on a more sustained basis, the need for a valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

Table Of Contents***Deposits***

The following table is a summary of Bancorp's deposits at the dates shown:

| <i>(in thousands)</i> | June 30, 2014 | December 31, 2013 |
|--|------------------|-------------------------|
| Non-interest bearing | \$61,685 | \$55,358 |
| Interest bearing | | |
| NOW | 30,133 | 28,618 |
| Savings | 85,218 | 80,983 |
| Money market | 26,873 | 29,310 |
| Time certificates, less than \$100,000 | 117,513 | 129,548 |
| Time certificates, \$100,000 or more | 105,010 | 106,387 |
| Total interest bearing | 364,747 | 374,846 |
| Total Deposits | \$426,432 | \$430,204 |

Deposits decreased \$3.8 million from \$430.2 million at December 31, 2013 to \$426.4 million at June 30, 2014. This was primarily due to decreases in certificates of deposit (CDs) of \$13.4 million resulting from strategic pricing initiatives intended to reduce higher cost deposits. Decrease in money market balances of \$2.4 million were primarily due to shift in balances to savings account. Partially offsetting the noted decreases was an increase of \$4.2 million in savings accounts reflecting increases in both consumer and commercial savings accounts due to promotional activities and a non-interest bearing balance increase of \$6.3 million or 11.4%.

Borrowings

At June 30, 2014 and December 31, 2013, total borrowings were \$80.2 million and \$65.2 million respectively. In addition to the outstanding borrowings disclosed in the consolidated balance sheet, the Bank has the ability to borrow approximately \$75 million in additional advances from the Federal Home Loan Bank of Boston ("FHLB"), including a \$2 million overnight line of credit. The Bank has also established a line of credit at the Federal Reserve Bank.

The subordinated debentures of \$8.2 million are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has entered into a guarantee, which together with its obligations under the subordinated debentures and the declaration of trust governing the Trust provides a full and unconditional guarantee of amounts on the capital securities. The subordinated debentures, which bear interest at three-month LIBOR plus 3.15% (3.3836% at June 30, 2014), mature on March 26, 2033. Beginning in the second quarter of 2009, the Company deferred quarterly interest payments on the subordinated debentures for 20 consecutive quarters as permitted under the terms of the debentures. Interest was still being accrued and charged to operations. The Company made a payment of approximately \$1.6 million of all interest payable in June 2014.

The duration of the trust is 30 years, with an early redemption feature at the Company's option on a quarterly basis.

Table Of Contents

Capital

Capital increased \$1.5 million compared to December 31, 2013 as a result of year-to-date net income of \$844,000, other comprehensive income of \$501,000 and \$130,000 of share based compensation.

Off-Balance Sheet Arrangements

Bancorp's off-balance sheet arrangements, which primarily consist of commitments to lend, increased by \$6.1 million from \$79.3 million at December 31, 2013 to \$85.4 million at June 30, 2014, primarily due to increases of \$5.4 million in future loan commitments and \$3.7 million in undisbursed construction loans offset by decreases of \$5.3 million in home equity lines of credit.

Table Of Contents**RESULTS OF OPERATIONS*****Interest and dividend income and expense***

The following tables present average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid for major balance sheet components:

