1ST CONSTITUTION BANCORP
Form 10-Q
August 14, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012
or

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

For the transition period from _____ to _____

Commission file Number: 000-32891

1ST CONSTITUTION BANCORP
(Exact Name of Registrant as Specified in Its Charter)

New Jersey (State of Other Jurisdiction of Incorporation or Organization)	22-3665653 (I.R.S. Employer Identification No.)
2650 Route 130, P.O. Box 634, Cranbury, NJ (Address of Principal Executive Offices)	08512 (Zip Code)

(609) 655-4500
(Issuer’s Telephone Number, Including Area Code)

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

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

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 x No o

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer (Do not check if a smaller reporting company)	o	Smaller reporting company	x

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

As of August 12, 2012, there were 5,093,725 shares of the registrant's common stock, no par value, outstanding.

1ST CONSTITUTION BANCORP

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

1st Constitution Bancorp and Subsidiaries
Consolidated Balance Sheets
(unaudited)

	June 30, 2012	December 31, 2011
ASSETS		
CASH AND DUE FROM BANKS	$ 16,567,985	$ 15,183,853
FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS	11,413	11,406
Total cash and cash equivalents	16,579,398	15,195,259
INVESTMENT SECURITIES:		
Available for sale, at fair value	97,537,598	93,683,774
Held to maturity (fair value of $128,856,455 and $147,621,280 at June 30, 2012, and December 31, 2011, respectively)	122,992,218	142,474,423
Total securities	220,529,816	236,158,197
LOANS HELD FOR SALE	16,595,846	19,234,111
LOANS	479,795,092	475,431,771
Less- Allowance for loan losses	(6,257,420)	(5,534,450)
Net loans	473,537,672	469,897,321
PREMISES AND EQUIPMENT, net	10,629,160	10,439,304
ACCRUED INTEREST RECEIVABLE	2,767,959	2,996,848
BANK-OWNED LIFE INSURANCE	13,804,079	13,578,981
OTHER REAL ESTATE OWNED	11,604,744	12,409,201
OTHER ASSETS	11,449,899	11,817,693
Total assets	$ 777,498,573	$ 791,726,915
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits		
Non-interest bearing	$ 129,822,625	$ 105,470,543
Interest bearing	539,248,825	518,391,942
Total deposits	669,071,450	623,862,485

BORROWINGS		25,300,000		88,300,000
REDEEMABLE SUBORDINATED DEBENTURES		18,557,000		18,557,000
ACCRUED INTEREST PAYABLE		1,010,905		1,186,511
ACCRUED EXPENSES AND OTHER LIABILITIES		5,885,943		4,821,144
Total liabilities		719,825,298		736,727,140
COMMITMENTS AND CONTINGENCIES				
SHAREHOLDERS' EQUITY:				
Preferred stock, no par value; 5,000,000 shares authorized; none issued				
Common stock, no par value, 30,000,000 shares authorized; 5,101,907 and 5,096,054 shares issued and 5,093,725 and 5,094,503 shares outstanding as of June 30, 2012 and December 31, 2011 respectively		41,073,077		40,847,929
Retained earnings		15,535,446		13,070,606
Treasury Stock, at cost, 8,182 and 1,551 shares at June 30, 2012 and December 31, 2011, respectively		(68,492)		(10,222)
Accumulated other comprehensive income		1,133,244		1,091,462
Total shareholders' equity		57,673,275		54,999,775
Total liabilities and shareholders' equity	$	777,498,573	$	791,726,915

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Income
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
INTEREST INCOME	2012	2011	2012	2011
Loans, including fees	$ 6,319,104	$ 5,167,439	$12,733,563	$10,521,646
Securities				
Taxable	1,143,554	1,503,134	2,327,759	2,788,078
Tax-exempt	411,225	351,728	831,794	636,800
Federal funds sold and short-term investments	33,306	63,004	48,340	72,110
Total interest income	7,907,189	7,085,305	15,941,456	14,018,634
INTEREST EXPENSE				
Deposits	1,079,048	1,530,274	2,265,522	2,928,404
Borrowings	103,639	103,712	221,561	210,632
Redeemable subordinated debentures	96,580	237,280	195,892	501,434
Total interest expense	1,279,267	1,871,266	2,682,975	3,640,470
Net interest income	6,627,922	5,214,039	13,258,481	10,378,164
PROVISION FOR LOAN LOSSES	549,998	275,000	1,149,996	674,998
Net interest income after provision for loan losses	6,077,924	4,939,039	12,108,485	9,703,166
NON-INTEREST INCOME				
Service charges on deposit accounts	231,256	234,898	459,228	410,740
Gain on sales of loans	495,147	411,643	963,364	848,382
Income on bank-owned life insurance	113,176	103,522	225,098	198,659
Other income	348,387	390,249	705,441	707,281
Total non-interest income	1,187,966	1,140,312	2,353,131	2,165,062
NON-INTEREST EXPENSE				
Salaries and employee benefits	3,154,903	2,843,948	6,095,253	5,420,612
Occupancy expense	613,534	580,969	1,337,320	1,147,707
Data processing expenses	252,545	313,776	516,120	617,249
FDIC insurance expenses	139,873	246,458	287,266	474,005
Other operating expenses	1,213,119	1,170,634	2,750,532	2,159,044
Total non-interest expenses	5,373,974	5,155,785	10,986,491	9,818,617
Income before income taxes	1,891,916	923,566	3,475,125	2,049,611
INCOME TAXES	593,808	94,650	1,010,285	430,827
Net income	$ 1,298,108	$ 828,916	$2,464,840	$1,618,784
NET INCOME PER SHARE				
Basic	$ 0.25	$ 0.16	$0.48	$0.32
Diluted	$ 0.25	$ 0.16	$0.48	$0.32

