

1ST CONSTITUTION BANCORP
Form 10-K
March 26, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2014

TRANSITION REPORT UNDER 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 or Other Jurisdiction of
Incorporation or Organization)

22-3665653
IRS Employer Identification
Number)

2650 Route 130, P.O. Box 634, Cranbury, NJ 08512
(Address of Principal Executive Offices, including Zip
Code)

(609) 655-4500
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which
Common stock, no par value	registered NASDAQ

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.
Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

(Do not check if a 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

The aggregate market value of the registrant’s common stock held by non-affiliates of the registrant, computed by reference to the price at which the common stock was last sold, or the average bid and asked price of such common stock, as of the last business day of the registrant’s most recently completed second quarter, is \$58,458,134.

As of February 28, 2015, 7,160,253 shares of the registrant’s common stock were outstanding.

Portions of the registrant’s definitive Proxy Statement for its 2015 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form10-K.

FORM 10-K

TABLE OF CONTENTS

PART I

<u>Item 1.</u>	<u>Business</u>	1
<u>Item 1A.</u>	<u>Risk Factors</u>	13
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>	22
<u>Item 2.</u>	<u>Properties</u>	22
<u>Item 3.</u>	<u>Legal Proceedings</u>	24
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	24

PART II

<u>Item 5.</u>	<u>Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	24
<u>Item 6.</u>	<u>Selected Financial Data</u>	25
<u>Item 7.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	52
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data Changes in and Disagreements With Accountants on</u>	52
<u>Item 9.</u>	<u>Accounting and Financial Disclosure</u>	52
<u>Item 9A.</u>	<u>Controls and Procedures</u>	53
<u>Item 9B.</u>	<u>Other Information</u>	54

PART III

<u>Item 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>	54
<u>Item 11.</u>	<u>Executive Compensation</u>	54
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	54
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	54
<u>Item 14.</u>	<u>Principal Accounting Fees and Services</u>	54

PART IV

<u>Item 15.</u>	<u>Exhibits, Financial Statement Schedules</u>	55
<u>SIGNATURES</u>		59

Forward-Looking Statements

This Annual Report on Form 10-K for the year ended December 31, 2014 (this “Form 10-K”) contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 relating to, without limitation, our future economic performance, plans and objectives for future operations, and projections of revenues and other financial items that are based on our beliefs, as well as assumptions made by and information currently available to us. The words “may,” “will,” “anticipate,” “should,” “would,” “believe,” “contemplate,” “could,” “project,” “predict,” “expect,” “continue,” and “intend,” as well as other similar words and expressions of the future, are intended to identify forward-looking statements.

These forward-looking statements generally relate to our plans, objectives and expectations for future events and include statements about our expectations, beliefs, plans, objectives, intentions, assumptions and other statements that are not historical facts. These statements are based upon our opinions and estimates as of the date they are made. Although we believe that the expectations reflected in these forward-looking statements are reasonable, such forward-looking statements are subject to known and unknown risks and uncertainties that may be beyond our control, which could cause actual results, performance and achievements to differ materially from results, performance and achievements projected, expected, expressed or implied by the forward-looking statements.

Examples of events that could cause actual results to differ materially from historical results or those anticipated, expressed or implied include, without limitation, changes in the overall economy and interest rate changes; inflation, market and monetary fluctuations; the ability of our customers to repay their obligations; the accuracy of our financial statement estimates and assumptions, including the adequacy of the estimate made in connection with determining the adequacy of the allowance for loan losses; increased competition and its effect on the availability and pricing of deposits and loans; significant changes in accounting, tax or regulatory practices and requirements; changes in deposit flows, loan demand or real estate values; legislation or regulatory changes, including the Dodd-Frank Act; changes in monetary and fiscal policies of the U.S. Government; changes in loan delinquency rates or in our levels of non-performing assets; our ability to declare and pay dividends; changes in the economic climate in the market areas in which we operate; the frequency and magnitude of foreclosure of our loans; changes in consumer spending and saving habits; the effects of the health and soundness of other financial institutions, including the FDIC’s need to increase the Deposit Insurance Fund assessments; technological changes; the effect of harsh weather conditions, including hurricanes and man-made disasters; the economic impact of any future terrorist threats and attacks, acts of war or threats thereof and the response of the United States to any such threats and attacks; our ability to integrate acquisitions and achieve cost savings; other risks described from time to time in our filings with the Securities and Exchange Commission (the “SEC”); and our ability to manage the risks involved in the foregoing. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on profitability. Additional information concerning the factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Item 1. “Business”, Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, and elsewhere in this Annual Report on Form 10-K and in our other filings with the SEC. However, other factors besides those listed in Item 1A. Risk Factors or discussed in this Annual Report also could adversely affect our results and you should not consider any such list of factors to be a complete list of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We undertake no obligation to publicly revise any forward-looking statements or cautionary factors, except as required by law.

PART I

Item 1. Business.

1st Constitution Bancorp

1st Constitution Bancorp (the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of 1st Constitution Bank (the “Bank”) and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. As of December 31, 2014, the Company has two employees, both of whom are full-time. The Bank is a wholly-owned subsidiary of the Company. Other than its investment in the Bank, the Company currently conducts no other significant business activities.

The main office of the Company and the Bank is located at 2650 Route 130 Cranbury, New Jersey 08512, and the telephone number is (609) 655-4500.

1st Constitution Bank

The Bank is a commercial bank formed under the laws of the State of New Jersey and engages in the business of commercial and retail banking. As a community bank, the Bank offers a wide range of services (including demand, savings and time deposits and commercial and consumer/installment loans) to individuals, small businesses and not-for-profit organizations principally in the Fort Lee area of Bergen County and in Middlesex, Mercer, Somerset and Monmouth Counties of New Jersey. The Bank conducts its operations through its main office located in Cranbury, New Jersey, and operates eighteen additional branch offices in downtown Cranbury, Hamilton Square, Hightstown, Hillsborough, Hopewell, Jamesburg, Lawrenceville, Perth Amboy, Plainsboro, Skillman, West Windsor, Fort Lee, Princeton, Rumson, Fair Haven, Shrewsbury, Oceanport and Asbury Park, New Jersey. The Bank's deposits are insured up to applicable legal limits by the Federal Deposit Insurance Corporation ("FDIC"). As of December 31, 2014, the Bank had 185 employees, of which 173 were full-time employees.

Management efforts focus on positioning the Bank to meet the financial needs of the communities in Middlesex, Mercer, Somerset and Monmouth Counties and the Fort Lee area of Bergen County and to provide financial services to individuals, families, institutions and small businesses. To achieve this goal, the Bank is focusing its efforts on:

- personal service;
- expansion of its branch network;
- innovative product offerings; and
- technological advances and e-commerce.

Expansion of the Bank

On February 7, 2014, the Company and the Bank closed on the merger of Rumson-Fair Haven Bank and Trust Company, a New Jersey state commercial bank ("RFHB"), with and into the Bank, with the Bank continuing as the surviving entity (the "2014 Merger"), pursuant to the terms and conditions of that certain Agreement and Plan of Merger, dated August 14, 2013 and as amended on September 19, 2013 (the "Merger Agreement"), by and between the Company, the Bank and RFHB. At the time of the merger, RFHB had approximately \$220 million in assets, approximately \$144 million in loans and approximately \$190 million in deposits. RFHB operated five offices in Monmouth County, New Jersey which became branches of the Bank as a result of the 2014 Merger.

Subject to the terms and conditions of the Merger Agreement, at the effective time of the 2014 Merger, each share of RFHB common stock issued and outstanding immediately prior to such effective time was converted into and became the right to receive, at the election of the holder, either 0.7772 shares of common stock of the Company, \$7.50 in cash or a combination of cash and shares of common stock of the Company, subject to proration as described in the Merger Agreement, so that 60% of the aggregate merger consideration consisted of cash and 40% consisted of shares of common stock of the Company. Cash was paid in lieu of fractional shares. In the aggregate, the Company paid approximately \$14.8 million in cash and issued 1,019,223 shares of common stock of the Company as 2014 Merger consideration to RFHB shareholders. Included in the cash and stock consideration amounts were a total of \$98,919 that was used to cash out outstanding options to acquire shares of RFHB common stock and 5,829 shares of common stock of the Company that were issued in exchange for restricted stock awards for RFHB common stock. Cash used as consideration in the 2014 Merger was provided by the Bank from existing cash assets.

The Bank continually evaluates opportunities to expand its products and services to existing and new customers and expand into new markets through the acquisition of other banks and bank offices within and contiguous to its existing markets and/or by opening new branch offices.

2

Personal Service

The Bank provides a wide range of commercial and consumer banking services to individuals, families, institutions and small businesses in central and coastal New Jersey and the Fort Lee area of Bergen County. The Bank's focus is to understand the needs of the community and the customers and tailor products, services and advice to meet those needs. The Bank seeks to provide a high level of personalized banking services, emphasizing quick and flexible responses to customer demands.

Technological Advances and e-Commerce

The Bank recognizes that customers want to receive service via their most convenient delivery channel, be it the traditional branch office, by telephone, ATM, or the internet. For this reason, the Bank continues to enhance its e-commerce capabilities. At www.1stconstitution.com, customers have easy access to online banking, including account access, and to the Bank's bill payment system. Consumers and businesses may also access their accounts and make deposits through their mobile devices. Consumers can apply online for loans and interact with senior management through the e-mail system. Business customers have access to cash management information and transaction capability through the Bank's online Cash Manager product which permits business customers to make deposits, originate ACH payments, initiate wire transfers, retrieve account information and place "stop payment" orders. This overall expansion in electronic banking offers the Bank's customers means to access the Bank's services easily and at their own convenience.

Competition

The Bank experiences substantial competition in attracting and retaining deposits and in making loans. In attracting deposits and borrowers, the Bank competes with commercial banks, savings banks, and savings and loan associations, as well as regional and national insurance companies and non-bank financial institutions, mutual funds, regulated small loan companies and local credit unions, regional and national sponsors of money market funds and corporate and government borrowers. Within the direct market area of the Bank, there are a significant number of offices of competing financial institutions. In New Jersey generally, and in the Bank's local market specifically, the Bank's most direct competitors are large commercial banks including Bank of America, PNC Bank, JP Morgan Chase, Wells Fargo and Santander Bank, as well as savings banks and savings and loan associations, including Provident Bank, Investors Bank and Hudson City Savings Bank.

The Bank is at a competitive disadvantage compared with these larger national and regional commercial and savings banks. By virtue of their larger capital, asset size or reserves, many of such institutions have substantially greater lending limits (ceilings on the amount of credit a bank may provide to a single customer that are linked to the institution's capital) and other resources than the Bank. Many such institutions are empowered to offer a wider range of services, including trust services, than the Bank and, in some cases, have lower funding costs (the price a bank must pay for deposits and other borrowed monies used to make loans to customers) than the Bank. In addition to having established deposit bases and loan portfolios, these institutions, particularly large national and regional commercial and savings banks, have the financial ability to finance extensive advertising campaigns and to allocate considerable resources to locations and products perceived as profitable.

In addition, non-bank financial institutions offer services that compete for customers' investable funds and deposits with the Bank. For example, brokerage firms and insurance companies offer such instruments as short-term money market funds, corporate and government securities funds, mutual funds and annuities. It is expected that competition in these areas will continue to increase. Some of these competitors are not subject to the same degree of regulation and supervision as the Company and the Bank and therefore may be able to offer customers more attractive products than the Bank.

However, management of the Bank believes that loans to small and mid-sized businesses and professionals, which represent the main commercial loan business of the Bank, are not always of primary importance to the larger banking institutions. The Bank competes for this segment of the market by providing responsive personalized services, making timely local decisions, and acquiring knowledge of its customers and their businesses.

Lending Activities

The Bank's lending activities include both commercial and consumer loans. Loan originations are derived from a number of sources including real estate broker referrals, mortgage loan companies, direct solicitation by the Bank's loan officers, existing depositors and borrowers, builders, attorneys, walk-in customers and, in some instances, other lenders. The Bank has established disciplined and systematic procedures for approving and monitoring loans that vary depending on the size and nature of the loans.

Commercial Lending

The Bank offers a variety of commercial loan services, including term loans, lines of credit, and loans secured by equipment and receivables. A broad range of short-to-medium term commercial loans, both secured and unsecured, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition and development of real estate and improvements), and the purchase of equipment and machinery. Commercial loans are granted based on the borrower's ability to generate cash flow to support its debt obligations and other cash related expenses. A borrower's ability to repay commercial loans is substantially dependent on the success of the business itself and on the quality of its management. As a general practice, the Bank takes as collateral a security interest in any available real estate, equipment, inventory, receivables or other personal property of its borrowers, although occasionally the Bank makes commercial loans on an unsecured basis. Generally, the Bank requires personal guarantees of its commercial loans to offset the risks associated with such loans.

Commercial Construction Financing

Construction financing is provided to businesses to expand their facilities and operations and to real estate developers for the acquisition, development and construction of residential properties. First mortgage construction loans are made to developers and builders primarily for single family homes or smaller multi-family buildings (less than ten units) that are presold, or are to be sold or leased on a speculative basis.

The Bank lends to builders and developers with established relationships, successful operating histories and sound financial resources.

Residential Consumer Lending

A portion of the Bank's lending activities consists of the origination of fixed and adjustable rate residential first mortgage loans secured by owner-occupied property located in the Bank's primary market areas. Home mortgage lending is unique in that a broad geographic territory may be serviced by originators working from strategically placed offices either within the Bank's traditional banking facilities or from affordable storefront locations in commercial buildings. The Bank also offers construction loans, reverse mortgages, second mortgage home improvement loans and home equity lines of credit.

The Bank finances the construction of individual, owner-occupied single-family houses on the basis of written underwriting and construction loan management guidelines. These loans are made to qualified individual borrowers and are generally supported by a take-out commitment from a permanent lender. The construction phase of these loans has certain risks, including the viability of the contractor, the contractor's ability to complete the project within the budget and changes in interest rates.

The Bank will generally sell its originated residential mortgage loans in the secondary market. The decision to sell is made prior to origination. The sale to the secondary market allows the Bank to mitigate its interest rate risks related to such lending operations. This brokerage arrangement allows the Bank to accommodate its clients' demands while eliminating the interest rate risk for the 15- to 30 year period generally associated with such loans.

For commercial and residential mortgage loans the Bank in most cases requires borrowers to obtain and maintain title, fire, and extended casualty insurance, and, where required by applicable regulations, flood insurance. The Bank maintains its own errors and omissions insurance policy to protect against loss in the event of failure of a mortgagor to pay premiums on fire and other hazard insurance policies. Mortgage loans originated by the Bank customarily include a "due on sale" clause, which gives the Bank the right to declare a loan immediately due and payable in certain circumstances, including, without limitation, upon the sale or other disposition by the borrower of the real property

subject to a mortgage. In general, the Bank enforces due on sale clauses.

4

Non-Residential Consumer Lending

Non-residential consumer loans made by the Bank include loans for automobiles, recreation vehicles, and boats, as well as personal loans (secured and unsecured) and deposit account secured loans. The Bank also conducts various indirect lending activities through established retail companies in its market areas. Non-residential consumer loans are attractive to the Bank because they typically have a shorter term and carry higher interest rates than are charged on other types of loans. Non-residential consumer loans, however, do pose additional risk of collectability when compared to traditional types of loans, such as residential mortgage loans.

Consumer loans are granted based on employment and financial information solicited from prospective borrowers as well as credit records collected from various reporting agencies. The stability of the borrower, willingness to pay and credit history are the primary factors to be considered. The availability of collateral is also a factor considered in making such a loan. The Bank seeks collateral that can be assigned and has good marketability with a clearly adequate margin of value. The geographic area of the borrower is another consideration, with preference given to borrowers in the Bank's primary market areas.