| | Three months ended June 30, | | | | | | | |
|--|-------------------------------|--------------------------------|-----------------|---|--------------------|--------------------------------|-----------------|---|
| | 2014 | | | | 2013 | | | |
| | Average Balance | Interest Income/ Expense | Average Rate | % | Average Balance | Interest Income/ Expense | Average Rate | % |
| | <i>(dollars in thousands)</i> | | | | | | | |
| Interest earning assets: | | | | | | | | |
| Loans | \$412,393 | \$ 4,667 | 4.54 | % | \$470,236 | \$ 5,045 | 4.30 | % |
| Investments | 46,317 | 175 | 1.52 | % | 50,727 | 255 | 2.02 | % |
| Interest bearing deposits in banks | 42,405 | 14 | 0.13 | % | 18,583 | 9 | 0.19 | % |
| Total interest earning assets | 501,115 | 4,856 | 3.89 | % | 539,546 | 5,309 | 3.95 | % |
| | | | | | | | | |
| Cash and due from banks | 1,922 | | | | 4,458 | | | |
| Premises and equipment, net | 16,751 | | | | 4,803 | | | |
| Allowance for loan losses | (5,488) | | | | (5,739) | | | |
| Other assets | 25,836 | | | | 29,308 | | | |
| Total Assets | \$540,136 | | | | \$572,376 | | | |
| | | | | | | | | |
| Interest bearing liabilities: | | | | | | | | |
| Deposits | \$369,043 | \$ 607 | 0.66 | % | \$416,326 | \$ 1,032 | 0.99 | % |
| FHLB advances | 61,066 | 33 | 0.22 | % | 37,209 | 167 | 1.80 | % |
| Subordinated debt | 8,248 | 82 | 3.99 | % | 8,248 | 71 | 3.45 | % |
| Other borrowings | - | - | N/A | | 538 | 6 | 4.47 | % |
| Total interest bearing liabilities | 438,357 | 722 | 0.66 | % | 462,321 | 1,276 | 1.11 | % |
| | | | | | | | | |
| Demand deposits | 55,150 | | | | 61,016 | | | |
| Accrued expenses and other liabilities | 3,496 | | | | 4,170 | | | |
| Shareholders' equity | 43,133 | | | | 44,869 | | | |
| Total liabilities and equity | \$540,136 | | | | \$572,376 | | | |
| | | | | | | | | |
| Net interest income | | \$ 4,134 | | | | \$ 4,033 | | |
| Interest margin | | | 3.31 | % | | | 3.00 | % |
| Interest spread | | | 3.23 | % | | | 2.84% | |

Table Of Contents

| | Six months ended June 30, 2014 | | | | 2013 | | | |
|--|-----------------------------------|--------------------------------|-----------------|---|--------------------|--------------------------------|-----------------|---|
| | Average Balance | Interest Income/ Expense | Average Rate | | Average Balance | Interest Income/ Expense | Average Rate | |
| | <i>(dollars in thousands)</i> | | | | | | | |
| Interest earning assets: | | | | | | | | |
| Loans | \$414,916 | \$ 9,358 | 4.55 | % | \$468,077 | \$10,241 | 4.41 | % |
| Investments | 46,848 | 351 | 1.51 | % | 51,172 | 532 | 2.10 | % |
| Interest bearing deposits in banks | 38,692 | 26 | 0.14 | % | 37,731 | 37 | 0.20 | % |
| Total interest earning assets | 500,456 | 9,735 | 3.92 | % | 556,980 | 10,810 | 3.91 | % |
| | | | | | | | | |
| Cash and due from banks | 1,917 | | | | 4,978 | | | |
| Premises and equipment, net | 15,866 | | | | 4,400 | | | |
| Allowance for loan losses | (5,553) | | | | (5,877) | | | |
| Other assets | 25,765 | | | | 30,112 | | | |
| Total Assets | \$538,451 | | | | \$590,593 | | | |
| | | | | | | | | |
| Interest bearing liabilities: | | | | | | | | |
| Deposits | \$369,536 | \$ 1,244 | 0.68 | % | \$422,016 | \$2,161 | 1.03 | % |
| FHLB advances | 59,503 | 66 | 0.22 | % | 43,569 | 518 | 2.40 | % |
| Subordinated debt (1) | 8,248 | 282 | 6.89 | % | 8,248 | 142 | 3.47 | % |
| Other borrowings | - | - | N/A | | 3,751 | 82 | 4.41 | % |
| Total interest bearing liabilities | 437,287 | 1,592 | 0.73 | % | 477,584 | 2,903 | 1.23 | % |
| | | | | | | | | |
| Demand deposits | 54,691 | | | | 61,135 | | | |
| Accrued expenses and other liabilities | 3,702 | | | | 4,898 | | | |
| Shareholders' equity | 42,771 | | | | 46,976 | | | |
| Total liabilities and equity | \$538,451 | | | | \$590,593 | | | |
| | | | | | | | | |
| Net interest income | | \$ 8,143 | | | | \$7,907 | | |
| Interest margin | | | 3.28 | % | | | 2.86 | % |
| Interest spread | | | 3.19 | % | | | 2.68 | % |

(1) Subordinated debt interest expense for the six months ended June 30, 2014 includes a \$117,000 expense applicable to a prior year adjustment.