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Comprehensive Income
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
NET INCOME	$ 1,298,108	$ 828,916	$ 2,464,840	$ 1,618,784
Other comprehensive income, net of tax				
Unrealized gains on securities available for sale	28,135	936,493	37,930	819,296
Pension liability	1,926	1,926	3,852	3,853
Unrealized gain on interest rate swap contract	-	107,191	-	211,562
Other comprehensive income	30,061	1,045,610	41,782	1,034,711
Comprehensive income	$ 1,328,169	$ 1,874,526	$ 2,506,622	$ 2,653,495

The accompanying notes are an integral part of these financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
For the Six Months Ended June 30, 2012 and 2011
(unaudited)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Shareholders' Equity
BALANCE, January 1, 2011	$38,899,855	$10,741,779	$(58,652)	$ 98,174	$49,681,156
Exercise of stock options and issuance of vested shares under employee benefit programs	75,058		11,597		86,655
Share-based compensation	27,200				27,200
Treasury stock purchased			(15,354)		(15,354)
Net income for the six months ended June 30, 2011		1,618,784			1,618,784
Other comprehensive income				1,034,711	1,034,711
Balance, June 30, 2011	$39,002,113	$12,360,563	$(62,409)	$ 1,132,885	$52,433,152
Balance, January 1, 2012	$40,847,929	$13,070,606	$(10,222)	$ 1,091,462	$54,999,775
Exercise of stock options, net, and issuance of vested shares under employee benefit programs	176,371				176,371
Share-based compensation	48,777				48,777
Treasury stock purchased			(58,270)		(58,270)
Net Income for the six months ended June 30, 2012		2,464,840			2,464,840
Other comprehensive income				41,782	41,782
Balance, June 30, 2012	$41,073,077	$15,535,446	$(68,492)	$ 1,133,244	$57,673,275

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

	Six Months Ended June 30, 2012	2011
OPERATING ACTIVITIES:		
Net income	$ 2,464,840	$ 1,618,784
Adjustments to reconcile net income to net cash provided by operating activities-		
Provision for loan losses	1,149,996	674,998
Provision for loss on other real estate owned	501,644	147,178
Depreciation and amortization	579,455	510,473
Net amortization of premiums and discounts on securities	750,689	815,173
Gains on sales of loans held for sale	(963,364)	(848,382)
Originations of loans held for sale	(79,079,430)	(47,402,373)
Proceeds from sales of loans held for sale	82,681,059	62,498,228
Income on Bank – owned life insurance	(225,098)	(198,659)
Share-based compensation expense	224,221	187,921
Decrease (increase) in accrued interest receivable	228,889	(276,159)
Decrease (increase) in other assets	211,685	(1,574,006)
Decrease in accrued interest payable	(175,606)	(240,064)
Increase (decrease) in accrued expenses and other liabilities	895,796	(914,212)
Net cash provided by operating activities	9,244,776	14,998,900
INVESTING ACTIVITIES:		
Purchases of securities -		
Available for sale	(28,280,554)	(69,849,189)
Held to maturity	-	(83,188,354)
Proceeds from maturities and prepayments of securities -		
Available for sale	24,322,808	44,610,442
Held to maturity	18,892,905	22,600,347
Net (increase) decrease in loans	(5,260,752)	69,306,181
Capital expenditures	(635,328)	(347,008)
Additional investment in other real estate owned	(81,812)	(607,158)
Proceeds from sales of other real estate owned	855,030	1,629,315
Cash consideration received in connection with acquisition of branches	-	101,539,588
Net cash provided by investing activities	9,812,297	85,694,164
FINANCING ACTIVITIES:		
Exercise of stock options and issuance of vested shares	176,371	86,655
Purchase of Treasury Stock	(58,270)	(15,354)
Net increase (decrease) in demand, savings and time deposits	45,208,965	(12,517,290)
Net (decrease) in borrowings	(63,000,000)	(15,900,000)
Net cash used in financing activities	(17,672,934)	(28,345,989)
Increase in cash and cash equivalents	1,384,139	72,347,075

CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		15,195,259		17,710,501
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	16,579,398	$	90,057,576
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid during the period for -				
Interest	$	2,858,581	$	3,880,534
Income taxes		887,000		857,000
Non-cash investing activities				
Real estate acquired in full satisfaction of loans in foreclosure	$	470,405	$	3,107,664

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Notes To Consolidated Financial Statements
June 30, 2012 (Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying unaudited Consolidated Financial Statements include 1st Constitution Bancorp (the "Company"), its wholly-owned subsidiary, 1st Constitution Bank (the "Bank"), and the Bank's wholly-owned subsidiaries, 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 1st Constitution Title Agency, 204 South Newman Street Corp. and 249 New York Avenue, LLC. 1st Constitution Capital Trust II, a subsidiary of the Company, is not included in the Company's consolidated financial statements as it is a variable interest entity and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") including the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Form 10-K for the year ended December 31, 2011, filed with the SEC on March 23, 2012.

In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) which are necessary for a fair presentation of the operating results for the interim periods have been included. The results of operations for periods of less than a year are not necessarily indicative of results for the full year.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2012 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

(2) Acquisition of Unaffiliated Branches

On March 25, 2011, the Bank acquired certain deposit and other liabilities, real estate and related assets of the Rocky Hill, Hillsborough and Hopewell, New Jersey branch banking offices from another financial institution for a purchase price of $9.85 million (the "March 2011 Acquisition"). The March 2011 Acquisition was completed pursuant to the terms and conditions of the Branch Purchase and Assumption Agreement and Agreement for Purchase dated as of December 30, 2010, which was previously disclosed on a Current Report on Form 8-K filed by the Company with the SEC on January 3, 2011.

The Company accounted for this transaction using applicable accounting guidance regarding business combinations. The fair value of savings and transaction deposit accounts acquired was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. A core deposit intangible was ascribed to the value of non-maturity deposits based upon an independent third party evaluation which was prepared using the actual characteristics of the deposits and assumptions we believe to be reasonable. Certificates of deposit accounts were valued utilizing a discounted cash flows analysis based upon the underlying accounts' contractual maturities and interest rates. The present value of the projected cash flow was then determined using discount rates based upon certificate of deposit interest rates available in the marketplace for accounts with similar terms. The fair value of the three branch buildings was determined via appraisals performed by qualified independent third party appraisers. The fair value of loans acquired, all of which were performing, was assumed to approximate amortized cost based upon the small size and nature of those loans.

As a result of the March 2011 Acquisition, the three branches became branches of the Bank. Included in the March 2011 Acquisition were the assumption of deposit liabilities of $111.9 million, primarily consisting of demand deposits, and the acquisition of cash of approximately $101.5 million, fixed assets of approximately $4.6 million, which includes, without limitation, ownership of the real estate and improvements upon which the branches are situated, and loans of $862,000. The Bank recorded goodwill of approximately $3.2 million and a core deposit intangible asset of approximately $1.7 million as a result of the March 2011 Acquisition.

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(3) Net Income Per Common Share

Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding during each period.

Diluted net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of potential common stock warrants, common stock options and unvested restricted stock awards (as defined below), using the treasury stock method. All share information has been adjusted for the effect of a 5% common stock dividend declared December 15, 2011 and paid on February 2, 2012 to shareholders of record on January 17, 2012.

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per common share (EPS) calculations. Dilutive securities in the tables below exclude common stock options and warrants with exercise prices that exceed the average market price of the Company's common stock during the periods presented. Inclusion of these common stock options and warrants would be anti-dilutive to the diluted earnings per common share calculation.

	Three Months Ended June 30, 2012		
	Income	Weighted-average shares	Per share Amount
Basic earnings per common share:			
Net income	$ 1,298,108	5,096,317	$0.25
Effect of dilutive securities:			
Stock options and unvested stock awards		102,094	
Diluted EPS:			
Net income plus assumed conversion	$ 1,298,108	5,198,411	$0.25

	Three Months Ended June 30, 2011		
	Income	Weighted-average shares	Per share Amount
Basic earnings per common share:			
Net income	$ 828,916	5,043,504	$0.16
Effect of dilutive securities:			
Stock options and unvested stock awards		48,938	
Diluted EPS			
Net income plus assumed conversion	$ 828,916	5,092,442	$0.16

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	Six Months Ended June 30, 2012		
	Income	Weighted-average shares	Per share Amount
Basic earnings per share:			
Net income	$ 2,464,840	5,096,252	$0.48
Effect of dilutive securities:			
Stock options and unvested stock awards		81,062	
Diluted EPS			
Net income plus assumed conversion	$ 2,464,840	5,177,314	$0.48