Supervision and Regulation

Banking is a complex, highly regulated industry. The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of monetary policy. In furtherance of those goals, Congress has created several largely autonomous regulatory agencies and enacted a myriad of legislation that governs banks, bank holding companies and the banking industry. This regulatory framework is intended primarily for the protection of depositors and not for the protection of the Company's shareholders or creditors. Descriptions of, and references to, the statutes and regulations below are brief summaries thereof, and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

State and Federal Regulations

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "BHCA"). As a bank holding company, the Company is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the BHCA. The Federal Reserve Board may also make examinations of the Company and its subsidiaries. The Company is subject to capital standards similar to, but separate from, those applicable to the Bank.

Under the BHCA, bank holding companies that are not financial holding companies generally may not acquire the ownership or control of more than 5% of the voting shares, or substantially all of the assets, of any company, including a bank or another bank holding company, without the Federal Reserve Board's prior approval. The Company has not applied to become a financial holding company but did obtain such approval to acquire the shares of the Bank. A bank holding company that does not qualify as a financial holding company is generally limited in the types of activities in which it may engage to those that the Federal Reserve Board had recognized as permissible for bank holding companies prior to the date of enactment of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999. For example, a holding company and its banking subsidiary are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or lease or sale of any property or the furnishing of services. At present, the Company does not engage in any significant activity other than owning the Bank.

In addition to federal bank holding company regulation, the Company is registered as a bank holding company with the New Jersey Department of Banking and Insurance (the "Department"). The Company is required to file with the Department copies of the reports it files with the federal banking and securities regulators.

The Federal Reserve Board has issued a supervisory letter to bank holding companies that contains guidance on when the board of directors of a bank holding company should eliminate or defer or severely limit dividends including, for example, when net income available for shareholders for the past four quarters net of dividends paid during that period is not sufficient to fully fund the dividends. The letter also contains guidance on the redemption of stock by bank holding companies which urges bank holding companies to advise the Federal Reserve Board of any such redemption or repurchase of common stock for cash or other value which results in the net reduction of a bank holding company's capital at the beginning of the quarter below the capital outstanding at the end of the quarter.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) has a broad impact on the financial services industry, including significant regulatory and compliance requirements, including, among other things, (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; and (v) numerous other provisions designed to improve supervision and oversight of, and strengthen safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act established a framework for systemic risk oversight within the financial system to be distributed among federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the FDIC.

Effective in July 2011, the Dodd-Frank Act eliminated federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. As of the date of this Form 10-K, we do not pay interest on demand deposits. This significant change to existing law has not had an adverse impact on our net interest margin for the years ended December 31, 2014, and 2013.

The Dodd-Frank Act also changed the base for FDIC deposit insurance assessments. Assessments are based on average consolidated total assets less tangible equity capital of a financial institution, rather than on deposits. The Dodd-Frank Act also increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per account owner. The Dodd-Frank Act also provided unlimited deposit insurance for non-interest bearing transaction accounts and Interest on Lawyer Trust Accounts (“IOLTAs”), where the accrued interest is paid to state bar associations or other organizations to fund legal assistance programs, through December 31, 2012. Effective January 1, 2013, non-interest bearing transaction accounts were no longer insured separately from account owners’ other accounts at the same federally insured financial institution. Instead, non-interest bearing transaction accounts are now added to any of an account owner’s other accounts in the applicable ownership category, and the aggregate balance is insured up to \$250,000. Effective January 1, 2013, IOLTAs became subject to the \$250,000 maximum amount of deposit insurance. If an IOLTA qualifies for pass-through coverage as a fiduciary account, then each separate client for whom a law firm holds funds in such IOLTA may be insured up to \$250,000 for his or her funds. The legislation also increased the required minimum reserve ratio for the Deposit Insurance Fund, from 1.15% to 1.35% of insured deposits, and directed the FDIC to offset the effects of increased assessments on depository institutions with less than \$10 billion in assets, including the Bank.

The Dodd-Frank Act requires publicly traded companies to give their stockholders a non-binding vote on executive compensation (“say on pay”) and so-called “golden parachute” payments. It also provides that the listing standards of the national securities exchanges shall require listed companies to implement and disclose “clawback” policies mandating the recovery of incentive compensation paid to executive officers in connection with accounting restatements. Such listing standards have yet to be implemented.

The Dodd-Frank Act created the Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets, which authority does not extend to the Bank at this time since we do not meet the asset threshold.

The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws. The Dodd-Frank Act requires minimum leverage (Tier 1) and risk based capital requirements for bank and savings and loan holding companies, which exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities; however, bank holding companies with

assets of less than \$15 billion as of December 31, 2009 are permitted to include trust preferred securities that were issued before May 19, 2010 as Tier 1 capital.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and certain yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum, they will increase our operating and compliance costs and could increase our interest expense.

Capital Adequacy

The Company is required to comply with minimum capital adequacy standards established by the Federal Reserve Board. There are two basic measures of capital adequacy for bank holding companies and the depository institutions that they own: a risk based measure and a leverage measure. All applicable capital standards must be satisfied for a bank holding company to be considered in compliance.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) required each federal banking agency to revise its risk-based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of non-traditional activities. In addition, pursuant to FDICIA, each federal banking agency has promulgated regulations, specifying the levels at which a bank would be considered “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” or “critically undercapitalized,” and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution.

Prior to January 1, 2015, the regulations implementing these provisions of FDICIA provided that a bank would be classified as “well capitalized” if it (i) had a total risk-based capital ratio of at least 10.0 percent, (ii) had a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) had a Tier 1 leverage ratio of at least 5.0 percent, and (iv) met certain other requirements. A bank would be classified as “adequately capitalized” if it (i) had a total risk-based capital ratio of at least 8.0 percent, (ii) had a Tier 1 risk-based capital ratio of at least 4.0 percent, (iii) had a Tier 1 leverage ratio of (a) at least 4.0 percent, or (b) at least 3.0 percent if the bank was rated 1 in its most recent examination and was not experiencing or anticipating significant growth, and (iv) did not meet the definition of “well capitalized.” A bank would be classified as “undercapitalized” if it (i) had a total risk-based capital ratio of less than 8.0 percent, (ii) had a Tier 1 risk-based capital ratio of less than 4.0 percent, or (iii) had a Tier 1 leverage ratio of (a) less than 4.0 percent, or (b) less than 3.0 percent if the bank was rated 1 in its most recent examination and was not experiencing or anticipating significant growth. A bank would be classified as “significantly undercapitalized” if it (i) had a total risk-based capital ratio of less than 6.0 percent, (ii) had a Tier 1 risk-based capital ratio of less than 3.0 percent, or (iii) had a Tier 1 leverage ratio of less than 3.0 percent. An institution would be classified as “critically undercapitalized” if it had a tangible equity to total assets ratio that was equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if the FDIC had determined (i) that the insured depository institution was in unsafe or unsound condition or (ii) that, in the most recent examination of the insured depository institution, the insured depository institution received and had not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity.

As of December 31, 2014, the Bank’s capital ratios exceed the requirements to be considered a “well capitalized” institution under these regulations.

Prior to January 1, 2015, the risk-based capital guidelines for bank holding companies such as the Company required a minimum ratio of total capital to risk-weighted assets (including off-balance sheet activities, such as standby letters of credit) of 8%. At least half of the total capital was required to be Tier 1 capital, consisting principally of common shareholders’ equity, non-cumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interest in the equity accounts of consolidated subsidiaries, less goodwill. The remainder of the total capital (Tier 2 capital) may consist of a limited amount of subordinated debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, perpetual preferred stock and a limited amount of the general loan loss allowance. At December 31, 2014, the Company maintained a Tier 1 capital ratio of 11.41% and a total capital ratio of 12.28%.

In addition to the risk-based capital guidelines, the federal banking regulators established minimum leverage ratio (Tier 1 capital to total average assets) guidelines for bank holding companies. Prior to January 1, 2015, these guidelines provided for a minimum leverage ratio of 3% for those bank holding companies which have the highest

regulatory examination ratings and were not contemplating or experiencing significant growth or expansion. All other bank holding companies were required to maintain a leverage ratio of at least 4%. Banking organizations with supervisory, financial, operational, or managerial weaknesses, as well as organizations that are anticipating or experiencing significant growth, were expected to maintain capital ratios well above the minimum levels. Moreover, higher capital ratios may be required for any bank holding company if warranted by its particular circumstances or risk profile. In all cases, bank holding companies should hold capital commensurate with the level and nature of the risks, including the volume and severity of problem loans, to which they were exposed. At December 31, 2014, the Company's leverage ratio was 9.53%.

The risk-based capital guidelines prior to January 1, 2015 were based upon the 1988 capital accord of the International Basel Committee on Banking Supervision, a committee of central banks and bank supervisors and regulators from the major industrialized countries that develops broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply.

In December 2010, the Group of Governors and Heads of Supervisors of the Basel Committee on Banking Supervision, the oversight body of the Basel Committee, published its "calibrated" capital standards for major banking institutions, referred to as Basel III. Under these standards, when fully phased-in on January 1, 2019, banking institutions will be required to maintain heightened Tier 1 common equity, Tier 1 capital, and total capital ratios, as well as maintaining a "capital conservation buffer." The Tier 1 common equity and Tier 1 capital ratio requirements will be phased-in incrementally between January 1, 2013 and January 1, 2015; the deductions from common equity made in calculating Tier 1 common equity will be phased-in incrementally over a four-year period commencing on January 1, 2014; and the capital conservation buffer will be phased-in incrementally between January 1, 2016 and January 1, 2019. The Basel Committee also announced that a countercyclical buffer of 0% to 2.5% of common equity or other fully loss-absorbing capital will be implemented according to national circumstances as an extension of the conservation buffer.

In July 2013, the Federal Reserve Board and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implement the revised standards of Basel III and address relevant provisions of the Dodd-Frank Act. The Federal Reserve Board's final rules and the FDIC's interim final rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of \$500 million or more, and top-tier savings and loan holding companies ("banking organizations"). Among other things, the rules establish a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and increase the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets). Banking organizations will also be required to have a total capital ratio of 8% (unchanged from current rules) and a Tier 1 leverage ratio of 4% (unchanged from current rules). The rules also limit a banking organization's ability to pay dividends, engage in share repurchases or pay discretionary bonuses if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The rules become effective for the Company and the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning in January 1, 2016 at 0.625% of common equity Tier 1 capital to risk-weighted assets and would increase by that amount each year until fully implemented in January 2019 at 2.5% of common equity Tier 1 capital to risk-weighted assets.

With respect to the Bank, the FDIC also revised its prompt corrective action rules by (i) introducing a Common Equity Tier 1, or CET1, ratio requirement at each capital quality level (other than critically undercapitalized); (ii) increasing the minimum Tier 1 capital ratio requirement for each category; and (iii) requiring a leverage ratio of 5 percent to be well-capitalized. Effective as of January 1, 2015, the FDIC's regulations implementing these provisions of FDICIA provide that an institution will be classified as "well capitalized" if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 8.0 percent, (iii) has a CET1 ratio of at least 6.5 percent, (iv) has a Tier 1 leverage ratio of at least 5.0 percent, and (v) meets certain other requirements. An institution will be classified as "adequately capitalized" if it (i) has a total risk-based capital ratio of at least 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) has a CET1 ratio of at least 4.5 percent, (iv) has a Tier 1 leverage ratio of at least 4.0 percent, and (v) does not meet the definition of "well capitalized." An institution will be classified as "undercapitalized" if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 6.0 percent, (iii) has a CET1 ratio of less than 4.5 percent or (iv) has a Tier 1 leverage ratio of less than 4.0 percent. An institution will be classified as "significantly undercapitalized" if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, (iii) has a CET1 ratio of less than 3.0 percent or (iv) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as "critically undercapitalized" if it has a tangible equity to total assets ratio that is equal to or less than

2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating. Similar categories apply to bank holding companies. When the capital conservation buffer is fully phased in, the capital ratios applicable to depository institutions will exceed the ratios to be considered well-capitalized under the prompt corrective action regulations.

Under the new capital rules in effect on January 1, 2015, management estimates that the Bank's CET1 risk-based capital, Tier 1 risk-based capital, total risk-based capital and leverage capital ratios would be 11.23%, 11.23%, 12.09%, and 9.40%, respectively, at December 31, 2014. The Bank is classified as a non-advanced approaches bank for regulatory purposes and plans to permanently opt out of including the amount of accumulated other comprehensive income in the computation of regulatory capital. Management estimates that the new capital rules will not have a significant effect on the Company's regulatory capital position.

On May 30, 2006, the Company established 1st Constitution Capital Trust II, a Delaware business trust and wholly-owned subsidiary of the Company (“Trust II”), for the sole purpose of issuing \$18 million of trust preferred securities (the “Capital Securities”). Trust II utilized the \$18 million proceeds along with \$557,000 invested in Trust II by the Company to purchase \$18,557,000 of floating rate junior subordinated debentures issued by the Company and due to mature on June 15, 2036. The Capital Securities were issued in connection with a pooled offering involving approximately 50 other financial institution holding companies. All of the Capital Securities were sold to a single pooling vehicle. The floating rate junior subordinated debentures are the only asset of Trust II and have terms that mirror the Capital Securities. These debentures are redeemable in whole or in part prior to maturity after June 15, 2011. Trust II is obligated to distribute all proceeds of a redemption of these debentures, whether voluntary or upon maturity, to holders of the Capital Securities. The Company’s obligation with respect to the Capital Securities and the debentures, when taken together, provide a full and unconditional guarantee on a subordinated basis by the Company of the obligations of Trust II to pay amounts when due on the Capital Securities. Interest payments on the floating rate junior subordinated debentures flow through Trust II to the pooling vehicle. Based on the final regulatory rule, the Company has included all of its \$18 million trust preferred securities in Tier 1 capital at December 31, 2014 and 2013.

The Company issued a warrant on December 23, 2008 to the United States Department of the Treasury (the “Treasury”) under the Troubled Asset Relief Program (“TARP”) Capital Purchase Program (the “CPP”). This warrant was sold by the Treasury on November 23, 2011 and exchanged for two new warrants which permit the holders thereof to acquire as of December 31, 2014, on an adjusted basis resulting from declarations of stock dividends to holders of common stock since the issuance of the two warrants, 255,540 shares of common stock of the Company at a price of \$7.044 per share.

The two warrants provide for the adjustment of the exercise price and the number of shares of the Company’s common stock issuable upon exercise pursuant to customary anti-dilution provisions, such as upon stock splits or distributions of securities or other assets to holders of the Company’s common stock. As of the date of this Form 10-K, the two warrants remain outstanding, are immediately exercisable and have an expiration date of December 23, 2018.

Restrictions on Dividends

The primary source of cash to pay dividends, if any, to the Company’s shareholders and to meet the Company’s obligations is dividends paid to the Company by the Bank. Dividend payments by the Bank to the Company are subject to the New Jersey Banking Act of 1948 (the “Banking Act”) and the Federal Deposit Insurance Act (the “FDIA”). Under the Banking Act and the FDIA, the Bank may not pay any dividends if after paying the dividend it would be undercapitalized under applicable capital requirements. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the immediately preceding year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividend that undermines the bank holding company’s ability to serve as a source of strength to its banking subsidiary. A bank holding company may not pay dividends when it is insolvent.

The Company has never paid a cash dividend and the Company’s Board of Directors has no plans to pay a cash dividend in the foreseeable future.

Priority on Liquidation

The Company is a legal entity separate and distinct from the Bank. The rights of the Company as the sole shareholder of the Bank, and therefore the rights of the Company's creditors and shareholders, to participate in the distributions and earnings of the Bank when the Bank is not in bankruptcy, are subject to various state and federal law restrictions as discussed above under the heading "Restrictions on Dividends." In the event of a liquidation or other resolution of an insured depository institution such as the Bank, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of an obligation of the institution to its shareholders (the Company) or any shareholder or creditor of the Company. The claims on the Bank by creditors include obligations in respect of federal funds purchased and certain other borrowings, as well as deposit liabilities.