Table Of Contents

The following rate volume analysis reflects the impact that changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities had on net interest income during the periods indicated. Information is provided in each category with respect to changes attributable to changes in volume (changes in volume multiplied by prior rate), changes attributable to changes in rates (changes in rates multiplied by prior volume) and the total net change. The change resulting from the combined impact of volume and rate is allocated proportionately to the change due to volume and the change due to rate.

| | Three months ended June 30, 2014 vs 2013 | | | Six Months ended June 30, 2014 vs 2013 | | |
|------------------------------------|---|---------|---------|---|---------|---------|
| | Increase (decrease) in Interest Income/Expense Due to change in: | | | Increase (decrease) in Interest Income/Expense Due to change in: | | |
| | Volume | Rate | Total | Volume | Rate | Total |
| | <i>(dollars in thousands)</i> | | | <i>(dollars in thousands)</i> | | |
| Interest earning assets: | | | | | | |
| Loans | \$(648) | \$270 | \$(378) | \$(946) | \$63 | \$(883) |
| Investments | (23) | (57) | (80) | (42) | (139) | (181) |
| Interest bearing deposits in banks | 14 | (9) | 5 | - | (11) | (11) |
| Total interest earning assets | (657) | 204 | (453) | (988) | (87) | (1,075) |
| Interest bearing liabilities: | | | | | | |
| Deposits | \$(126) | \$(299) | \$(425) | \$(246) | \$(671) | \$(917) |
| FHLB advances | 147 | (281) | (134) | 185 | (637) | (452) |
| Subordinated debt | - | 11 | 11 | - | 140 | 140 |
| Other borrowings | (6) | - | (6) | (82) | - | (82) |
| Total interest bearing liabilities | 15 | (569) | (554) | (143) | (1,168) | (1,311) |
| Net interest income | \$(672) | \$773 | \$101 | \$(845) | \$1,081 | \$236 |

For the quarter ended June 30, 2014, net interest income was \$4,134,000 an increase of \$101,000 or 2.5% from net interest income of \$4,033,000 for the quarter ended June 30, 2013. Interest expense decrease of \$554,000 was partially offset by lower interest income of \$453,000.

The interest income reduction was primarily due to lower average earning assets and lower investment yields partially offset by increased total yield on loans. Average interest earning assets decreased \$38.4 million, or 7.1%, to \$501.1 million from \$539.5 million and was responsible for \$657,000 of the reduction in interest income. The decrease in investment yields was primarily due to repricing of bonds to lower rates. Average loan yields increased primarily due to improved asset quality and higher loan fees.

The interest expense reduction of \$554,000 for the quarter ended June 30, 2014 was primarily due to strategic reduction of rates paid on term deposits, and resulting term deposit average balance reduction of \$29.2 million, in addition to lower interest expense on borrowings due to rate reductions. From April 2013 to September 2013, the Bank prepaid higher rate borrowings, replacing these with borrowings at lower rates.

Table Of Contents

Net interest margin for the three months ended June 30, 2014 was 3.31% as compared to 3.00% for the three months ended June 30, 2013 primarily due to the Bank's reduction in total cost of funds to 0.59% from 0.98%.

For the six months ended June 30, 2014, net interest income was \$8,143,000 an increase of \$236,000 or 3.0% from net interest income of \$7,907,000 for the six months ended June 30, 2013. Interest expense decrease of \$1,311,000 was partially offset by lower interest income of \$1,075,000. In the quarter ended March 31, 2014, Bancorp recorded interest expense of \$117,000 on subordinated debt which was related to prior years. Excluding this adjustment net interest income would have been \$353,000 or 4.5% higher for the six months ended June 30, 2014 as compared to the six months ended June 30, 2013.

Similar to quarterly results, the year-to-date interest income reduction was primarily due to lower average earning assets and lower investment yields partially offset by increased total yield on loans. Average interest earning assets decreased \$56.5 million, or 10.1%, to \$500.5 million from \$557.0 million and was responsible for \$988,000 of the reduction in interest income. The decrease in investment yields was primarily due to repricing of bonds to lower rates. Average loan yields increased primarily due to improved asset quality and higher loan fees.