	Six Months Ended June 30, 2011		
	Income	Weighted-average shares	Per share Amount
Basic earnings per common share:			
Net income	$ 1,618,784	5,043,324	$0.32
Effect of dilutive securities:			
Stock options and unvested stock awards		61,722	
Diluted EPS:			
Net income plus assumed conversion	$ 1,618,784	5,105,046	$0.32

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(4) Investment Securities

Amortized cost, gross unrealized gains and losses, and the estimated fair value by security type are as follows:

June 30, 2012:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$ 16,984,686	$ 115,414	$0	$ 17,100,100
Residential collateralized mortgage obligations – GSE	11,038,324	428,381	0	11,466,705
Residential collateralized mortgage obligations – non-GSE	3,522,276	120,913	(10,204)	3,632,985
Residential mortgage backed securities – GSE	34,832,648	2,045,098	(4)	36,877,742
Obligations of State and Political subdivisions	5,350,838	389,276	(1,017)	5,739,097
Trust preferred debt securities – single issuer	2,464,748	0	(568,775)	1,895,973
Corporate Debt Securities	19,219,511	24,192	(167,507)	19,076,196
Restricted stock	1,723,800	0	0	1,723,800
Mutual fund	25,000	0	0	25,000
	$ 95,161,831	$ 3,123,274	$ (747,507)	$ 97,537,598

June 30, 2012:	Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to maturity-						
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$3,098,502	$0	$3,098,502	$39,763	$0	$3,138,265
Residential collateralized Mortgage obligations – GSE	22,705,219	0	22,705,219	1,105,555	0	23,810,774
Residential collateralized Mortgage obligations - non-GSE	13,471,005	0	13,471,005	760,872	0	14,231,877
Residential mortgage backed	18,054,413	0	18,054,413	945,468	0	18,999,881

securities – GSE						
Obligations of State and Political subdivisions	43,109,946	0	43,109,946	2,996,861	0	46,106,807
Trust preferred debt securities – pooled	651,788	(500,944)	150,844	0	(61,602)	89,242
Corporate debt securities	22,402,289	0	22,402,289	89,769	(12,449)	22,479,609
	$123,493,162	$(500,944)	$122,992,218	$5,938,288	$(74,051)	$128,856,455

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December 31, 2011:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$ 19,400,856	$ 71,833	$ 0	$ 19,472,689
Residential collateralized mortgage obligations – GSE	13,421,544	476,589	0	13,898,133
Residential collateralized mortgage obligations – non-GSE	4,177,115	143,480	(20,151)	4,300,444
Residential mortgage backed securities – GSE	40,655,157	2,032,059	(7)	42,687,209
Obligations of State and Political subdivisions	5,366,145	339,747	(5,378)	5,700,514
Trust preferred debt securities – single issuer	2,463,296	0	(712,055)	1,751,241
Corporate Debt Securities	1,443,762	0	(7,818)	1,435,944
Restricted stock	4,412,600	0	0	4,412,600
Mutual fund	25,000	0	0	25,000
	$ 91,365,475	$ 3,063,708	$ (745,409)	$ 93,683,774

December 31, 2011:	Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to maturity-						
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$ 11,118,649	$ 0	$ 11,118,649	$ 59,571	$ 0	$ 11,178,220
Residential collateralized mortgage obligations – GSE	24,705,415	0	24,705,415	1,007,737	0	25,713,152
Residential mortgage backed securities – GSE	14,386,327	0	14,386,327	704,792	0	15,091,119

Residential mortgage backed securities – non-GSE	20,260,354	0	20,260,354	801,882	0	21,062,236
Obligations of State and Political subdivisions	46,820,985	0	46,820,985	2,848,587	(2,507)	49,667,065
Trust preferred debt securities – pooled	646,574	(500,944)	145,630	0	(142,122)	3,508
Corporate debt securities	25,037,063	0	25,037,063	85,701	(216,784)	24,905,980
	$ 142,975,367	$ (500,944)	$ 142,474,423	$ 5,508,270	$ (361,413)	$ 147,621,280

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Restricted stock at June 30, 2012 and December 31, 2011 consisted of $1,708,800 and $4,397,600, respectively, of Federal Home Loan Bank of New York stock and $15,000 of Atlantic Central Bankers Bank stock.

The amortized cost and estimated fair value of investment securities at June 30, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Restricted stock is included in "Available for sale - Due in one year or less."