Financial Institution Legislation

The Gramm-Leach-Bliley Financial Modernization Act of 1999 (the "Modernization Act") became effective in early 2000. The Modernization Act:

- allows bank holding companies meeting management, capital and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than is permissible for a bank holding company, including insurance underwriting and making merchant banking investments in commercial and financial companies; if a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals;
- allows banks to establish subsidiaries to engage in certain activities which a financial holding company could engage in, if the bank meets certain management, capital and Community Reinvestment Act standards;
- allows insurers and other financial services companies to acquire banks and removes various restrictions that currently apply to bank holding company ownership of securities firms and mutual fund advisory companies; and establishes the overall regulatory structure applicable to financial holding companies that also engage in insurance and securities operations.

The Modernization Act modified other laws, including laws related to financial privacy and community reinvestment.

The Modernization Act also amended the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

Additional proposals to change the laws and regulations governing the banking and financial services industry are frequently introduced in Congress, in state legislatures and before the various bank regulatory agencies. The likelihood and timing of any such changes and the impact such changes might have on the Company cannot be determined at this time.

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act"), which became law on July 30, 2002, added new legal requirements affecting corporate governance, accounting and corporate reporting for companies with publicly traded securities.

The Sarbanes-Oxley Act provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O of the Federal Reserve Board);

- independence requirements for audit committee members;
- disclosure of whether at least one member of the audit committee is a “financial expert” (as such term is defined by the Securities and Exchange Commission (“SEC”) and if not, why not;
- independence requirements for outside auditors;

- a prohibition by a company’s registered public accounting firm from performing statutorily mandated audit services for the company if the company’s chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date;
- certification of financial statements and annual and quarterly reports by the principal executive officer and the principal financial officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement due to corporate misconduct;
 - disclosure of off-balance sheet transactions;
 - two-business day filing requirements for insiders filing Forms 4;
- disclosure of a code of ethics for financial officers and filing a Form 8-K for a change or waiver of such code;
 - “real time” filing of periodic reports;
 - posting of certain SEC filings and other information on the company’s website;
- the reporting of securities violations “up the ladder” by both in-house and outside attorneys;
 - restrictions on the use of non-GAAP financial measures;
 - the formation of a public accounting oversight board; and
- various increased criminal penalties for violations of securities laws.

Additionally, Section 404 of the Sarbanes-Oxley Act requires that a public company subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), include in its annual report (i) a management’s report on internal control over financial reporting assessing the company’s internal controls, and (ii) if the company is an “accelerated filer” or a “large accelerated filer”, an auditor’s attestation report, completed by the registered public accounting firm that prepares or issues an accountant’s report which is included in the company’s annual report, attesting to the effectiveness of management’s internal control assessment. The Company is currently classified as a “Smaller Reporting Company” and accordingly, is not subject to the auditor’s attestation report requirements.

Each of the national stock exchanges, including the Nasdaq Global Market where the Company’s common stock is listed, have in place corporate governance rules, including rules requiring director independence, and the adoption of charters for the nominating, corporate governance, and audit committees. These rules are intended to, among other things, make the board of directors independent of management and allow shareholders to more easily and efficiently monitor the performance of companies and directors. These burdens increase the Company’s legal and accounting fees and the amount of time that the Board of Directors and management must devote to corporate governance issues.

Section 302(a) of Sarbanes-Oxley requires the Company’s principal executive officer and principal financial officer to certify that the Company’s Quarterly and Annual Reports do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which they were made,

not misleading. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's disclosure controls and procedures and internal control over financial reporting; they have made certain disclosures to the Company's auditors and the audit committee of the Board of Directors about the Company's internal control over financial reporting; and they have included information in the Company's Quarterly and Annual Reports about their evaluation of disclosure controls and procedures and whether there have been significant changes in the Company's internal controls over financial reporting.

As part of the USA Patriot Act, signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "Act"). The Act authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the Act expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

The Department of Treasury has issued regulations implementing the due diligence requirements. These regulations require minimum standards to verify customer identity and maintain accurate records, encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibit the anonymous use of "concentration accounts," and require all covered financial institutions to have in place an anti-money laundering compliance program.

As a New Jersey-chartered commercial bank, the Bank is subject to supervision and examination by the New Jersey Department of Banking and Insurance. The Bank is also subject to regulation and examination by the FDIC, which is its principal federal bank regulator.

The Bank must comply with various requirements and restrictions under federal and state law, including the maintenance of reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that may be charged thereon, limitations on the types of investments that may be made and the services that may be offered, and restrictions on dividends as described in the preceding section. Consumer laws and regulations also affect the operations of the Bank. In addition to the impact of regulation, commercial banks are affected significantly by the actions of the Federal Reserve Board which influence the money supply and credit availability in the national economy.

Community Reinvestment Act

Under the Community Reinvestment Act ("CRA"), as implemented by FDIC regulations, a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with CRA. CRA requires the FDIC to assess an institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by the applicable institution. CRA requires public disclosure of an institution's CRA rating and requires that the FDIC provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. An institution's CRA rating is considered in determining whether to grant charters, branches and other deposit facilities, relocations, mergers, consolidations and acquisitions. Performance less than satisfactory may be the basis for denying an application. At its last CRA examination, the Bank was rated "satisfactory" under CRA.

FIRREA

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”), a depository institution insured by the FDIC can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. These provisions have commonly been referred to as FIRREA’s “cross guarantee” provisions. Further, under FIRREA, the failure to meet capital guidelines could subject a bank to a variety of enforcement remedies available to federal regulatory authorities.

FIRREA also imposes certain independent appraisal requirements upon a bank’s real estate lending activities and further imposes certain loan-to-value restrictions on a bank’s real estate lending activities. Banking regulators have promulgated regulations in these areas.

Insurance of Deposits

The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. This limit is \$250,000 per account owner. FDICIA is applicable to depository institutions and deposit insurance. FDICIA requires the FDIC to establish a risk-based assessment system for all insured depository institutions. Under this legislation, the FDIC is required to establish an insurance premium assessment system based upon: (i) the probability that the insurance fund will incur a loss with respect to the institution, (ii) the likely amount of the loss, and (iii) the revenue needs of the insurance fund. In compliance with this mandate, the FDIC has developed a matrix that sets the assessment premium for a particular institution in accordance with its capital level and overall rating by the primary regulator. Under the matrix as currently in effect, the assessment rate ranges from 0 to 27 basis points of assessed deposits.

In February 2011, the FDIC adopted final rules to implement changes required by the Dodd-Frank Act with respect to the FDIC assessment rules. In particular, the definition of an institution's deposit insurance assessment base was changed from total deposits to total assets less tangible equity. In addition, the FDIC revised the deposit insurance assessment rates down. The changes were effective April 1, 2011. The new initial base assessment rates range from 5 to 9 basis points for Risk Category I banks to 35 basis points for Risk Category IV banks. Risk Category II and III banks will have an initial base assessment rate of 14 or 23 basis points, respectively. However, if the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

Lending Limits

In January 2013, the New Jersey Department of Banking and Insurance issued an order requiring a New Jersey chartered bank's calculation of lending limits to any person or entity to include credit exposure to such person or entity arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction. Previously, such credit exposure was not included in a New Jersey chartered bank's calculation of lending limits. New Jersey chartered banks had until July 1, 2013 to comply with the operative provisions of the order, which include compliance with all of the rules set forth in the Office of the Comptroller of the Currency's Interim Final Rule on Lending Limits (codified at 12 C.F.R pts. 32, 159 and 160). This change in the calculation of lending limits did not have a significant impact on the Bank's operations.

Volcker Rule

On December 10, 2013, the Federal Reserve, the Office of the Comptroller of the Currency, the FDIC, the Commodity Futures Trading Commission and the SEC issued final rules to implement the Volcker Rule contained in section 619 of the Dodd-Frank Act, generally to become effective on July 21, 2015. The Volcker Rule prohibits an insured depository institution and its affiliates from: (i) engaging in "proprietary trading" and (ii) investing in or sponsoring certain types of funds (defined as "Covered Funds") subject to certain limited exceptions. The rule also effectively prohibits short-term trading strategies by any U.S. banking entity if those strategies involve instruments other than those specifically permitted for trading and prohibits the use of some hedging strategies. The Company identified no investments held as of December 31, 2014 that meet the definition of Covered Funds and that are required to be divested by July 21, 2015 under the foregoing rules.

Item 1A. Risk Factors.

The following are some important factors that could cause the Company's actual results to differ materially from those referred to or implied in any forward-looking statement. These are in addition to the risks and uncertainties discussed elsewhere in this Form 10-K and the Company's other filings with the SEC.

A prolonging of the economic downturn or the return of negative developments in the financial services industry could negatively impact our operations.

The global and U.S. economic downturn has resulted in uncertainty in the financial markets in general with the possibility of a slow recovery or a fall back into recession. The Federal Reserve, in an attempt to help the overall economy, has kept interest rates low through its targeted federal funds rate, the purchase of mortgage- backed securities and the purchase of Treasury securities. If the Federal Reserve increases the federal funds rate, overall interest rates will likely rise which may negatively impact the housing markets and the U.S. economic recovery. A prolonging of the economic downturn or the return of negative developments in the financial services industry could negatively impact our operations by causing an increase in our provision for loan losses and a deterioration of our loan portfolio. Such a downturn may also adversely affect our ability to originate or sell loans. The occurrence of any of these events could have an adverse impact on our financial performance.

A prolonging or worsening of the downturn affecting the economy and/or the real estate market in our primary market area would adversely affect our loan portfolio and our growth potential.

Much of the Company's lending is in northern and central New Jersey. As a result of this geographic concentration, a further continued significant broad-based deterioration in economic conditions in the New Jersey metropolitan area could have a material adverse impact on the quality of the Company's loan portfolio, results of operations and future growth potential. A prolonged decline in economic conditions in our market area could restrict borrowers' ability to pay outstanding principal and interest on loans when due, and consequently, adversely affect the cash flows and results of operations of the Company's business.

The Company's loan portfolio is largely secured by real estate collateral located in the State of New Jersey. Conditions in the real estate markets in which the collateral for the Company's loans are located strongly influence the level of the Company's non-performing loans and results of operations. A continued decline in the New Jersey real estate markets could adversely affect the Company's loan portfolio. Decreases in local real estate values would adversely affect the value of property used as collateral for the Company's loans. Adverse changes in the economy also may have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings.

The Company faces significant competition.

The Company faces significant competition from many other banks, savings institutions and other financial institutions which have branch offices or otherwise operate in the Company's market area. Non-bank financial institutions, such as securities brokerage firms, insurance companies and money market funds, engage in activities which compete directly with traditional bank business, which has also led to greater competition. Many of these competitors have substantially greater financial resources than the Company, including larger capital bases that allow them to attract customers seeking larger loans than the Company is able to accommodate and the ability to aggressively advertise their products and to allocate considerable resources to locations and products perceived as profitable. There can be no assurance that the Company and the Bank will be able to successfully compete with these entities in the future.

The Company is subject to interest rate risk.

The Company's earnings are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's mortgage-backed securities portfolio. If the spread between the interest rates paid on deposits and other borrowings and the interest rates received on loans and other investments narrows, the Company's net interest income, and therefore earnings, could be adversely affected. This also includes the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rate indices underlying various interest-earning assets and interest bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk).

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

Historically low interest rates may adversely affect our net interest income and profitability.

During the last seven years, it has been the policy of the Federal Reserve Board to maintain interest rates at historically low levels through its targeted federal funds rate and the purchase of mortgage-backed securities and Treasury securities. As a result, yields have been at levels lower than were available prior to 2008 on securities we have purchased and loans we have originated. Consequently, the average yield on our interest-earning assets has decreased during the low interest rate environment. As a general matter, our interest-bearing assets re-price or mature more quickly than our interest-bearing liabilities. Our ability to lower our interest expense is limited at these interest rate levels, while the average yield on our interest-earning assets may continue to decrease. While the Federal Reserve Board may raise interest rates in 2015, we believe that interest rates will still remain relatively low for the near future. Accordingly, our net interest margin may decline, which may have an adverse effect on our profitability.

The Company is subject to risks associated with speculative construction lending.

The risks associated with speculative construction lending include the borrower's inability to complete the construction process on time and within budget, the sale of the project within projected absorption periods, the economic risks associated with real estate collateral, and the potential of a rising interest rate environment. Such loans may include financing the development and/or construction of residential subdivisions. This activity may involve financing land purchases, infrastructure development (i.e. roads, utilities, etc.), as well as construction of residences or multi-family dwellings for subsequent sale by developer/builder. Because the sale of developed properties is integral to the success of developer business, loan repayment may be especially subject to the volatility of real estate market values. Management has established underwriting and monitoring criteria to minimize the inherent risks of speculative commercial real estate construction lending. Further, management concentrates lending efforts with developers demonstrating successful performance on marketable projects within the Bank's lending areas.

Our mortgage warehouse lending business represents a significant portion of our overall lending activity and is subject to numerous risks.

Our primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of our 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.

A significant portion of our loan portfolio consists of the mortgage warehouse lines of credit. Risks associated with these loans include, without limitation, (i) credit risks relating to the mortgage bankers that borrow from us, (ii) the risk of intentional misrepresentation or fraud by any of such mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or (iv) unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

The impact of interest rates on our mortgage warehouse business can be significant. Changes in interest rates can impact the number of residential mortgages originated and initially funded under mortgage warehouse lines of credit and thus our mortgage warehouse related revenues. A decline in mortgage rates generally increases the demand for mortgage loans. Conversely, in a constant or increasing rate environment, we would expect fewer loans to be originated. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of net income produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may overstate or understate actual subsequent experience. Further, the concentration of our loan portfolio on loans originated through our mortgage warehouse business increases the risk associated with our loan portfolio because of the concentration of loans in a single line of business, namely

one-to-four family residential mortgage lending, and in a particular segment of that business, namely mortgage warehouse lending.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loan and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance. Material additions to our allowance would materially decrease our net income.

In addition, bank regulators periodically review our loan portfolio and our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs or reclassify loans. Any increase in our allowance for loan losses or loan charge-offs or loan reclassifications as required by these regulatory authorities might have a material adverse effect on our financial condition and results of operations.

If we do not successfully integrate banks that we may acquire in the future, the combined bank may be adversely affected.

If we make any acquisitions in the future, we will need to integrate those acquired entities into our existing business and systems. We may experience difficulties in accomplishing this integration or in effectively managing the combined bank after any future acquisitions. The integration of any acquired entity will also divert the attention of our management. We cannot assure you that we will be successful in integrating any future acquisitions into our own business.

The expected benefits from acquiring another entity may not be realized if the combined bank does not achieve certain cost savings and other benefits.

Our belief that cost savings and revenue enhancements are achievable in any future acquisition is a forward-looking statement that is inherently uncertain. The combined bank's actual cost savings and revenue enhancements, if any, for any future acquisition cannot be quantified at this time. Any actual cost savings or revenue enhancements will depend on future expense levels and operating results, the timing of certain events and general industry, regulatory and business conditions. Many of these events will be beyond the control of the combined bank.

Federal and state government regulation impacts the Company's operations.

The operations of the Company and the Bank are heavily regulated and will be affected by present and future legislation and by the policies established from time to time by various federal and state regulatory authorities. In particular, the monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future. Among the instruments of monetary policy used by the Federal Reserve Board to implement its objectives are changes in the discount rate charged on bank borrowings. It is not possible to predict what changes, if any, will be made to the monetary policies of the Federal Reserve Board or to existing federal and state legislation or the effect that such changes may have on the future business and earnings prospects of the Company.