The interest expense reduction of \$1,311,000 for the six months ended June 30, 2014 was primarily due to strategic reduction of rates paid on term deposits, and resulting term deposit average balance reduction of \$36.7 million, in addition to lower interest expense on borrowings due to previously mentioned replacement of higher rate borrowings with borrowings at lower rates.

Net interest margin for the six months ended June 30, 2014 was 3.28% as compared to 2.86% for the six months ended June 30, 2013 primarily due to the Bank's reduction in average funding rates. Excluding the \$117,000 subordinated interest expense adjustment net margin for the six months ended June 30, 2014 was 3.33%.

Provision for Loan Losses

Based on management's most recent evaluation of the adequacy of the allowance for loan losses, the provision for loan losses was unchanged for the three months ended June 30, 2014. The provision for loan loss provision was also unchanged for the three months ended June 30, 2013.

An analysis of the changes in the allowance for loan losses is presented under “Allowance for Loan Losses.”

Non-interest income

Non-interest income decreased \$146,000 from \$769,000 for the quarter ended June 30, 2013 to \$623,000 for the quarter ended June 30, 2014. This was primarily due to decreases in mortgage banking activity of \$102,000, and gains of \$51,000 and \$28,000 recognized in 2013 from a branch sale and portfolio loan sales, respectively. These decreases were partially offset by rental income resulting from the Bank’s purchase of the previously leased Greenwich branch building in November, 2013.

For the six months ended June 30, 2014, non-interest income decreased \$40,000, or 3.2%, to \$1.2 million as compared to \$1.3 million for the six months ended June 30, 2013. This decrease was primarily due to decreases in mortgage banking activity of \$148,000 and the previously noted gains totaling \$79,000, partially offset by higher rental income.

Table Of Contents

Non-interest expense

Non-interest expense decreased \$4.5 million or 51.4% from \$8.7 million for the quarter ended June 30, 2013 to \$4.2 million for the quarter ended June 30, 2014. Excluding prepayment penalty on borrowings of \$2.7 million and net restructuring charges of \$394,000 incurred in the quarter ended June 30, 2013, non-interest expense decreased \$1.4 million or 24.5%. Decreases included lower salaries and benefits of \$601,000 and lower professional and other outside services expense of \$313,000, both resulting from management initiatives to reduce non-interest expense.

For the six months ended June 30, 2014 non-interest expense decreased \$6.6 million or 43.5% to \$8.5 million from \$15.1 million for the same period in 2013. Excluding the prepayment penalty on borrowings of \$2.7 million and net restructuring charges of \$394,000 incurred in 2013, non-interest expense decreased \$3.5 million or 28.9%. This reduction was primarily due to expense reduction initiatives cited earlier. Salaries and benefits decreased \$1.6 million. Professional and other outside services expenses decreased \$731,000 and regulatory assessments decreased \$211,000.

LIQUIDITY

Bancorp's liquidity ratio was 15.75% at June 30, 2014 compared to 11.50% at December 31, 2013. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets, as described in the accompanying consolidated balance sheets, are considered liquid assets: cash and due from banks, federal funds sold, short-term investments and unpledged available-for-sale securities. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp's short-term assets provide sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts and to meet other anticipated cash operating requirements.

CAPITAL

The following table illustrates Bancorp's regulatory capital ratios at June 30, 2014 and December 31, 2013 respectively:

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

| | June 30, 2014 | December 31, 2013 |
|---------------------------|------------------|----------------------|
| Tier 1 Leverage Capital | 9.61% | 9.33% |
| Tier 1 Risk-based Capital | 12.96% | 12.70% |
| Total Risk-based Capital | 14.215 | 13.95% |

The following table illustrates the Bank's regulatory capital ratios at June 30, 2014 and December 31, 2013 respectively:

| | June 30, 2014 | December 31, 2013 |
|---------------------------|------------------|----------------------|
| Tier 1 Leverage Capital | 9.63% | 9.28% |
| Tier 1 Risk-based Capital | 12.99% | 12.61% |
| Total Risk-based Capital | 14.24% | 13.86% |

Table Of Contents

IMPACT OF INFLATION AND CHANGING PRICES

Bancorp's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Notwithstanding this, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect Bancorp's earnings in future periods.