	Amortized Cost	Fair Value
Available for sale-		
Due in one year or less		
U.S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	$ 6,033,171	$ 6,063,510
Residential backed securities-GSE	36,231	38,052
Corporate Debt Securities	1,755,664	1,760,441
Restricted Stock	1,723,800	1,723,800
Mutual Fund	25,000	25,000
	$ 9,573,866	$ 9,610,803
Due after one year through five years		
U.S. Treasury securities and obligations of US Government sponsored corporations ("GSE")and agencies	$ 10,951,515	$ 11,036,590
Residential mortgage backed securities-GSE	288,221	304,807
Obligations of State and Political subdivisions	593,820	597,801
Corporate Debt Securities	16,376,971	16,242,005
	$ 28,210,527	$ 28,181,203
Due after five years through ten years		
Residential collateralized mortgage obligations -GSE	$ 168,877	$ 174,044
Residential mortgage backed Securities - GSE	3,357,223	3,662,711
Obligations of State and Political Subdivisions	2,712,683	2,991,213
	$ 6,238,783	$ 6,827,968
Due after ten years		
Residential collateralized mortgage obligations -GSE	$ 10,869,447	$ 11,292,661
Residential collateralized mortgage obligations –non GSE	3,522,276	3,632,985
Residential mortgage backed securities - GSE	31,150,973	32,872,172
Obligations of State and Political subdivisions	2,044,335	2,150,083
Trust Preferred Debt Securities-single issuer	2,464,749	1,895,973
Corporate Debt Securities	1,086,876	1,073,750
	$ 51,138,655	$ 52,917,624
Total	$ 95,161,831	$ 97,537,598

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Held to maturity-		
Due in one year or less		
Obligations of State and Political subdivisions	$ 1,665,786	$ 1,669,328
Corporate Debt Securities	13,475,530	13,523,475
	$ 15,141,316	$ 15,192,803
Due after one year through five years		
U.S. Treasury securities and obligations of US Government sponsored corporations (“GSE”) and agencies	$ 3,098,502	$ 3,138,265
Obligations of State and Political subdivisions	5,198,416	5,410,645
Corporate Debt Securities	8,926,759	8,956,134
	$ 17,223,677	$ 17,505,044
Due after five years through ten years		
Residential collateralized mortgage obligations – GSE	$ 635,319	$ 651,756
Residential mortgage backed securities – GSE	4,016,700	4,144,974
Obligations of State and Political subdivisions	22,961,646	24,580,362
	$ 27,613,665	$ 29,377,092
Due after ten years		
U.S. Treasury securities and obligations of US Government sponsored corporations (“GSE”) and agencies	$ 0	$ 0
Residential collateralized mortgage obligations - GSE	22,069,900	23,159,018
Residential collateralized mortgage obligations – non GSE	13,471,005	14,231,877
Residential mortgage backed securities - GSE	14,037,713	14,854,907
Obligations of State and Political subdivisions	13,284,098	14,446,472
Trust Preferred Debt Securities - Pooled	651,788	89,242
	$ 63,514,504	$ 66,781,516
Total	$ 123,493,162	$ 128,856,455

Gross unrealized losses on securities and the estimated fair value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2012 and December 31, 2011 are as follows:

June 30, 2012		Less than 12 months		12 months or longer		Total	
	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrea Loss
Residential collateralized mortgage obligations – non-GSE	1	$ 0	$ 0	$ 206,518	$ (10,204)	$ 206,518	$ (10

Residential mortgage backed securities - GSE	1	5,113	(4)	0	0	5,113	
Obligations of State and Political Subdivisions	1	522,653	(1,017)	0	0	522,653	(1
Trust preferred debt securities – single issuer	4	0	0	1,895,973	(568,775)	1,895,973	(568
Trust preferred debt securities – pooled	1	0	0	89,242	(562,546)	89,242	(562
Corporate Debt Securities	21	16,074,746	(176,517)	1,180,379	(3,439)	17,255,125	(179
Total temporarily impaired securities	29	$ 16,602,512	$ (177.538)	$ 3,372,112	$ (1,144,964)	$ 19,974,624	$ (1,322

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December 31, 2011	Number of Securities	Less than 12 months Fair Value	Less than 12 months Unrealized Losses	12 months or longer Fair Value	12 months or longer Unrealized Losses	Total Fair Value	Total Unrea Los
Residential collateralized mortgage Obligations – non-GSE	1	$ 0	$ 0	$ 251,723	$ (20,151)	$ 251,723	$ (2
Residential mortgage backed securities GSE	1	5,280	(7)	0	0	5,280	
Obligations of State and Political Subdivisions	3	1,049,362	(7,885)	0	0	1,049,362	(
Trust preferred debt securities – Single issuer	4	0	0	1,751,241	(712,055)	1,751,241	(71
Trust preferred debt securities – Pooled	1	0	0	3,508	(643,066)	3,508	(64
Corporate debt securities	25	13,668,246	(211,075)	666,956	(13,527)	14,335,202	(22
Total temporarily impaired securities	35	$ 14,722,888	$ (218,967)	$ 2,673,428	$ (1,388,799)	$ 17,396,316	$ (1,60