The Company and the Bank are subject to examination, supervision and comprehensive regulation by various federal and state agencies. Compliance with the rules and regulations of these agencies may be costly and may limit growth and restrict certain activities, including payment of dividends, investments, loans and interest rate charges, interest rates paid on deposits, and locations of offices. The Bank is also subject to capitalization guidelines set forth in federal legislation and regulations.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the impact of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, the cost of compliance could adversely affect the Company's result of operations.

Legislative and regulatory reforms may materially adversely impact our financial condition, results of operations, liquidity, or stock price.

The Dodd-Frank Act restructures the regulation of depository institutions. The Dodd-Frank Act contains various provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. Also included was the creation of the Consumer Financial Protection Bureau, a new federal agency administering consumer and fair lending laws, a function that was previously performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions has been reduced as well. We expect that many of the requirements called for in the Dodd-Frank Act will be implemented over time, and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on financial institutions' operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

In addition, international banking industry regulators have largely agreed upon significant changes in the regulation of capital required to be held by banks and their holding companies to support their businesses. The new international rules, known as Basel III, generally increase the capital required to be held and narrow the types of instruments which will qualify as providing appropriate capital and impose a new liquidity measurement. The Basel III requirements are complex and will be phased in over many years.

The Basel III rules do not apply to U.S. banks or holding companies automatically. Among other things, the Dodd-Frank Act requires U.S. regulators to reform the system under which the safety and soundness of banks and other financial institutions, individually and systemically, are regulated. That reform effort will include the regulation of capital and liquidity.

On July 2, 2013, the Federal Reserve approved a final rule (the “Final Rule”) to establish a new comprehensive regulatory capital framework for all U.S. banking organizations. On July 9, 2013, the Final Rule was approved as an interim final rule by the FDIC. Effective January 1, 2015, these new requirements establish the following minimum capital ratios: (1) a common equity Tier 1 (“CET1”) capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total capital ratio of 8.0% of risk-weighted assets; and (4) a leverage ratio of 4.0%. In addition, there is a new requirement to maintain a capital conservation buffer, comprised of CET1 capital, in an amount greater than 2.5% of risk-weighted assets over the minimum capital required by each of the minimum risk-based capital ratios in order to avoid limitations on the organization’s ability to pay dividends, repurchase shares or pay discretionary bonuses. The capital conservation buffer requirement will be phased in, beginning January 1, 2016, and initially require a buffer amount greater than 0.625% during 2016 in order to avoid these limitations. Following 2016, the required amount of the capital conservation buffer will continue to increase each year until January 1, 2019 when the buffer amount must be greater than 2.5% in order to avoid the above limitations.

The new regulations also changed what qualifies as capital for purposes of meeting these various capital requirements, as well as the risk weight of certain assets for purposes of the risk-based capital ratios.

Under the new regulations, in order to be considered well-capitalized for prompt corrective action purposes, the Bank will be required to maintain the following ratios: (1) a CET1 ratio of at least 6.5% of risk-weighted assets; (2) a Tier 1 capital ratio of at least 8.0% of risk weighted assets; (3) a total capital ratio of a least 10.0% of risk-weighted assets; and (4) a leverage ratio of at least 5.0%. Under the new capital rules in effect on January 1, 2015, management estimates that the Bank’s CET1 risk-based capital, Tier 1 risk-based capital, total risk-based capital and leverage capital ratios would be 11.23%, 11.23%, 12.09%, and 9.40%, respectively, at December 31, 2014.

The application of these more stringent capital requirements could increase the Company’s cost of capital, among other things. Any permanent significant increase in the Company’s cost of capital could have significant adverse impacts on the profitability of many of our products, the types of products we could offer profitably, our overall profitability, and our overall growth opportunities, among other things. Implementation of changes to asset risk weightings for risk based capital calculations or items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could also result in management modifying the Company’s business strategy and limiting the Company’s ability to repurchase our common stock. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in us having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Although most financial institutions would be affected, these business impacts could be felt unevenly, depending upon the business and product mix of each institution. Other potential effects could include higher dilution of common shareholders if we had to issue additional shares and a higher risk that we might fall below regulatory capital thresholds in an adverse economic cycle.

Any additional changes in the regulation and oversight of the Company, in the form of new laws, rules and regulations, could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or prospects.

The price of our common stock may fluctuate.

The price of our common stock on the NASDAQ Global Market constantly changes and recently, given the uncertainty in the financial markets, has fluctuated widely. From the beginning of fiscal year 2013 through the end of fiscal year 2014, our stock price fluctuated between a high of \$11.90 per share and a low of \$7.00 per share. We expect that the market closing price of our common stock will continue to fluctuate. Consequently, the current market price of our common stock may not be indicative of future market prices, and we may be unable to sustain or increase the value of an investment in our common stock.

Our common stock price can fluctuate as a result of a variety of factors, many of which are beyond our control. These factors include:

- quarterly fluctuations in our operating and financial results;
- operating results that vary from the expectations of management, securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- events negatively impacting the financial services industry which result in a general decline in the market valuation of our common stock;
 - announcements of material developments affecting our operations or our dividend policy;
 - future sales of our equity securities;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
 - changes in accounting standards, policies, guidance, interpretations or principles; and
 - general domestic economic and market conditions.

In addition, recently the stock market generally has experienced extreme price and volume fluctuations, and industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of our operating results.

The Bank is subject to liquidity risk.

Liquidity risk is the potential that the Bank will be unable to meet its obligations as they become due, capitalize on growth opportunities as they arise, or pay regular dividends because of an inability to liquidate assets or obtain adequate funding in a timely basis, at a reasonable cost and within acceptable risk tolerances.

Liquidity is required to fund various obligations, including credit commitments to borrowers, mortgage and other loan originations, withdrawals by depositors, repayment of borrowings, dividends to shareholders, operating expenses and capital expenditures.

Liquidity is derived primarily from retail deposit growth and retention; principal and interest payments on loans; principal and interest payments; sale, maturity and prepayment of investment securities; net cash provided from operations and access to other funding sources.

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole. If we become unable to obtain funds when needed, it could have a material adverse effect on our business and in turn, our consolidated financial condition and results of operations.

The Company is subject to liquidity risk.

Our recurring cash requirements, at the holding company level, primarily consist of interest expense on junior subordinated debentures issued to capital trusts. Holding company cash needs are routinely satisfied by dividends collected from the Bank.

While we expect that the holding company will continue to receive dividends from the Bank sufficient to satisfy holding company cash needs, in the event that the Bank has insufficient resources or is subject to legal or regulatory restrictions on the payment of dividends, the Bank may be unable to provide dividends or a sufficient level of dividends to the holding company; in that event, the holding company may have insufficient funds to satisfy its obligations as they become due.

Future growth, operating results or regulatory requirements may require us to raise additional capital but that capital may not be available.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. To the extent our future operating results erode capital or we elect to expand through loan growth or acquisition, we may be required to raise additional capital. Our ability to raise capital will depend on conditions in the capital markets, which are outside of our control, and on our financial performance. Accordingly, we cannot be assured of our ability to raise capital when needed or on favorable terms. If we cannot raise additional capital when needed, we will be subject to increased regulatory supervision and the imposition of restrictions on our growth and business. These actions could negatively impact our ability to operate or further expand our operations and may result in increases in operating expenses and reductions in revenues that could have a material effect on our consolidated financial condition and results of operations.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

In February 2011, the FDIC adopted final rules to implement changes required by the Dodd-Frank Act with respect to the FDIC assessment rules. In particular, the definition of an institution's deposit insurance assessment base was changed from total deposits to total assets less tangible equity. In addition, the FDIC revised the deposit insurance assessment rates down. The revised initial base assessment rates range from 5 to 9 basis points for Risk Category I banks to 35 basis points for Risk Category IV banks. Risk Category II and III banks will have an initial base assessment rate of 14 or 23 basis points, respectively. If the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

Insured depository institution failures, as well as deterioration in banking and economic conditions, could significantly increase the loss provisions of the FDIC, resulting in a decline in the designated reserve ratio of the Deposit Insurance Fund to historical lows. Effective January 1, 2011, the FDIC increased the designated reserve ratio from 1.25 to 2.00. In addition, the Dodd-Frank Act permanently increased the deposit insurance limit on FDIC deposit insurance coverage to \$250,000 per insured depositor, retroactive to January 1, 2008, which may result in even larger losses to the Deposit Insurance Fund.

The FDIC may further increase or decrease the assessment rate schedule in order to manage the Deposit Insurance Fund to prescribed statutory target levels. An increase in the risk category for the Bank or in the assessment rates could have an adverse effect on the Bank's earnings. The FDIC may terminate deposit insurance if it determines the institution involved has engaged in or is engaging in unsafe or unsound banking practices, is in an unsafe or unsound condition, or has violated applicable laws, regulations or orders.

Future offerings of debt or other securities may adversely affect the market price of our stock.

In the future, the Company may attempt to increase its capital resources or, if the Company's or the Bank's capital ratios fall below the required minimums, the Company or the Bank could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock.

The Company may issue additional shares of common stock which may dilute the ownership and voting power of our shareholders and the book value of our common stock.

The Company is currently authorized to issue up to 30,000,000 shares of common stock, of which 7,160,253 shares were outstanding on February 28, 2015. We may decide to issue additional shares of common stock for any corporate purposes. Our Board of Directors has authority, without action or vote of our shareholders, to issue all or part of the authorized but unissued shares of common stock in public offerings or up to 20% of our outstanding common stock in non-public offerings. Any issuance of shares of our common stock will dilute the percentage ownership interest of our common shareholders and may reduce the market price of our common stock or dilute the book value of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

The Company may lose lower-cost funding sources.

Checking, savings, and money market deposit account balances and other forms of customer deposits can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments, the Company could lose a relatively low-cost source of funds, increasing its funding costs and reducing the Company's net interest income and net income.

There may be changes in accounting policies or accounting standards.

The Company's accounting policies are fundamental to understanding its financial results and condition. Some of these policies require the use of estimates and assumptions that may affect the value of the Company's assets or liabilities and financial results. The Company identified its accounting policies regarding the allowance for loan losses, security impairment, goodwill and other intangible assets, and income taxes to be critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain. Under each of these policies, it is possible that materially different amounts would be reported under different conditions, using different assumptions, or as new information becomes available.

From time to time the Financial Accounting Standards Board ("FASB") and the SEC change the financial accounting and reporting standards that govern the form and content of the Company's external financial statements. Recently, FASB has proposed new accounting standards related to fair value accounting and accounting for leases that could materially change the Company's financial statements in the future. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, SEC, banking regulators and the Company's independent auditors) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond the Company's control, can be hard to predict and could materially impact how the Company reports its financial results and condition. In certain cases, the Company could be required to apply a new or revised standard retroactively or apply an existing standard differently (also retroactively) which may result in the Company restating prior period financial statements in material amounts.

The Company encounters continuous technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company

may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

The Company is subject to operational risk.

The Company faces the risk that the design of its controls and procedures, including those to mitigate the risk of fraud by employees or outsiders, may prove to be inadequate or are circumvented, thereby causing delays in detection of errors or inaccuracies in data and information. Management regularly reviews and updates the Company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

The Company may also be subject to disruptions of its systems arising from events that are wholly or partially beyond its control (including, for example, computer viruses or electrical or telecommunications outages), which may give rise to losses in service to customers and to financial loss or liability. The Company is further exposed to the risk that its external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as is the Company) and to the risk that the Company's (or its vendors') business continuity and data security systems prove to be inadequate.

The Company's performance is largely dependent on the talents and efforts of highly skilled individuals. There is intense competition in the financial services industry for qualified employees. In addition, the Company faces increasing competition with businesses outside the financial services industry for the most highly skilled individuals. The Company's business operations could be adversely affected if it were unable to attract new employees and retain and motivate its existing employees.

Loss of, or failure to adequately safeguard, confidential or proprietary information may adversely affect the Company's operations, net income or reputation.

The Company regularly collects, processes, transmits and stores significant amounts of confidential information regarding its customers, employees and others. This information is necessary for the conduct of the Company's business activities, including the ongoing maintenance of deposit, loan, investment management and other account relationships for our customers, and receiving instructions and affecting transactions for those customers and other users of the Company's products and services. In addition to confidential information regarding its customers, employees and others, the Company compiles, processes, transmits and stores proprietary, non-public information concerning its own business, operations, plans and strategies. In some cases, this confidential or proprietary information is collected, compiled, processed, transmitted or stored by third parties on behalf of the Company.

Information security risks have generally increased in recent years because of the proliferation of new technologies and the increased sophistication and activities of perpetrators of cyber-attacks. A failure in or breach of the Company's operational or information security systems, or those of the Company's third-party service providers, as a result of cyber-attacks or information security breaches or due to employee error, malfeasance or other disruptions could adversely affect our business, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and/or cause losses. As a result, cyber security and the continued development and enhancement of the controls and processes designed to protect the Company's systems, computers, software, data and networks from attack, damage or unauthorized access remain a priority for the Company.

If this confidential or proprietary information were to be mishandled, misused or lost, the Company could be exposed to significant regulatory consequences, reputational damage, civil litigation and financial loss. Mishandling, misuse or loss of this confidential or proprietary information could occur, for example, if the confidential or proprietary information were erroneously provided to parties who are not permitted to have the information, either by fault of the

systems or employees of the Company, or the systems or employees of third parties which have collected, compiled, processed, transmitted or stored the information on the Company's behalf, where the information is intercepted or otherwise inappropriately taken by third parties or where there is a failure or breach of the network, communications or information systems which are used to collect, compile, process, transmit or store the information.

Although the Company employs a variety of physical, procedural and technological safeguards to protect this confidential and proprietary information from mishandling, misuse or loss, these safeguards do not provide absolute assurance that mishandling, misuse or loss of the information will not occur, or that if mishandling, misuse or loss of the information did occur, those events would be promptly detected and addressed. Additionally, as information security risks and cyber threats continue to evolve, the Company may be required to expend additional resources to continue to enhance its information security measures and/or to investigate and remediate any information security vulnerabilities.

There may be claims and litigation.

From time to time as part of the Company's normal course of business, customers make claims and take legal actions against the Company based on actions or inactions of the Company. If such claims and legal actions are not resolved in a manner favorable to the Company, they may result in financial liability and/or adversely affect the market perception of the Company and its products and services. This may also impact customer demand for the Company's products and services. Any financial liability or reputation damage could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on its financial condition and results of operations.

Severe weather, acts of terrorism and other external events could significantly impact our business.