MANAGEMENT CHANGES

In February, 2014, the Company announced the appointment of Richard A. Muskus as Executive officer responsible for lending effective March 17, 2014. The OCC has reviewed the Notice of Change of Director or Senior Executive officer submitted and has determined that the notice is technically complete as of June 24, 2014.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of Bancorp's business, the primary source of market risk is interest rate risk, which is the impact that changing interest rates have on current and future earnings. In addition, Bancorp's loan portfolio is primarily secured by real estate in the Company's market area. As a result, the changes in valuation of real estate could also impact Bancorp's earnings.

Qualitative Aspects of Market Risk

Bancorp's goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp's assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is on maintaining a proper

balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio and purchase short-term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest-bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies are matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee meets on a monthly basis, but may convene more frequently as conditions dictate. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors on a monthly basis regarding its activities. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee (“ALCO”), which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions during the period and determines compliance with Bank policies.

Quantitative Aspects of Market Risk

Management analyzes Bancorp’s interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation and GAP analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are “interest sensitive.” An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Table Of Contents

Management's goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Simulation analysis is only an estimate of Bancorp's interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The table below sets forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in Bancorp's portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results of these changes are added to or subtracted from the base case; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may also overstate the impact of short-term repricings. As a result of the historically low interest rate environment, the calculated effects of the 100 and 200 basis point downward shocks cannot absolutely reflect the risk to earnings and equity since the interest rates on certain balance sheet items have approached their minimums and therefore, it is not possible for the analyses to fully measure the true impact of these downward shocks.

Table Of Contents

Net Interest Income and Economic Value

Summary Performance

June 30, 2014

| Projected Interest Rate Scenario | Net Interest Income | | | Net Portfolio Value | | |
|----------------------------------|---------------------|-----------|-----------|---------------------|-----------|-----------|
| | Estimated | \$ Change | % Change | Estimated | \$ Change | % Change |
| | Value | from Base | from Base | Value | from Base | from Base |
| + 200 | 15,990 | (299) | -1.8 % | 62,021 | (7,309) | -10.5 % |
| + 100 | 16,253 | (36) | -0.2 % | 65,625 | (3,705) | -5.3 % |
| BASE | 16,289 | | | 69,330 | | |
| -100 | 16,447 | 158 | 1.0 % | 75,059 | 5,729 | 8.3 % |
| -200 | 16,357 | 68 | 0.4 % | 78,660 | 9,330 | 13.5 % |

December 31, 2013

| Projected Interest Rate Scenario | Net Interest Income | | | Net Portfolio Value | | |
|----------------------------------|---------------------|-----------|-----------|---------------------|-----------|-----------|
| | Estimated | \$ Change | % Change | Estimated | \$ Change | % Change |
| | Value | from Base | from Base | Value | from Base | from Base |
| + 200 | 16,147 | (780) | -4.6 % | 59,238 | (11,808) | -16.6 % |
| + 100 | 16,656 | (271) | -1.6 % | 65,079 | (5,967) | -8.4 % |
| BASE | 16,927 | | | 71,046 | | |
| -100 | 17,124 | 197 | 1.2 % | 78,332 | 7,286 | 10.3 % |
| -200 | 16,864 | (63) | -0.4 % | 82,687 | 11,641 | 16.4 % |

Item 4: Controls and Procedures

Based on an evaluation of the effectiveness of Bancorp's disclosure controls and procedures performed by Bancorp's management, with the participation of Bancorp's Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp's Chief Executive Officer and Chief Financial Officer concluded that Bancorp's disclosure controls and procedures have been effective.

As used herein, “disclosure controls and procedures” means controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in Bancorp’s internal controls over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during Bancorp’s fiscal quarter ended June 30, 2014 that has materially affected, or is reasonably likely to materially affect, Bancorp’s internal controls over financial reporting.

Table Of Contents**PART II - OTHER INFORMATION*****Item 1: Legal Proceedings***

Neither Bancorp nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Bancorp or the Bank is a party or any of its property is subject.

Item 1A: Risk Factors

During the three months ended June 30, 2014, there were no material changes to the risk factors relevant to Bancorp's operations, which are described in the Annual Report on Form 10-K for the year ended December 31, 2013.