Residential collateralized mortgage obligations and residential mortgaged-backed securities: The unrealized losses on investments in residential collateralized residential mortgage obligations and mortgage-backed securities were caused by interest rate increases. The contractual cash flows of these securities are guaranteed by the issuer, which are generally government or government sponsored agencies. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Obligations of State and Political Subdivisions: The unrealized losses on investments in these securities were caused by interest rate increases. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Corporate debt securities: The unrealized losses on investments in corporate debt securities were caused by interest rate increases. None of the corporate issuers have defaulted on interest payments. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

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Trust preferred debt securities – single issuer: The investments in these securities with unrealized losses are comprised of four corporate trust preferred securities that mature in 2027, all of which were single-issuer securities. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. None of the corporate issuers have defaulted on interest payments. Because the decline in fair value is attributable to widening of interest rate spreads, the lack of an active trading market for these securities and, to a lesser degree, market concerns on the issuers' credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Trust preferred debt security – pooled: This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PreTSL XXV")), consisting primarily of financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment charge of $864,727, of which $363,783 was determined to be a credit loss and charged to operations and $500,944 was recognized in other comprehensive income (loss) component of shareholders' equity.

The primary factor used to determine the credit portion of the impairment loss to be recognized in the income statement for this security was the discounted present value of projected cash flow where that present value of cash flow was less than the amortized cost basis of the security. The present value of cash flow was developed using an EITF 99-20 model that considered performing collateral ratios, the level of subordination to senior tranches of the security, credit ratings of and projected credit defaults in the underlying collateral.

On a quarterly basis, management evaluates this security to determine if there is any additional other-than-temporary impairment. As of June 30, 2012, our evaluation was as follows:

a. We obtained the PreTSL XXV Depository Institutions Issuer List as of June 30, 2012 from the FTN Financial Corp. ("FTN") website and reviewed the financial ratios and capital levels of each individual financial institution issuer.

b. We sorted the financial institutions on the issuer list to develop three "buckets" (or categories) for further deferred/default analysis based upon the indicated "Texas Ratio." The Texas Ratio is calculated by dividing the institution's Non-Performing Assets plus loans 90 days past due by the combined total of Tangible Equity plus the Allowance for Loan Losses. The three buckets consisted of those institutions with a Texas Ratio of:

(1) Above 100;

(2) 75 to 100; and

(3) Below 75.

c. We then applied the following asset specific deferral/default assumptions to each of these buckets:

(1) Above 100 – 100% default; 0% recovery;

(2) 75 to 100 – 100% deferred; 15% recovery at 2 years from initial date of deferral; and

(3) Below 75 – no deferral/default.

d. We then ran a cash flow projection to analyze the impact of future deferral/default activity by applying the following assumption on those institutions in bucket (3) of our analysis:

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- Defaults at 75 basis points applied annually; 15% recovery with a 2-year lag from the initial date of deferral.

Our rationale for these metrics is as follows: (1) the FDIC lists the number of bank failures each year from 1934 – 2008. Comparing bank failures to the number of FDIC institutions produces an annual average default rate of 36 basis points. Given the continuing uncertain economic environment, we believe double this amount, or 75 basis points, to be an appropriate measurement for defaults; and (2) Standard & Poor's published "Global Methodology for Rating Trust Preferred/Hybrid Securities Revised" on November 21, 2008. This analysis uses a recovery assumption of 15%, which we also deem an appropriate measurement.

Our position is that it is appropriate to apply this future default factor in our analysis as it is not realistic to assume no adverse conditions will occur over the remaining 25 year stated maturity of this pooled security even though the individual institutions are currently performing according to terms.

e. This June 30, 2012 projection of future cash flows produced a present value factor that exceeded the carrying value of the pooled trust preferred security; therefore, management concluded that no OTTI issues were present at June 30, 2012.

A number of factors or combinations of factors could cause management to conclude in one or more future reporting periods that an unrealized loss that exists with respect to PreTSL XXV constitutes an additional credit impairment. These factors include, but are not limited to, failure to make interest payments, an increase in the severity of the unrealized loss, an increase in the continuous duration of the unrealized loss without an impairment in value or changes in market conditions and/or industry or issuer specific factors that would render management unable to forecast a full recovery in value. In addition, the fair value of trust preferred securities could decline if the overall economy and the financial condition of the issuers continue to deteriorate and there remains limited liquidity for this security.

The following table sets forth information with respect to this security at June 30, 2012:

										Excess Subordination (2)	
Security	Class	Amortized Cost	Fair Value	Unrealized (Loss)	Percent of Underlying Collateral Performing	Percent of Underlying Collateral In Deferral (1)	Percent of Underlying Collateral In Default (1)	Expected Deferrals and Defaults as a % of Remaining Performing Collateral	Moody's S&P / Ratings	Amount	% of Current Performing Collateral
PreTSL XXV	B-1	$651,788	$89,242	($562,546)	65.8%	16.7%	17.5%	15.6%	C/ NR	$102,500,000	20.0%

Notes to table above:

(1) This percentage represents the amount of specific deferrals / defaults that have occurred, plus those that are known for the following quarters to the total amount of original collateral. Fewer deferrals / defaults produce a lower percentage.