A significant portion of our primary markets are located near coastal waters which could generate naturally occurring severe weather, or in response to climate change, that could have a significant impact on our ability to conduct business. Additionally, surrounding areas, including New Jersey, may be central targets for potential acts of terrorism against the United States. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. Although we have established disaster recovery policies and procedures, the occurrence of any such event in the future could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations. On October 29, 2012, Hurricane Sandy caused destruction along the East Coast, including in New Jersey, and resulted in, among other things, severe property damage and the closure of many businesses and financial markets. The financial impact to the Company was minimal as our mortgage loan customers in the areas affected by Hurricane Sandy did not sustain severe damage to their real properties and we experienced no loan delinquencies specifically related to Hurricane Sandy. In 2014, our market area was the subject of severe cold weather and several snow storms which disrupted commercial activities and the Bank's operations.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We currently operate 19 branch offices in New Jersey, which includes the Bank's main office in Cranbury, New Jersey. In addition, we have a Mortgage Warehouse Funding Office which we lease in Somerset, New Jersey and an Operations Center which we lease in Cranbury, New Jersey. The following table provides certain information with respect to our offices as of February 28, 2015:

Location	Leased or Owned	Original Year Leased or Acquired	Year of Lease Expiration
----------	--------------------	--	-----------------------------

Main Office	2650 Route 130 Cranbury, New Jersey	Leased	1989	2017
Village Office	74 North Main Street Cranbury, New Jersey	Owned	2005	-

Plainsboro Office	Plainsboro Village Center 11 Shalks Crossing Road Plainsboro, New Jersey	Leased	1998	2021
Hamilton Office	3659 Nottingham Way Hamilton, New Jersey	Leased	1999	2024
Princeton Office	The Windrows at Princeton Forrestal 2000 Windrow Drive Princeton, New Jersey	Leased	2001	2016
Perth Amboy Office	145 Fayette Street Perth Amboy, New Jersey	Leased	2003	2019
Jamesburg Office	1 Harrison Street Jamesburg, New Jersey	Owned	2002	-
West Windsor Office	44 Washington Road Princeton Jct, New Jersey	Leased	2004	2017
Fort Lee Office	180 Main Street Fort Lee, New Jersey	Leased	2006	2019
Hightstown Office	140 Mercer Street Hightstown, New Jersey	Leased	2007	2024
Mortgage Warehouse Funding Office	285 Davidson Avenue Somerset, New Jersey	Leased	2009	2015
Lawrenceville Property	150 Lawrenceville-Pennington Road Lawrenceville, New Jersey	Owned	2009	-
South River Operations Center	1246 South River Road, Bldg. 2 Cranbury, New Jersey	Leased	2010	2020

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Rocky Hill Office	995 Route 518 Skillman, New Jersey	Owned	2011	-
Hopewell Office	86 East Broad Street Hopewell, New Jersey	Owned	2011	-
Hillsborough Office	32 New Amwell Road Hillsborough, New Jersey	Owned	2011	-
Rumson Office	20 Bingham Avenue Rumson, New Jersey	Leased	2014	2016

Fair Haven Office	636 River Road Fair Haven, New Jersey	Leased	2014	2017
Asbury Park Office	511 Cookman Avenue Asbury Park, New Jersey	Owned	2014	-
Shrewsbury Office	500 Broad Street Shrewsbury, New Jersey	Leased	2014	2030
Oceanport Office	251 East Main Street Oceanport, New Jersey	Leased	2014	2015

Management believes the foregoing facilities are suitable for the Company's and the Bank's present and projected operations.

Item 3. Legal Proceedings.

The Company may, in the ordinary course of business, become a party to litigation involving collection matters, contract claims and other legal proceedings relating to the conduct of its business. Management is not aware of any material pending legal proceedings against the Company which, if determined adversely, would have a material adverse effect on the Company's financial position or results of operations.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities.

The common stock of the Company trades on the Nasdaq Global Market under the trading symbol "FCCY". The following are the high and low sales prices per share for each quarter during 2014 and 2013, as reported on the Nasdaq Global Market.

	2014		2013 (1)	
	High	Low	High	Low
First Quarter	\$ 11.30	\$ 10.00	\$ 9.10	\$ 7.00
Second Quarter	10.77	10.02	9.67	8.50
Third Quarter	10.94	9.70	11.33	9.28
Fourth Quarter	11.50	10.10	11.90	9.70

(1) Prices have been retroactively adjusted in the first quarter of 2013 for the 5% stock dividend declared December 20, 2012 and paid January 31, 2013 to shareholders of record on January 14, 2013.

As of February 20, 2015, there were approximately 296 record holders of the Company's common stock.

The Company did not declare a stock dividend in 2014 or 2013.

The Company has never paid a cash dividend on its common stock and there are no plans to pay a cash dividend on its common stock at this time. In addition, please refer to the discussion under the heading "Shareholders' Equity and Dividends" under Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional restrictions on cash dividends.

Issuer Purchases of Equity Securities

On July 21, 2005, the Board of Directors of the Company authorized a common stock repurchase program under which the Company may repurchase in open market or privately negotiated transactions up to 5% of its common shares outstanding at that date. The Company undertook this repurchase program in order to increase shareholder value. The following table provides common stock repurchases made by or on behalf of the Company during the three months ended December 31, 2014, which purchases were made under the stock repurchase program.

Issuer Purchases of Equity Securities (1)

Period		Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Maximum Number of Shares That May Yet be Purchased Under the Program
Beginning	Ending				
October 1, 2014	October 31, 2014	-	\$ -	-	124,534
November 1, 2014	November 30, 2014	600	10.56	600	123,934
December 1, 2014	December 31, 2014	-	-	-	123,934
Total		600	\$ -	600	123,934

(1) The Company's common stock repurchase program covers a maximum of 225,824 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on July 21, 2005, as adjusted for subsequent stock dividends.

Item 6. Selected Financial Data.

Not required.

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

This discussion should be read in conjunction with the consolidated financial statements, notes and tables included elsewhere in this report. Throughout the following sections, the "Company" refers to 1st Constitution Bancorp and, as the context requires, its wholly-owned subsidiary, 1st Constitution Bank (the "Bank") and the Bank's wholly-owned subsidiaries as of December 31, 2014, which were 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 204 South Newman Street Corp. and 249 New York Avenue, LLC. 1st Constitution Capital Trust II ("Trust II"), a subsidiary of the Company as of December 31, 2014, 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. The purpose of this discussion and analysis is to assist in the understanding and evaluation of the Company's financial condition, changes in financial condition and results of operations.

Critical Accounting Policies and Estimates

“Management’s Discussion and Analysis of Financial Condition and Results of Operations” is based upon the Company’s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Company’s Consolidated Financial Statements for the year ended December 31, 2014 contains a summary of the Company’s significant accounting policies.

Management believes the Company's policies with respect to the methodologies for the determination of the allowance for loan losses and for determining other-than-temporary security impairment involve a higher degree of complexity and requires management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors. The provision for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available to it, the level of the allowance for loan losses remains an estimate which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Company's loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Company's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or should the Central New Jersey area experience an adverse economic shock. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Company's control.

Real estate acquired through foreclosure, or a deed-in-lieu of foreclosure is recorded at fair value less estimated selling costs at the date of acquisition or transfer, and subsequently at the lower of its new cost or fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to the extent it exceeds estimated fair value less estimated selling costs, at which time a provision for losses on such real estate is charged to operations. Appraisals are critical in determining the fair value of the other real estate owned amount. Assumptions for appraisals are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable.

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets (level 1) or quoted prices on similar assets (level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of quoted prices, valuation techniques would be used to determine fair value of any investments that require inputs that are both significant to the fair value measurement and unobservable (level 3). Valuation techniques are based on various assumptions, including, but not limited to cash flows, discount rates, rate of return, adjustments for nonperformance and liquidity, and liquidation values. A significant degree of judgment is involved in valuing investments using level 3 inputs. The use of different assumptions could have a positive or negative effect on consolidated financial condition or results of operations.

Management must periodically evaluate if unrealized losses (as determined based on the securities valuation methodologies discussed above) on individual securities classified as held to maturity or available for sale in the investment portfolio are considered to be other-than-temporary. The analysis of other-than-temporary impairment requires the use of various assumptions, including, but not limited to, the length of time an investment's book value is greater than fair value, the severity of the investment's decline, as well as any credit deterioration of the investment. If the decline in value of an investment is deemed to be other-than-temporary, the investment is written down to fair value and a non-cash impairment charge is recognized in the period of such evaluation.

The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment.

Deferred tax assets are recorded on the consolidated balance sheet at net realizable value. The Company periodically performs an assessment to evaluate the amount of deferred tax assets it is more likely than not to realize. Realization of deferred tax assets is dependent upon the amount of taxable income expected in future periods, as tax benefits require taxable income to be realized. If a valuation allowance is required, the deferred tax asset on the consolidated balance sheet is reduced via a corresponding income tax expense in the consolidated statement of income.

Rights Offering to Existing Shareholders

During the third quarter of 2012, the Company launched a shareholders' common stock rights offering, which expired on October 5, 2012. The Company received gross proceeds of \$5.0 million from holders of subscription rights who exercised their basic subscription rights and from holders who exercised the over-subscription privilege. The rights offering was fully subscribed. Accordingly, the Company issued a total of 555,555 shares of common stock to the holders of subscription rights who validly exercised their subscription rights, including pursuant to the exercise of the over-subscription privilege.

Merger of Rumson-Fair Haven Bank and Trust Company with and into the Bank in 2014

On February 7, 2014, the Company completed its acquisition of Rumson-Fair Haven Bank and Trust Company, a New Jersey State chartered commercial bank ("RFHB"), by merging RFHB with and into the Bank, with the Bank as the surviving entity. The merger agreement among the Company, the Bank and RFHB (the "Merger Agreement") provided that the shareholders of RFHB would receive, at their election, for each outstanding share of RFHB common stock that they own at the effective time of the merger, either 0.7772 shares of the Company common stock or \$7.50 in cash or a combination thereof, subject to proration as described in the Merger Agreement, so that 60% of the aggregate merger consideration consisted of cash and 40% consisted of shares of the Company's common stock. The Company issued an aggregate of 1,019, 223 shares of its common stock and paid approximately \$14.8 million in cash in the transaction.

The merger was accounted for under the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at their estimated fair values as of the acquisition date. RFHB's results of operations have been included in the Company's Consolidated Statements of Income since February 7, 2014.

The merger of RFHB had a significant positive effect on the financial position and operations of the Company. At the time of the merger, RFHB had loans of \$144 million, investment securities of \$30 million, deposits of \$190 million and borrowings of \$10 million.

Results of Operations

Summary

The Company reported net income of \$4.4 million or \$0.61 per diluted share for the year ended December 31, 2014 compared to net income of \$5.8 million or \$0.95 per diluted share for the year ended December 31, 2013. The results of operations for 2014 were impacted by two events during the first and second quarters of 2014. For the first quarter ended March 31, 2014, the Company completed the merger of RFHB with and into the Bank and incurred \$1.4 million of merger-related expenses that reduced net income by \$0.9 million or \$0.13 per diluted share. For the second quarter ended June 30, 2014, a loan for approximately \$3.7 million was fully charged off and the provision for loan losses was increased by a similar amount due to an apparent fraud by the borrower and its principals. The additional provision for loan losses reduced net income by \$2.2 million or \$0.30 per diluted share.

Net income adjusted for the effect of these events (Adjusted Net Income) was \$7.5 million for the year ended December 31, 2014 and earnings per diluted share, as adjusted (Adjusted Earnings per Diluted Share), was \$1.05. For the year ended December 31, 2013, net income as adjusted for the after-tax cost of RFHB merger-related expenses of \$0.3 million was \$6.1 million or \$1.00 per diluted share. These adjusted measures are considered non-GAAP measures.

The following is a reconciliation of the non-GAAP measures to reported net income and net income per diluted share.

1st Constitution Bancorp				
Reconciliation of Non-GAAP Measures (1)				
Year ended December 31,				
(Dollars in thousands, except per share data)	2014		2013	
Adjusted Net Income				
Net Income	\$ 4,356		\$ 5,780	
Adjustments:				
Provision for loan losses related to fraud	3,656		-	
Merger-related expenses	1,532		326	
Income tax effect of adjustments (2)	(2,031)		(24)	
Adjusted net income	\$ 7,513		\$ 6,082	
Adjusted Net Income per Diluted Share				
Adjusted net income	\$ 7,513		\$ 6,082	
Diluted shares outstanding	7,146,654		6,102,043	
Adjusted net income per diluted shares	\$ 1.05		\$ 1.00	
Adjusted return on assets	0.79	%	0.76	%
Adjusted return on equity	9.21	%	9.19	%

(1) The Company used the non-GAAP financial measures, adjusted net income and adjusted net income per diluted share because the Company believes that it is useful for the users of the financial information to understand the effect on net income of the merger related expenses incurred in the merger with RFHB and the large provision for loan losses recorded as a result of the apparent fraud by a borrower and its principals. These non-GAAP measures improve the comparability of the current period results with the results of prior periods. The Company cautions that the non-GAAP financial measures should be considered in addition to, but not as a substitute for, the Company's GAAP results.

(2) Tax effected at an income tax rate of 39.94%, less the impact of non-deductible merger expenses.

Return on average assets ("ROAA") and return on average equity ("ROAE") as reported were 0.46% and 5.34%, respectively, for the year ended December 31, 2014, compared to 0.72% and 8.73%, respectively, for the year ended December 31, 2013. ROAA and ROAE decreased for the year ended December 31, 2014 due to a decrease in net income for the year ended December 31, 2014 that was due primarily to the charge-off of an apparently fraudulent loan and one-time expenses related to the RFHB merger. ROAA and ROAE as adjusted were 0.79% and 9.21% for the year ended December 31, 2014 compared to 0.76% and 9.19% for the year ended December 31, 2013,

respectively.

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

28

Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 85.0% of the Company's net revenues (net interest income plus non-interest income) for the year ended December 31, 2014 and 81% of net revenues for the year ended December 31, 2013. Net interest income also depends upon the relative amount of average interest earning assets, average interest-bearing liabilities, and the interest rate earned or paid on them, respectively.

The Company's net interest income increased on a tax equivalent basis by \$8.0 million, or 31.1%, to \$33.8 million for the year ended December 31, 2014 from \$25.8 million reported for the year ended December 31, 2013. The increase was driven by the internal growth of the loan portfolio and the inclusion of the operations of RFHB.

The net interest margin for the year ended December 31, 2014 was 3.84% as compared to the 3.44% net interest margin recorded for the year ended December 31, 2013, an increase of 40 basis points. This increase in the Company's net interest income and net interest margin for the year ended December 31, 2014 as compared with the corresponding 2013 period was primarily due to three factors: (1) the increase of \$129.8 million in interest-earning assets primarily due to the loans and securities acquired as a result of the merger with RFHB; (2) the increase in the average loan to average asset ratio to 59.6% in 2014 compared to 49.8% in 2013; and (3) the decrease of 5 basis points in the average cost of interest-bearing liabilities to 0.67% for the year ended December 31, 2014 compared to 0.72% for the year ended December 31, 2013.

The following tables set forth the Company's consolidated average balances of assets, liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the years ended December 31, 2014, 2013 and 2012, respectively. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

Average Balance Sheets with Resultant Interest and Rates

(yields on a tax-equivalent basis)

	2014		2013		2012			
(Dollars in thousands)	Average Balance	Interest	Average Yield	Average Balance	Interest	Average Yield	Average Balance	Interest
Assets:								
Federal Funds Sold/Short-Term Investments								
	\$60,933	\$150	0.25 %	\$120,125	\$300	0.25 %	\$31,405	\$82
Investment Securities:								
Taxable	168,992	4,022	2.38 %	162,246	3,915	2.41 %	170,090	4,434
Tax-exempt (4)	87,455	3,419	3.91 %	69,158	3,270	4.73 %	51,118	2,482
Total	256,447	7,441	2.90 %	231,404	7,185	3.10 %	221,207	6,916
Loan Portfolio (1):								
Construction	77,159	5,233	6.78 %	43,391	2,757	6.35 %	56,803	3,674
Residential Real Estate	45,572	1,855	4.07 %	11,492	589	5.13 %	11,673	604
Home Equity	22,070	1,201	5.44 %	9,293	495	5.33 %	10,226	575
Commercial business and Commercial Real Estate	271,888	15,893	5.85 %	145,470	10,392	7.14 %	145,309	10,873
Mortgage Warehouse Lines	124,127	5,589	4.50 %	151,336	7,096	4.69 %	204,853	9,735
Installment	340	19	5.58 %	266	17	6.39 %	341	23
All Other Loans	22,223	1,090	4.90 %	38,214	1,221	3.20 %	34,383	1,160
Total	563,379	30,879	5.48 %	399,462	22,568	5.65 %	463,588	26,644
Total Interest-Earning Assets	880,759	38,470	4.37 %	750,991	30,052	4.00 %	716,200	33,642
Allowance for Loan Losses	(7,487)			(6,857)			(6,370)	
Cash and Due From Banks	14,620			9,999			12,570	
Other Assets	57,689			47,401			52,092	
Total Assets	\$945,581			\$801,534			\$774,492	
Liabilities and Shareholders' Equity:								
Interest-Bearing Liabilities:								
Money Market and NOW Accounts	\$286,235	\$954	0.33 %	\$222,581	\$758	0.34 %	\$203,419	\$989
Savings Accounts	199,078	904	0.45 %	198,169	894	0.45 %	192,959	1,164
Certificates of Deposit under \$100,000	70,574	910	1.29 %	68,741	860	1.25 %	70,101	1,077
Certificates of Deposit of \$100,000 and Over	98,891	1,031	1.04 %	71,616	976	1.36 %	76,526	1,084
Other Borrowed Funds	23,724	516	2.18 %	10,285	415	4.04 %	17,805	451
Trust Preferred Securities	18,557	344	1.90 %	18,557	352	1.90 %	18,557	386
Total Interest-Bearing Liabilities	697,059	4,658	0.67 %	589,949	4,255	0.72 %	579,367	5,151
Net Interest Spread (2)			3.70 %			3.28 %		

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Demand Deposits	159,935		137,873		127,558
Other Liabilities	7,065		7,500		8,913
Total Liabilities	864,059		735,322		715,838
Shareholders' Equity	81,522		66,212		58,654
Total Liabilities and Shareholders' Equity	\$945,581		\$801,534		\$774,492
Net Interest Margin (3)	\$33,812	3.84%	\$25,797	3.44%	\$28,491

- (1) Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include nonaccrual loans with no related interest income. Please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Non-Performing Assets" for a discussion of the Bank's policy with regard to non-accrual loans.
- (2) The interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.
- (3) The net interest margin is equal to net interest income divided by average interest earning assets.
- (4) Tax- equivalent basis.