Item 6: Exhibits

| <u>No.</u> | <u>Description</u> |
|------------|--|
| 2 | Agreement and Plan of Reorganization dated as of June 28, 1999 between Bancorp and the Bank (incorporated by reference to Exhibit 2 to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 2.1 | Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of December 16, 2009 (incorporated by reference to Exhibit 10.1 to Bancorp's Current Report on Form 8-K dated December 17, 2009). |
| 2.2 | Amendment to Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of May 3, 2010 (incorporated by reference to Exhibit 10(a) to Bancorp's Current Report on Form 8-K dated May 4, 2010). |
| 3(i) | Certificate of Incorporation of Bancorp, (incorporated by reference to Exhibit 3(i) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 3(i)(A) | Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2004 (Commission File No. 000-29599)). |
| 3(i)(B) | Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006 (incorporated by reference to Exhibit 3(i)(B) to Bancorp's Quarterly Report of Form 10-Q for the quarter ended September 30, 2006 (commission File No. 000-29599)). |

Table Of Contents

| <u>No.</u> | <u>Description</u> |
|------------|--|
| 3(i) (C) | Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. (incorporated by reference to Exhibit 3(i) to Bancorp's current report Form 8-K dated October 21, 2010. |
| 3(ii) | Amended and Restated By-laws of Bancorp (incorporated by reference to Exhibit 3(ii) to Bancorp's Current Report on Form 8-K dated November 1, 2010 (Commission File No. 000-29599)) |
| 10(a) (2) | 2012 Stock Plan of Bancorp (incorporated by reference from Annex A to the Proxy Statement on Form 14C filed November 1, 2011. |
| 10(a) (14) | Change of Control Agreement, dated as of January 1, 2007 among Philip W. Wolford, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(14) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)). |
| 10(a) (15) | Formal Written Agreement between Patriot National Bank and the Office of the Comptroller of the Currency (incorporated by reference to Exhibit 10(a)(15) to Bancorp's Current Report on Form 8-K dated February 9, 2009 (Commission File No. 000-29599)). |
| 10(a) (16) | Formal Written Agreement between Patriot National Bank and the Federal Reserve Bank of New York (incorporated by reference to Exhibit 10(a)(16) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2010 (Commission File No. 000-29599)). |
| 10(a) (17) | Financial Services Agreement dated November 8, 2011 of Bancorp (incorporated by reference to Exhibit 10(a)(20) on the Quarterly Report on Form 10-Q dated November 10, 2011. |
| 10(a) (20) | Amended Financial Services Agreement, dated August 7, 2014. |
| 14 | Code of Conduct for Senior Financial Officers (incorporated by reference to Exhibit 14 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599). |
| 21 | Subsidiaries of Bancorp (incorporated by reference to Exhibit 21 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 1999 (Commission File No. 000-29599)). |
| 31(1) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31(2) | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32 | Section 1350 Certifications |
| <u>No.</u> | <u>Description</u> |
| 101.INS# | XBRL Instance Document |
| 101.SCH# | XBRL Schema Document |

101.CAL#XBRL Calculation Linkbase Document

101.LAB#XBRL Labels Linkbase Document

Table Of Contents

101.PRE#XBRL Presentation Linkbase Document

101.DEF#XBRL Definition Linkbase Document

The exhibits marked with the section symbol (#) are interactive data files. Pursuant to Rule 406T of Regulations S-T, these interactive data files (i) are not deemed filed or part of a registration statement of prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, irrespective of any general incorporation language included in any such filings, and otherwise are not subject to liability under these sections; and (ii) are deemed to have complied with Rule 405 of Regulations S-T (“Rule 405”) and are not subject to liability under the anti-fraud provisions of the Section 17(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 or under any other liability provision if we have made a good faith attempt to comply with Rule 405 and, after we become aware that the interactive data files fail to comply with Rule 405, we promptly amend the interactive data files.

Table Of Contents

SIGNATURES

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

PATRIOT NATIONAL BANCORP, INC.
(Registrant)

By: /s/ Christina L. Maier
Christina L. Maier
Executive Vice President
Chief Financial Officer

(On behalf of the registrant and as
Chief Financial Officer)

August 8, 2014