(2)

“Excess subordination” amount is the additional defaults / deferrals necessary in the next reporting period to deplete the entire credit enhancement (excess interest and over-collateralization) beneath our tranche within each pool to the point that would cause a “break in yield.” This amount assumes that all currently performing collateral continues to perform. A break in yield means that our security would not be expected to receive all the contractual cash flows (principal and interest) by maturity. The “percent of underlying collateral performing” is the ratio of the “excess subordination amount” to current performing collateral - a higher percent means there is more excess subordination to absorb additional defaults / deferrals, and the better our security is protected from loss.

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The following table presents a cumulative roll forward of the amount of other-than-temporary impairment related to credit losses, all of which relate to PreTSL XXV, which have been recognized in earnings for debt securities held to maturity and not intended to be sold.

(in thousands)	Three and six months ended June 30, 2012	Three and six months ended June 30, 2011
Balance at beginning of period	$ 364	$ 364
Change during the period	-	-
Balance at end of period	$ 364	$ 364

(5) Loans and Allowance for Loan Losses

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

The following table provides an aging of the loan portfolio by loan class at June 30, 2012:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Nonaccrual Loans
Commercial								
Construction	$0	$0	$0	$0	$59,650,806	$59,650,806	$0	$0
Commercial Business	599,605	0	262,737	862,342	57,197,323	58,059,665	42,320	479,072
Commercial Real Estate	2,609,703	0	1,093,793	3,703,496	103,662,142	107,365,638	0	2,024,487
Mortgage Warehouse Lines	0	0	0	0	230,776,678	230,776,678	0	0
Residential Real Estate	463,679	0	0	463,679	10,860,661	11,324,340	0	140,492
Consumer								
Loans to Individuals	0	0	54,904	54,904	11,384,790	11,439,694	0	54,904
Other	0	0	0	0	227,448	227,448	0	0
Deferred Loan Fees	0	0	0	0	950,823	950,823	0	0

Total	$3,762,987	$0	$1,411,434	$5,084,421	$474,710,671	$479,795,092	$42,320	$2,698,955

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The following table provides an aging of the loan portfolio by loan class at December 31, 2011:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Nonaccrual Loans
Commercial								
Construction	$ 0	$ 0	$ 140,055	$ 140,055	$ 49,145,728	$49,285,783	$ 0	$ 140,055
Commercial Business	364,743	564,152	122,535	1,051,430	49,733,244	50,784,674	0	669,166
Commercial Real Estate	0	245,874	503,877	749,751	98,887,225	99,636,976	0	1,443,220
Mortgage Warehouse Lines	0	0	0	0	249,345,831	249,345,831	0	0
Residential Real Estate	905,310	0	661,171	1,566,481	11,112,827	12,885,352	0	661,171
Consumer								
Loans to Individuals	0	144,904	77,858	222,762	11,996,878	12,219,640	0	77,858
Other	0	0	0	0	255,556	255,556	0	0
Deferred Loan Costs	0	0	0	0	1,017,959	1,017,959	0	0
Total	$1,270,053	$ 954,930	$1,505,496	$3,730,479	$471,701,292	$475,431,771	$ 0	$ 2,991,470

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management’s assessment of probable estimated losses. The Company’s methodology for assessing the adequacy of the allowance for loan losses consists of several key elements. These elements include a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

The Company consistently applies the following comprehensive methodology. During the quarterly review of the allowance for loan losses, the Company considers a variety of factors that include:

- General economic conditions;
- Trends in charge-offs;
- Trends and levels of delinquent loans;
- Trends and levels of non-performing loans, including loans over 90 days delinquent;
- Trends in volume and terms of loans;
- Levels of allowance for specific classified loans; and
- Credit concentrations.

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

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

The specific reserve for impaired loans is established for specific loans which have been identified by management as being impaired. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which, in turn, employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

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

The Company may, from time to time, maintain an unallocated allowance to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

The following discusses the risk characteristics of each of our loan portfolio segments, commercial and consumer.

Commercial

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

Consumer

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

In general, for homogeneous groups, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and industry historical losses. These loan groups are then internally risk rated.

The Company considers the following credit quality indicators in assessing the risk in the loan portfolio:

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

The Company's internal credit risk grades are based on the definitions currently utilized by the bank regulatory agencies. The grades assigned and their definitions are as follows, and loans graded excellent, above average, good and watch list are treated as "pass" for grading purposes:

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1. Excellent - Loans that are based upon cash collateral held at the Bank and adequately margined. Loans that are based upon "blue chip" stocks listed on the major exchanges and adequately margined.