Changes in net interest income and net interest margin result from the interaction between the volume and composition of interest earning assets, interest bearing liabilities, related yields, and associated funding costs. The Rate/Volume Table demonstrates the impact on net interest income of changes in the volume of interest earning assets and interest bearing liabilities and changes in interest rates earned and paid.

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

As indicated in the Rate/Volume Table, the principal factor contributing to the increase in net interest income for the year ended December 31, 2014 was an increase in the volume of loans in the loan portfolio, partially offset by the lower yield earned on loans.

Rate/Volume Table (Dollars in thousands) (Tax-equivalent basis)	Amount of Increase (Decrease)					
	2014 versus 2013 Due to Change in:			2013 versus 2012 Due to Change in:		
	Volume	Rate	Total	Volume	Rate	Total
Interest Income:						
Loans:						
Construction	\$ 2,216	\$ 259	\$ 2,476	\$ (858)	\$ (58)	\$ (916)
Residential Real Estate	1,568	(302)	1,266	(10)	(5)	(15)
Home Equity	688	19	706	(51)	(29)	(80)
Commercial and Commercial Real Estate	8,202	(2,701)	5,501	13	(493)	(480)
Mortgage Warehouse Lines	(1,248)	(259)	(1,507)	(2,529)	(110)	(2,639)
Installment	4	(2)	2	(5)	(2)	(7)
All Other Loans	(646)	515	(131)	124	(63)	61
Total Loans	10,784	(2,471)	8,312	(3,316)	(760)	(4,076)
Investment Securities :						
Taxable	159	(52)	107	(191)	(327)	(518)
Tax-exempt	791	(642)	149	865	(78)	787
Total Investment Securities	950	(694)	256	674	(405)	269
Federal Funds Sold / Short-Term Investments	(150)	-	(150)	226	(8)	218
Total Interest Income	11,585	(3,165)	8,418	(2,416)	(1,173)	(3,589)
Interest Expense :						
Money Market and NOW Accounts	217	(22)	196	84	(315)	\$(231)
Savings Accounts	10	-	10	25	(295)	(270)
Certificates of Deposit under \$100,000	23	27	50	(17)	(200)	(217)
Certificates of Deposit of \$100,000 and Over	334	(280)	55	(66)	(42)	(108)
Other Borrowed Funds	417	(316)	101	(247)	211	(36)
Trust Preferred Securities	-	-	(8)	-	(34)	(34)
Total Interest Expense	1,001	(598)	403	(221)	(675)	(896)
Net Interest Income	\$ 10,583	\$ (2,567)	\$ 8,015	\$ (2,195)	\$ (498)	\$ (2,693)

As of December 31, 2014 loans were \$654 million and had increased \$281 million compared to \$373 million at December 31, 2013. The primary driver of the 75% increase in loans during 2014 was the origination of new loans and the \$163 million of internal growth of the Bank's loan portfolio. Loans acquired in the RFHB merger were \$118 million at the end of 2014.

Average interest-earning assets increased by \$129.8 million, or 17.3%, to \$880.8 million for the year ended December 31, 2014 from \$751.0 million for the year ended December 31, 2013. Overall, the yield on interest-earning assets, on a tax-equivalent basis, increased 37 basis points to 4.37% for the year ended December 31, 2014 compared to 4.00% for the year ended December 31, 2013 due primarily to the increase in construction, residential, commercial real estate and commercial business loans resulting from the internal growth of loans and the inclusion of the operations of

RFHB. The growth in average interest-earning assets and the increase in loans as a percentage of average interest-earning assets generated an \$8.4 million increase in total interest income for 2014.

Interest expense increased by \$403,000, or 9.5%, to \$4.7 million for the year ended December 31, 2014 from \$4.3 million for the year ended December 31, 2013. This increase in interest expense was principally attributable to the increase in money market, NOW account and certificate of deposit balances that were assumed as a result of the RFHB merger. Money market and NOW accounts increased on average by \$63.7 million in 2014, or 28.6%, as compared to 2013, and the cost on these deposits decreased one basis point in 2014 as compared to 2013. Average interest-bearing liabilities increased 18.2% in 2014 compared to 2013 principally due to the RFHB merger. The cost of total interest-bearing liabilities decreased 5 basis points to 0.67% in 2014 from 0.72% in 2013.

Average interest earning assets increased by \$34.8 million, or 4.9%, to \$751.0 million for the year ended December 31, 2013 from \$716.2 million for the year ended December 31, 2012. The average loan portfolio decreased by \$64.1 million, or 13.9%, to \$399.5 million for the year ended December 31, 2013 compared to \$463.6 million for the year ended December 31, 2012. The second half of 2013 saw an increase in long-term interest rates that resulted in the decrease in the balance of outstanding mortgage warehouse lines due to a significant decline in the volume of residential mortgages originated by mortgage warehouse customers. The average balance of mortgage warehouse lines decreased by \$53.5 million, or 26.1%, to \$151.3 million for the year ended December 31, 2013 compared to an average balance of \$204.9 million for the year ended December 31, 2012. Overall, the yield on interest-earning assets, on a tax-equivalent basis, decreased 70 basis points to 4.00% for the year ended December 31, 2013 compared to 4.70% for the year ended December 31, 2012.

The Company's net interest income decreased on a tax-equivalent basis by \$2.7 million, or 9.5%, to \$25.8 million for the year ended December 31, 2013 from \$28.5 million reported for the year ended December 31, 2012. As indicated in the Rate/Volume Table, the principal factor contributing to the decrease in net interest income for the year ended December 31, 2013 was a decrease in the volume of loans in the loan portfolio, combined with lower rates earned on interest-earning assets.

Interest expense decreased by \$896,000, or 17.4%, to \$4.3 million for the year ended December 31, 2013 from \$5.2 million for the year ended December 31, 2012. This decrease in interest expense was principally attributable to higher levels of interest-bearing liabilities priced at a significantly lower market interest rate level. Money market and NOW accounts increased on average by \$19.2 million in 2013, or 9.4%, as compared to 2012, which contributed to the funding of investment portfolio growth. The cost on these deposits decreased 15 basis points in 2013 as compared to 2012. Average interest-bearing liabilities rose 1.8% in 2013 compared to 2012. The cost of total interest-bearing liabilities decreased 17 basis points to 0.72% in 2013 from 0.89% in 2012.

Provision for Loan Losses

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, non-accrual loans, and problem loans as identified through internal classifications, collateral values, and the growth and size of the loan portfolio.

In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Using this evaluation process, the Company's provision for loan losses was \$5.7 million for the year ended December 31, 2014 compared to \$1.1 million for the year ended December 31, 2013. Net charge-offs for the years ended December 31, 2014 and 2013 were \$5.9 million and \$1.2 million, respectively. The increase in the provision for loan losses and net-charge offs was primarily attributable to the \$3.7 million provision for loan losses and corresponding charge-off of the entire balance of an apparently fraudulent loan in the second quarter of 2014. Charge-offs in 2014 also included \$0.9 million of gross charge-offs of specific reserves for potential loan losses that were recorded in prior periods.

Non-Interest Income

Total non-interest income for the year ended December 31, 2014 was relatively unchanged at \$5.8 million when compared to the year ended December 31, 2013. This component represented 15% of the Company's net revenues for the year ended December 31, 2014 and 19% of net revenues for the year ended December 31, 2013.

Service charges on deposit accounts increased by \$68,000 to \$988,000 for the year ended December 31, 2014 compared to \$920,000 for the year ended December 31, 2013. This component of non-interest income represented 17.2% and 15.8% of the total non-interest income for the years ended December 31, 2014 and 2013, respectively. The increase for the year ended December 31, 2014 was due to an increase in the number of deposit accounts subject to service charges, primarily as a result of the acquisition of deposit accounts from the RFHB merger.

Gains on sales of loans held for sale were relatively flat at \$2.1 million for each of the years ended December 31, 2014 and 2013. The Bank sells both residential mortgage loans and Small Business Administration loans in the secondary market.

Gains on sales of residential mortgages were \$0.8 million in 2014 compared to \$1.4 million in 2013 and loan sales declined to \$108.6 million compared to \$138.7 million in 2013 due to the increase in residential mortgage rates beginning in the second half of 2013 and continuing in general through 2014. Higher interest rates significantly reduced the volume of residential mortgages being refinanced in 2014 compared to 2013.

In 2014 sales of SBA loans were \$10.8 million and generated gains of \$1.2 million compared to sales of SBA loans of \$5.2 million in 2013, and gains of \$0.6 million. SBA loan originations and sales were higher in 2014 due to an increased focus on originating SBA eligible commercial loans.

In 2014, the Bank sold available-for-sale securities with an aggregate book value of \$28.1 million that resulted in a pre-tax loss of \$1,000. There were no sales of securities for the year ended December 31, 2013.

Non-interest income also includes income from bank-owned life insurance (“BOLI”), which amounted to \$564,000 for the year ended December 31, 2014 compared to \$457,000 for the year ended December 31, 2013. The increase in BOLI income was due to the Bank’s acquisition of \$4.5 million of BOLI assets in the RFHB merger.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rentals, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. The other income component of non-interest income was \$2.2 million for the year ended December 31, 2014 as compared to \$2.4 million for the year ended December 31, 2013.

Non-Interest Expenses

Non-interest expenses increased by \$5.9 million, or 27.4%, to \$27.3 million for the year ended December 31, 2014 from \$21.4 million for the year ended December 31, 2013. The increase in non-interest expenses included \$1.5 million of RFHB merger related expenses and \$2.8 million of expenses related to the inclusion of the former RFHB operations. The following table presents the major components of non-interest expenses for the years ended December 31, 2014 and 2013.

Non-interest Expenses (Dollars in thousands)	Year ended December 31,	
	2014	2013
Salaries and employee benefits	\$ 15,066	\$ 12,709
Occupancy expense	3,355	2,574
Data processing services	1,264	1,112
Equipment expense	870	884
Marketing	302	295
Telephone	422	364
Regulatory, professional and consulting fees	1,360	1,104
Merger-related expenses	1,532	326
FDIC deposit insurance	715	346
Directors’ fees	92	103
Other real estate owned expenses	236	353
Amortization of intangible assets	456	268
Other expenses	1,617	984
Total	\$ 27,287	\$ 21,422

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$2.4 million, or 18.5%, to \$15.1 million for the year ended December 31, 2014 compared to \$12.7 million for the year ended December 31, 2013. The increase in salaries and employee benefits for the year ended December 31, 2014 was due primarily to an increase in the number of employees, regular merit increases and increased health care costs. Salaries and benefits expense for former RFHB employees was \$1.1 million. As a result of the RFHB merger completed on February 7, 2014 and growth of the company’s operations, staffing levels increased to 179 full time equivalent employees at December 31, 2014 compared to 151 full time equivalent employees at December 31, 2013.

Occupancy expenses increased by \$781,000, or 30.3%, to \$3.4 million for the year ended December 31, 2014 compared to \$2.6 million for the year ended December 31, 2013. The increase in occupancy expenses for the year ended December 31, 2014 was primarily attributable to increased depreciation, property taxes and maintenance costs related to the five branch offices acquired as a result of the RFHB merger.

The cost of data processing services increased to \$1.3 million for the year ended December 31, 2014 from \$1.1 million for the year ended December 31, 2013 as additional expenses were incurred to support and maintain the five new branch locations acquired as a result of the RFHB merger within the Bank's information technology systems and the growth of loan and deposit transaction volumes.

Regulatory, professional and consulting fees increased by \$256,000, or 23.2%, to \$ 1.4 million for the year ended December 31, 2014 compared to \$1.1 million for the year ended December 31, 2013. During 2014, the Company incurred professional fees in connection with consultants engaged to assess the Company's compliance with regulatory requirements and risk management programs. In addition, the increase in regulatory, professional and consulting fees for the year ended December 31, 2014 was partially due to the Company's incurrence of higher legal fees in connection with the collection and recovery of non-performing assets.

During 2014, the Company incurred merger-related expenses of \$1.5 million in connection with the RFHB merger. These pre-tax expenses consisted primarily of (1) change-in-control payments of \$883,000; (2) data processing contract termination payments of \$228,000; (3) investment banker fees of \$207,000; (4) legal fees of \$94,000; and (5) severance payments of \$120,000.

Other real estate owned expenses decreased by \$117,000 to \$236,000 for the year ended December 31, 2014 compared to \$353,000 for the year ended December 31, 2013 as the Company incurred a lower level of property tax, maintenance and other costs on repossessed properties held as other real estate owned during 2014 compared to 2013. In addition, the Company recorded loss provisions of \$112,000 during 2014 and \$759,000 during 2013. At December 31, 2014, the Bank held three properties with an aggregate value of \$5.7 million as other real estate owned compared to three properties with an aggregate value of \$2.1 million at December 31, 2013.

FDIC insurance expense increased to \$715,000 for the year ended December 31, 2014 compared to \$346,000 for the year ended December 31, 2013 due to the adjustment of accrued expenses in 2013 and the assumption of deposits and borrowings upon completion of the RFHB merger.

Amortization of intangible assets increased \$188,000 to \$456,000 for the year ended December 31, 2014 when compared to \$268,000 for the year ended December 31, 2013 due to the recognition of the core deposit intangible asset of \$1.2 million recorded as a result of the RFHB merger.

All other expenses increased by \$633,000 to \$1.6 million for the year ended December 31, 2014 from \$984,000 for the year ended December 31, 2013 as a result of increases in payroll processing fees, ATM operation expenses and insurance premiums.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by tax equivalent net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Company's efficiency ratio increased to 68.9% for the year ended December 31, 2014 compared to 67.7% for the year ended December 31, 2013 primarily as a result of the \$5.9 million increase in expenses, including one-time merger expenses of \$1.5 million. Excluding the merger related expenses, the 2014 efficiency ratio was 65.1%.

Income Taxes

Pre-tax income decreased to \$5.4 million for the year ended December 31, 2014 from \$8.1 million for the year ended December 31, 2013.

The Company had income tax expense of \$1.1 million for the year ended December 31, 2014 compared to income tax expense of \$2.3 million for year ended December 31, 2013. The decrease in the income tax expense for the year ended December 31, 2014 compared to the year ended December 31, 2013 was primarily due to the \$2.6 million decrease in pre-tax income for 2014 compared to 2013. The Company's effective tax rate decreased to 19.8% in 2014 from 28.3% in 2013 due to lower pre-tax income in 2014 and the effect of tax exempt interest income.

Financial Condition

Cash and Cash Equivalents

At December 31, 2014, cash and cash equivalents totaled \$14.5 million compared to \$69.3 million at December 31, 2013. Cash and cash equivalents at December 31, 2014 consisted of cash and due from banks of \$14.5 million. There were no federal funds sold/short-term investments at December 31, 2014. At December 31, 2013, cash and cash equivalents and federal funds/short term investments were \$69.3 million and \$11,426, respectively. The decrease in cash and cash equivalents for the year ended December 31, 2014 compared to the same period in 2013 was primarily due to cash outflows to fund an increase in loan demand in the fourth quarter of 2014.

Investment Securities

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

(Dollars in thousands)					
	2014	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		\$ 1,538	\$ -	\$ (14)	\$ 1,524
Residential collateralized mortgage obligations- GSE		4,455	101	(23)	4,533
Residential mortgage backed securities – GSE		27,089	825	(143)	27,771
Obligations of State and Political subdivisions		21,733	299	(329)	21,703
Trust preferred debt securities – single issuer		2,472	-	(403)	2,069
Corporate debt securities		19,397	152	(28)	19,521
Other debt securities		1,265	1	(11)	1,255
Restricted stock		1,760	-	-	1,760
Mutual fund		25	-	-	25
		\$ 79,734	\$ 1,378	\$ (951)	\$ 80,161

	Amortized Cost	Other-Than- Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	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	\$-	\$ -	\$-	\$-	\$-	\$-
Residential collateralized mortgage obligations – GSE	19,304	-	19,304	700	-	20,004
Residential mortgage backed securities - GSE	56,528	-	56,528	1,563	(36)	58,055
Obligations of State and Political subdivisions	66,887		66,887	2,297	(92)	69,092
Trust preferred debt securities - pooled	657	(501)	156	405	-	561
Other debt securities	763	-	763	1	-	764
	\$144,139	\$ (501)	\$143,638	\$4,966	\$(128)	\$148,476

(Dollars in thousands)

	2013	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		\$22,387	\$33	\$(910)	\$21,510
Residential collateralized mortgage obligations - GSE		5,227	187	(1)	5,413
Residential mortgage backed securities – GSE		31,532	872	(438)	31,966
Obligations of State and Political subdivisions		22,207	150	(2,711)	19,646
Trust preferred debt securities – single issuer		2,469	-	(456)	2,013
Corporate debt securities		16,228	319	(29)	16,518
Other debt securities		1,103	-	(8)	1,095

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Restricted stock	1,013	-	-	1,013
Mutual fund	25	-	-	25
	\$102,191	\$1,561	\$(4,553)) \$99,199

36

	Amortized Cost	Other-Than- Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to maturity-						
Obligations of U.S. Government sponsored Corporations (“GSE”) and agencies	\$1,525	-	\$1,525	\$10	-	\$1,535
Residential collateralized mortgage obligations – GSE	24,571	-	24,571	500	(22)	25,049
Residential mortgage backed securities -GSE	65,241	-	65,241	611	(387)	65,465
Obligations of State and Political subdivisions	59,401	-	59,401	1,400	(1,296)	59,505
Trust preferred debt securities - pooled	657	(501)	156	-	(7)	149
Corporate debt securities	1,008	-	1,008	10	-	1,018
Other debt securities	915	-	915	-	(5)	910
	\$153,318	\$ (501)	\$152,817	\$2,531	\$(1,717)	\$153,631

The investment securities portfolio amounted to \$223.8 million, or 23.4% of total assets, at December 31, 2014 compared to \$252.0 million, or 33.9% of total assets, at December 31, 2013. Proceeds from maturities and prepayments for the year ended December 31, 2014 totaled \$50.8 million while purchases of investment securities totaled \$18.4 million during this period. On an average balance basis, the investment securities portfolio represented 29.1% and 30.8% of average interest-earning assets, respectively, for the years ended December 31, 2014 and 2013. The average yield earned on the portfolio, on a fully tax-equivalent basis, was 2.90% for the year ended December 31, 2014, which was a decrease of 20 basis points from 3.10% earned for the year ended December 31, 2013.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create more economically attractive returns. At December 31, 2014, available-for-sale securities amounted to \$80.2 million, a decrease of \$19.0 million from \$99.2 million at December 31, 2013.

The following table sets forth certain information regarding the amortized cost, estimated fair value, weighted average yields and contractual maturities of the Company’s investment portfolio as of December 31, 2014. 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. Federal Home Loan Bank stock is included in “Available for Sale - Due in one year or less.”

(Dollars in thousands)

	December 31, 2014		
	Amortized cost	Estimated Fair Value	Yield
Available for sale			
Due in one year or less	\$12,592	\$12,569	1.01%
Due after one year through five years	18,131	18,241	2.07%
Due after five years through ten years	12,542	12,785	3.25%
Due after ten years	36,469	36,566	3.48%
Total	\$79,734	\$80,161	2.73%
	Amortized cost	Estimated Fair Value	Yield
Held to maturity			
Due in one year or less	\$18,073	\$18,081	0.98%
Due after one year through five years	14,192	14,638	3.72%
Due after five years through ten years	35,934	37,226	3.41%
Due after ten years	75,940	78,532	3.45%
Total	\$144,139	\$148,476	3.17%

Proceeds from maturities and prepayments of securities available for sale amounted to \$23.6 million for the year ended December 31, 2014 compared to \$22.3 million for the year ended December 31, 2013. At December 31, 2014, the portfolio had net unrealized gains of \$427,000 compared to net unrealized losses of \$3.0 million at December 31, 2013. These unrealized gains (loss) are reflected net of tax in shareholders' equity as a component of accumulated other comprehensive income (loss).

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At December 31, 2014, securities held to maturity were \$143.6 million, a decrease of \$9.2 million from \$152.8 million at December 31, 2013. The fair value of the held-to-maturity portfolio at December 31, 2014 was \$148.5 million.

The Company regularly reviews the composition of the investment securities portfolio, taking into account market risks, the current and expected interest rate environment, liquidity needs and its overall interest rate risk profile and strategic goals.

On a quarterly basis, management evaluates each security in the portfolio with an individual unrealized loss to determine if that loss represents other-than-temporary impairment. During the fourth quarter of 2009, management determined that it was necessary, following other-than-temporary impairment requirements, to write down the cost basis of the Company's only pooled trust preferred security. 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 \$865,000 with respect to this security. No other-than-temporary impairment losses were recorded during 2014 and 2013. See Note 3 to the consolidated financial statements for additional information.

Loans Held for Sale

Loans held for sale at December 31, 2014 amounted to \$8.4 million compared to \$10.9 million at December 31, 2013. As indicated in the Consolidated Statements of Cash Flows, the amount of loans originated for sale was \$114.8 million for 2014 compared with \$139.0 million for 2013. The amount of loans held for sale varies from period to period due to changes in the amount and timing of sales of residential mortgage loans.

Loans

The loan portfolio, which represents the Bank's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Bank's primary lending focus continues to be mortgage warehouse lines, construction loans, commercial loans, owner-occupied commercial mortgage loans and tenanted commercial real estate loans. Total loans averaged \$563.4 million for the year ended December 31, 2014, an increase of \$163.9 million, or 41.0%, compared to an average of \$399.5 million for the year ended December 31, 2013. At December 31, 2014, total loans amounted to \$654.3 million, which was a \$281.0 million increase when compared to \$373.3 million at December 31, 2013, and included \$118.0 million in loans acquired from RFHB. The average yield earned on the loan portfolio was 5.48% for the year ended December 31, 2014 compared to 5.65% for the year ended December 31, 2013, a decrease of 17 basis points.

The following table represents the components of the loan portfolio for the dates indicated.

(Dollars in thousands)	December 31, 2014		2013		2012		2011		2010	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Construction loans	\$ 95,627	15%	\$ 51,002	14%	\$ 55,691	11%	\$ 49,286	10%	\$ 67,891	17%
Residential real estate loans	46,446	7%	13,764	4%	10,897	2%	12,885	3%	10,435	3%
Commercial business	110,771	17%	82,348	22%	57,865	11%	50,785	11%	54,733	13%
Commercial real estate	198,211	30%	98,390	26%	102,413	20%	99,637	21%	95,278	23%
Mortgage warehouse lines	179,172	27%	116,951	31%	284,128	54%	249,346	52%	169,576	41%
Loans to individuals	23,156	4%	9,766	3%	9,643	2%	12,220	3%	13,349	3%
Deferred loan costs	715	0%	944	0%	987	0%	1,018	0%	544	0%
All other loans	199	0%	171	0%	189	0%	256	0%	182	0%
Total	\$ 654,297	100%	\$ 373,336	100%	\$ 521,813	100%	\$ 475,433	100%	\$ 411,988	100%

Commercial business and commercial real estate loans averaged \$271.9 million for the year ended December 31, 2014, an increase of \$126.4 million when compared to the average of \$145.5 million for the year ended December 31, 2013. Of the increase, \$56 million reflects internal growth of the loan portfolio and \$70 million was due to the RFHB merger. Commercial business loans consist primarily of loans to small and middle market businesses and are typically working capital loans used to finance inventory, receivables or equipment needs. These loans are generally secured by business assets of the commercial borrower. The average yield on the commercial business and commercial real estate loan portfolio decreased 129 basis points to 5.85% for 2014 from 7.14% for 2013.

Construction loans averaged \$77.2 million for the year ended December 31, 2014, an increase of \$33.8 million, or 77.8%, compared to the average of \$43.4 million for the year ended December 31, 2013. Generally, these loans represent owner-occupied or investment properties and usually complement a broader commercial relationship between the Bank and the borrower. Construction loans are structured to provide for advances only after work is

completed and inspected by qualified professionals. The average yield on the construction loan portfolio increased 43 basis points to 6.78% for 2014 from 6.35% for 2013.

The Mortgage warehouse lines component of the loan portfolio increased by \$62.2 million, or 53.2%, to \$179.2 million at December 31, 2014 compared to \$117.0 million at December 31, 2013. Contrary to the expected seasonal decline in the fourth quarter of 2014, warehouse loans increased, reflecting mortgage warehouse customers' higher level of residential mortgage originations and sales activity.

The Bank's Mortgage Warehouse Funding Group offers revolving lines of credit that are available to licensed mortgage banking companies (the "Warehouse Line of Credit"). The Warehouse Line of Credit is used by the mortgage banker to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the Warehouse Line of Credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the Warehouse Funding Group are required to maintain deposit relationships with the Bank that, on average, represent 10% to 12% of the loan balances. The Bank had outstanding Warehouse Line of Credit advances of \$179.2 million at December 31, 2014 compared to \$117.0 million at December 31, 2013. During 2014 and 2013, Warehouse Lines of Credit averaged \$124.1 million and \$151.3 million, respectively, and yielded 4.50% and 4.69%, respectively. The number of active mortgage banking customers was 48 in each of 2014 and 2013.

Residential real estate loans increased \$32.7 million principally due to the merger with RFHB.

Loans to individuals are comprised primarily of home equity loans and increased \$13.4 million principally due to the merger with RFHB.

The following table provides information concerning the interest rate sensitivity of the commercial and commercial real estate loans and construction loans at December 31, 2014.

(Dollars in thousands)

Type	Within One Year	Maturity Range After One But Within Five Years (in thousands)	After Five Years	Total
Commercial Business & Commercial Real Estate	\$88,164	\$ 182,191	\$38,627	\$308,982
Construction Loans	90,012	3,217	1,398	95,627
Total	\$179,176	\$ 185,408	\$40,025	\$404,609
Fixed rate loans	\$23,357	\$ 49,876	\$33,169	\$106,402
Floating rate loans	155,819	135,532	6,856	298,207
Total	\$179,176	\$ 185,408	\$40,025	\$404,609

Non-Performing Assets

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

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

Non-performing loans decreased by \$1.5 million to \$4.8 million at December 31, 2014 from \$6.3 million at December 31, 2013. The major segment of non-accrual loans consists of commercial real estate loans which are in the process of collection. The table below sets forth non-performing assets and risk elements in the Bank's portfolio for the years indicated.

Non-Performing Assets and Loans

(Dollars in thousands)	December				
	2014	2013	31, 2012	2011	2010
Non-Performing loans:					
Loans 90 days or more past due and still accruing	\$ 317	\$ —	\$ 85	\$ —	\$ —
Non-accrual loans	4,523	6,322	5,878	2,991	8,809
Total non-performing loans	4,840	6,322	5,964	2,991	8,809
Other real estate owned	5,710	2,136	8,333	12,409	4,851
Other repossessed assets	66	-	-	-	-
Total non-performing assets	10,616	8,458	14,297	15,400	13,660
Performing troubled debt restructurings	3,925	3,859	2,012	774	-
Performing troubled debt restructurings and total non-performing assets	\$ 14,541	\$ 12,317	\$ 16,308	\$ 16,174	\$ 13,660
Non-performing loans to total loans	0.74%	1.69%	1.14%	0.63%	2.14%
Non-performing loans to total loans excluding warehouse lines	1.02%	2.47%	2.51%	1.32%	3.63%
Non-performing assets to total assets	1.11%	1.14%	1.70%	1.95%	2.12%
Non-performing assets to total assets excluding mortgage warehouse lines	1.37%	1.35%	2.57%	2.84%	2.88%
Total non-performing assets and performing troubled debt restructurings to total assets	1.52%	1.66%	1.94%	2.04%	2.12%

As the table demonstrates, non-performing loans to total loans decreased to 0.74% at December 31, 2014 from 1.69% at December 31, 2013 as loan quality continued to be considered sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Additional income before taxes amounting to \$568,000 and \$399,000 would have been recognized in 2014 and 2013, respectively, if interest on all loans had been recorded based upon original contract terms.

Non-performing assets increased by \$2.1 million to \$10.6 million at December 31, 2014 from \$8.5 million at December 31, 2013. Other real estate owned increased by \$3.6 million to \$5.7 million at December 31, 2014 from \$2.1 million at December 31, 2013. During the fourth quarter of 2014, the Bank foreclosed on its two largest non-performing loans totaling \$4.7 million and transferred \$3.9 million of real estate to OREO. The Bank is actively marketing the properties for sale. During 2014, the Bank was able to successfully dispose of a property with an aggregate carrying value of \$300,000 for a net gain of \$43,000. The Bank recorded loss provisions against other real estate owned properties of \$112,000 during 2014 and \$759,000 during 2013.

Non-performing assets represented 1.11% of total assets at December 31, 2014 compared to 1.14% at December 31, 2013.

At December 31, 2014, the Bank had ten loans totaling \$4.4 million that were troubled debt restructurings. Three of these loans totaling \$491,000 are included in the above table as non-accrual loans and the remaining seven loans totaling \$3.9 million are considered performing.

At December 31, 2013, the Bank had eight loans totaling \$4.2 million that were troubled debt restructurings. Two of these loans totaling \$373,000 are included in the above table as non-accrual loans and the remaining six loans totaling \$3.9 million are considered performing.

As provided by ASC 310-30, the excess of cash flows expected at acquisition over the initial investment in the purchase of a credit impaired loan is recognized as interest income over the life of the loan. Accordingly, RFHB loans acquired with evidence of deteriorated credit quality totaling \$1.2 million at December 31, 2014 were not classified as non-performing loans.