2. Above Average - Loans to companies whose balance sheets show excellent liquidity and whose long-term debt is on well-spread schedules of repayment easily covered by cash flow. Such companies have been consistently profitable and have diversification in their product lines or sources of revenue. The continuation of profitable operations for the foreseeable future is likely. Management is comprised of a mix of ages, experience, and backgrounds and management succession is in place. Sources of raw materials and service companies, the source of revenue is abundant. Future needs have been planned for. Character and repayment ability of individuals or company principals are excellent. Loans to individuals supported by high net worths and liquid assets.

3. Good - Loans to companies whose balance sheets show good liquidity and cash flow adequate to meet maturities of long-term debt with a comfortable margin. Such company has established a profitable record over a number of years, and there has been growth in net worth. Operating ratios are in line with those of the industry, and expenses are in proper relationship to the volume of business done and the profits achieved. Management is well-balanced and competent in their responsibilities. Economic environment is favorable; however, competition is strong. The prospects for growth are good. Loans in this category do not meet the collateral requirements of loans in categories 1 and 2 above. Loans to individuals supported by good net worths but whose supporting assets are illiquid.

3w. Watch List - Included in this category are loans evidencing problems identified by Bank management that require closer supervision. Such problem has not developed to the point which requires a Special Mention rating. This category also covers situations where the Bank does not have adequate current information upon which credit quality can be determined. The account officer has the obligation to correct these deficiencies within 30 days after the time of notification.

4. Special Mention - Loans or borrowing relationships that require more than the usual amount of attention by Bank management. Industry conditions may be adverse or weak. The borrower's ability to meet current payment schedules may be questionable, even though interest and principal are being paid as agreed. Heavy reliance has been placed on the collateral. Profits, if any, are interspersed with losses. Management is "one man" or incompetent or there is no plan for management succession. Expectations of a loan loss are not immediate; however, if present trends continue, a loan loss could be expected.

5. Substandard - Loans in this category possess weaknesses that jeopardize the ultimate collection of total outstandings. These weaknesses require close supervision by Bank management. Current financial statements are unavailable and the loan is inadequately protected by the collateral pledged. This category will normally include loans that have been classified as substandard by the regulators.

6. Doubtful - Loans with weaknesses inherent in the substandard classification and where collection or liquidation in full is highly questionable. It is likely that the loan will not be collected in full and the Bank will suffer some loss which is not quantifiable at the time of review.

7. Loss - Loans considered uncollectable and of such little value that their continuance as an active asset is not warranted. Loans in this category should immediately be eliminated from the Bank's loan loss reserve. Any accrued interest should immediately be backed out of income.

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The following table provides a breakdown of the loan portfolio by credit quality indicator at June 30, 2012.

Commercial Credit Exposure - By Internally Assigned Grade	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Grade:					
Pass	$54,594,154	$55,393,231	$80,134,127	$230,776,678	$11,183,848
Special Mention	1,041,045	1,159,276	19,287,729	0	0
Substandard	4,015,607	1,364,009	7,795,550	0	140,492
Doubtful	0	143,149	148,232	0	0
Total	$59,650,806	$58,059,665	$107,365,638	$230,776,678	$11,324,340

Consumer Credit Exposure - By Payment Activity	Loans To Individuals	Other
Performing	$11,384,790	$227,448
Nonperforming	54,904	0
Total	$11,439,694	$227,448

The following table provides a breakdown of the loan portfolio by credit quality indicator at December 31, 2011.

Commercial Credit Exposure - By Internally Assigned Grade	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Grade:					
Pass	$ 44,106,827	$ 47,973,545	$ 84,642,510	$249,345,831	$ 12,224,181
Special Mention	5,038,901	1,657,993	10,574,489	0	142,477
Substandard	107,405	865,160	3,823,225	0	518,694
Doubtful	32,650	287,976	596,752	0	0
Total	$ 49,285,783	$ 50,784,674	$ 99,636,976	$249,345,831	$ 12,885,352

Consumer Credit Exposure - By Payment Activity	Loans To Individuals	Other
Performing	$ 12,141,782	$ 255,556
Nonperforming	77,858	0
Total	$ 12,219,640	$ 255,556

Impaired Loans Disclosures

Loans are considered to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When a loan is placed on nonaccrual status, it is also considered to be impaired. Loans are placed on nonaccrual status when: (1) the full collection of interest or principal becomes uncertain; or (2) they are contractually past due 90 days or more as to interest or principal payments unless they are both well secured and in the process of collection.

The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method at June 30, 2012 and December 31, 2011:

Period-End Allowance for Credit Losses by Impairment Method – June 30, 2012

	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other	Unallocated	Deferred Fees	Total
Allowance for credit losses:										
Ending Balance	$ 1,647,605									