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

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

Allowance for Loan Losses and Related Provision

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

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

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

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements and is consistent with generally accepted accounting principles (GAAP) and interagency supervisory guidance. The allowance for loan losses methodology consists of two major components. The first component is an estimation of losses associated with individually identified impaired loans, which follows Accounting Standards Codification (ASC) Topic 310 (formerly SFAS 114). The second major component estimates losses under ASC Topic 450 (formerly SFAS 5), which provides guidance for estimating losses on groups of loans with similar risk characteristics. The Company's methodology results in an allowance for loan losses which includes a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

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

- Delinquencies and nonaccruals
- Portfolio quality
- Concentration of credit
- Trends in volume of loans
- Quality of collateral

- - Policy and procedures
- Experience, ability, and depth of management
- Economic trends – national and local
- External factors – competition, legal and regulatory

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful, and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans 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.

The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified 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 off against the allowance for loan losses.

The specific allowance for impaired loans is established for specific loans that have been identified by management as being impaired. These loans are considered to be impaired primarily because the loans have not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which 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, warehouse lines of credit and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other qualitative factor which may cause future losses to deviate from historical levels.

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

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

Commercial

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

Mortgage Warehouse Lines of Credit

The Company's Mortgage Warehouse Group provides revolving lines of credit that are available to licensed mortgage banking companies. The Warehouse Line of Credit is used by the mortgage banker to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the Warehouse Line of Credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest (the spread between our borrowing cost and the rate charged to the client) and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the Warehouse Lines of Credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 12% of the loan balances.

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

These factors, along with the other qualitative factors such as economic trends, concentrations of credit, trends in the volume of loans, portfolio quality, delinquencies and nonaccruals, are also considered and may have positive or negative effects on the allocated allowance. The aggregate amount resulting from the application of these qualitative factors determines the overall risk for the portfolio and results in an allocated allowance for warehouse lines of credit.

Consumer

The Company's loan portfolio consumer 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 historical losses. These loan groups are then internally risk rated.

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

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

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

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

Allowance for Loan Losses

(Dollars in thousands)	2014	2013	2012	2011	2010
Balance, beginning of year	\$7,039	\$7,151	\$5,534	\$5,763	\$4,505
Provision charged to operating expenses	5,750	1,077	2,150	2,558	2,325
Loans charged off:					
Construction loans	-	(562)	(57)	(2,362)	(450)
Residential real estate loans	(15)	-	(131)	-	-
Commercial and commercial real estate loans	(5,906)	(594)	(276)	(438)	(609)
Loans to individuals	(1)	(52)	(84)	-	(22)
Lease financing	-	-	-	-	-
All other loans	-	-	-	-	-
	(5,922)	(1,208)	(548)	(2,800)	(1,081)
Recoveries:					
Construction loans	-	-	3	9	-
Residential real estate loans	-	-	-	-	-
Commercial and commercial real estate loans	58	19	12	4	14
Loans to individuals	-	-	-	-	-
Lease financing	-	-	-	-	-
All other loans	-	-	-	-	-
	58	19	15	13	14
Net (charge offs)	(5,864)	(1,189)	(533)	(2,787)	(1,068)
Balance, end of year	\$6,925	\$7,039	\$7,151	\$5,534	\$5,763
Loans:					
At year end	\$654,297	\$373,336	\$521,814	\$475,432	\$411,987
Average during the year	563,379	399,462	463,587	374,685	406,228
Net charge offs to average loans outstanding	(1.04)%	(0.30)%	(0.11)%	(0.74)%	(0.26)%
Net charge-offs to average loans, excluding warehouse loans	(1.33)%	(0.48)%	(0.21)%	(1.15)%	(0.40)%
Allowance for loan losses to:					
Total loans at year end	1.06 %	1.89 %	1.37 %	1.16 %	1.40 %
Total loans at year end excluding mortgage warehouse lines and related allowance	1.27 %	2.52 %	2.41 %	1.95 %	2.06 %
Non-performing loans	143.08 %	111.34 %	119.92 %	185.01 %	65.42 %

At December 31, 2014, the allowance for loan losses was \$6.9 million compared to \$7.0 million at December 31, 2013, a decrease of \$114,000. The ratio of the allowance for loan losses to total loans at December 31, 2014 and 2013 was 1.06% and 1.89%, respectively. The allowance for loan losses as a percentage of non-performing loans was 143.08% at December 31, 2014 compared to 111.34% at December 31, 2013. Management believes that the quality of the loan portfolio remains sound, considering the economic climate and economy in the State of New Jersey, and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

The allowance for loan losses declined as a percentage of loans to 1.06% at December 31, 2014 from 1.89% at December 31, 2013 principally due to the application of the acquisition method of accounting in the merger of RFHB. The acquired loans were recorded at fair value and the \$1.7 million reserve for loan losses that had been recorded by RFHB was eliminated. The fair value adjustment included a credit risk adjustment discount of \$2.8 million, which was comprised of a non-accretive discount of \$0.8 million and an accretive general credit discount of \$2 million. At December 31, 2014, the total credit risk adjustment was approximately \$1.7 million and was comprised of a non-accretive credit discount of \$0.6 million and an accretive general credit risk fair value discount of \$1.1 million.

The following tables describe the allocation of the allowance for loan losses (“ALL”) among the various categories of loans and certain other information as of the dates indicated (in thousands). The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

(Dollars in thousands)

	December 31,																		
	2014		ALL		as a %		2013		ALL		as a %		2012		ALL		as a %		
	Amount	of	% of	Amount	of	% of	Amount	of	% of	Amount	of	% of	Amount	of	% of	Amount	of	% of	
		Loans	Loans		Loans	Loans		Loans	Loans		Loans	Loans		Loans	Loans		Loans	Loans	
Commercial and commercial real estate	\$4,154	1.34 %	47 %	\$4,294	2.38 %	48 %	\$3,235	2.01 %	31 %										
Construction loans	1,215	1.27 %	15 %	1,205	2.36 %	14 %	1,990	3.57 %	11 %										
Residential real estate loans	197	0.42 %	7 %	165	1.20 %	4 %	112	1.03 %	2 %										
Loans to individuals	131	0.57 %	3 %	111	1.14 %	3 %	105	1.07 %	2 %										
Subtotal	5,697	1.20 %	73 %	5,774	2.26 %	68 %	5,442	2.41 %	46 %										
Mortgage Warehouse lines	896	0.50 %	27 %	585	0.50 %	31 %	1,421	0.50 %	54 %										
Unallocated reserves	332	-	-	679	-	-	288	-	-										
Total	\$6,925	1.06 %	100 %	\$7,039	1.89 %	100 %	\$7,151	1.37 %	100 %										

	December 31,													
	2011		ALL		as a %		2010		ALL		as a %		of	
	Amount	of	% of	Amount	of	% of	Amount	of	% of	Amount	of	% of	Amount	of
		Loans	Loans		Loans	Loans		Loans	Loans		Loans	Loans		Loans
Commercial and commercial real estate	\$2,532	2.01 %	32 %	\$2,696	1.79 %	36 %								
Construction loans	1,055	2.14 %	10 %	1,744	2.57 %	16 %								
Residential real estate loans	91	0.71 %	3 %	68	0.65 %	3 %								
Loans to individuals	190	1.52 %	3 %	194	1.44 %	4 %								
Subtotal	3,868	1.95 %	48 %	4,702	2.06 %	59 %								
Mortgage warehouse lines	1,122	0.45 %	52 %	763	0.45 %	41 %								
Unallocated reserves	544	-	-	298	-	-								

Total	\$5,534	1.16	%	100	%	\$5,763	1.40	%	100	%
-------	---------	------	---	-----	---	---------	------	---	-----	---

The allowance for loan losses excluding the portion related to mortgage warehouse lines decreased to \$5.7 million at December 31, 2014 from \$5.8 million at December 31, 2013.

The allowance for loan losses excluding the portion related to mortgage warehouse lines increased to \$5.8 million at December 31, 2013 from \$5.4 million at December 31, 2012. This \$332,000 increase resulted from an increase of \$1.0 million in the specific allowances for loan losses on commercial real estate loans that were individually evaluated for impairment offset by a \$562,000 decrease in the specific allowance on construction loans that were charged off.

Deposits

The following table sets forth the balances and contractual rates payable to our customers, by account type, as of December 31, 2014 and 2013:

(Dollars in thousands)	December 31, 2014				December 31, 2013			
	Amount	Percent Of Total	Weighted Average Contractual Rate		Amount	Percent Of Total	Weighted Average Contractual Rate	
Non-interest bearing demand	\$ 162,281	20 %	0.34 %		\$ 121,892	19 %	0.33 %	
Interest bearing demand	297,679	37 %	0.46 %		200,738	32 %	0.47 %	
Savings	190,817	23 %	0.00 %		180,003	28 %	0.00 %	
Total core deposits	\$ 650,777	80 %	0.27 %		\$ 502,633	79 %	0.27 %	
Certificates of deposit	\$ 166,984	20 %	1.14 %		\$ 135,919	21 %	1.23 %	
Total deposits	\$ 817,761	100.00 %	0.49 %		\$ 638,552	100.00 %	0.51 %	

The following table indicates the amount of certificates of deposit by time remaining until maturity as of December 31, 2014.

(Dollars in thousands)	Maturity					Total
	3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months		
Certificates of deposit of \$100,000 or more	\$ 20,314	\$ 19,432	\$ 17,879	\$ 43,453	\$ 101,078	
Certificates of deposit less than \$100,000	14,488	10,547	13,431	27,440	65,906	
Total certificates of deposit	\$ 34,802	\$ 29,979	\$ 31,310	\$ 70,893	\$ 166,984	

The following table illustrates the components of average total deposits for the years indicated:

Average Deposit Balances

(Dollars in thousands)	2014		2013		2012	
	Average Balance	Percentage of Total	Average Balance	Percentage of Total	Average Balance	Percentage of Total
Non-interest bearing demand	\$ 159,935	20 %	\$ 137,873	20 %	\$ 127,558	19 %

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Interest bearing demand	286,235	35	%	222,581	32	%	203,419	30	%
Savings	199,078	24	%	198,169	29	%	192,959	29	%
Certificates of deposit of \$100,000 or more	98,891	12	%	71,616	9	%	76,526	11	%
Other certificates of deposit less than \$100,000	70,574	9	%	68,741	10	%	70,101	11	%
Total	\$814,713	100	%	\$698,980	100	%	\$670,563	100	%

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings deposits and certificates of deposit, are a fundamental and cost-effective source of funding. The flow of deposits is influenced significantly by general economic conditions, changes in market interest rates and competition. The Bank offers a variety of products designed to attract and retain customers, with the Bank's primary focus on the building and expanding of long-term relationships. Deposits for the year ended December 31, 2014 averaged \$814.7 million, an increase of \$115.7 million, or 16.6%, compared to \$699.0 million for the year ended December 31, 2013. At December 31, 2014, total deposits were \$817.8 million, an increase of \$179.2 million, or 28.1%, from \$638.6 million at December 31, 2013. The increase in total deposits and average deposits in 2014 was due principally to RFHB retained deposits of \$177 million. The average rate paid on the Bank's interest-bearing deposit balances for 2014 was 0.58%, a decrease from the 0.62% average rate for 2013.

Average non-interest bearing demand deposits increased by \$22.1 million, or 16.0%, to \$159.9 million for the year ended December 31, 2014 from \$137.9 million for the year ended December 31, 2013. At December 31, 2014, non-interest bearing demand deposits totaled \$162.3 million, an increase of 33.1% when compared to \$121.9 million at December 31, 2013. Non-interest bearing demand deposits made up 19.8% and 19.1%, respectively, of total deposits at December 31, 2014 and 2013, and represent a stable, interest-free source of funds.

Savings accounts increased by \$10.8 million, or 6.0%, to \$190.8 million at December 31, 2014 from \$180.0 million at December 31, 2013. In 2014, the average balance of savings accounts increased by \$909,000 to \$199.1 million compared to an average balance of \$198.2 million in 2013.

Interest bearing demand deposits, which include interest-bearing checking accounts, money market accounts and the Bank's premier money market product, 1st Choice account, increased by \$63.7 million, or 28.6%, to an average of \$286.2 million for 2014 from an average of \$222.6 million for 2013. The average cost of interest bearing demand deposits decreased one basis point to 0.33% for 2014 compared to 0.34% for 2013.

Certificates of deposit consist primarily of retail certificates of deposit and certificates of deposit with balances of \$100,000 or more. Certificates of deposit at December 31, 2014 were \$167.0 million, an increase of \$31 million from \$136.0 million at December 31, 2013. Retail certificates of deposit increased by \$1.8 million, or 2.7%, to an average of \$70.6 million for 2014 from an average of \$68.7 million for 2013. The average cost of these deposits increased to 1.29% for 2014 from 1.25% for 2013.

Borrowings

Borrowings are mainly comprised of Federal Home Loan Bank ("FHLB") borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The average balance of other borrowed funds increased by \$13.4 million to \$23.7 million for the year ended December 31, 2014 from an average balance of \$10.3 million for the year ended December 31, 2013. The average cost of other borrowed funds decreased 186 basis points to 2.18% for 2014 compared to 4.04% for 2013.

The balance of borrowings was \$25.1 million at December 31, 2014, which consisted of long-term FHLB advances of \$20.7 million and FHLB overnight funds purchased in the amount of \$4.4 million. The increase in long-term FHLB advances of \$10.7 million in 2014 was due to the assumption of \$10 million of FHLB advances in the RFHB merger. The balance of borrowings was \$10.0 million at December 31, 2013, consisting of a long-term FHLB advance of \$10 million.

Shareholders' Equity and Dividends

Shareholders' equity increased by \$18.7 million, or 27.4%, to \$87.1 million at December 31, 2014 from \$68.4 million at December 31, 2013. Tangible book value per common share was \$10.29 at December 31, 2014 compared to \$10.55 at December 31, 2013. The ratio of average shareholders' equity to total average assets was 8.62%, 8.26% and 7.57% for 2014, 2013, and 2012, respectively. The increase in shareholders' equity from December 31, 2013 to December 31, 2014 was primarily the result of net income of \$4.4 million for 2014, an increase of \$11.1 million in common stock issued in connection with the RFHB merger and an increase of \$2.5 million in other comprehensive income.

The Federal Reserve Board has issued a supervisory letter to bank holding companies that contains guidance on when the board of directors of a bank holding company should eliminate or defer or severely limit dividends, including, for example, when net income available for shareholders for the past four quarters net of dividends paid during that period is not sufficient to fully fund the dividends. The letter also contains guidance on the redemption of stock by bank holding companies which urges bank holding companies to advise the Federal Reserve of any such redemption or repurchase of common stock for cash or other value which results in the net reduction of a bank holding company's capital at the beginning of the quarter below the capital outstanding at the end of the quarter.

In lieu of cash dividends, the Company (and its predecessor, the Bank) declared a stock dividend every year for the years 1992 through 2012 and paid such dividends every year for the years 1993 through 2013. The Company did not declare a stock dividend in 2014 or 2013.

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

The Company and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board and the Federal Deposit Insurance Corporation. For information on regulatory capital, see "Capital Adequacy" in the "Supervision and Regulation" section under Item 1. "Business" and Note 19 of the Notes to Consolidated Financial Statements.

The Company believes that its shareholders' equity and regulatory capital position are adequate to support the planned operations of the company for the foreseeable future.

Off-Balance Sheet Arrangements and Contractual Obligations

The following table shows the amounts and expected maturities of significant commitments as of December 31, 2014. Further discussion of these commitments is included in Note 17 of the Notes to Consolidated Financial Statements.

(Dollars in thousands)

	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Off Balance Sheet:					
Standby letters of credit	\$2,649	\$ -	\$ -	\$ -	\$2,649
Commitments to extend credit	\$297,105	\$ -	\$ -	\$ -	\$297,105
Commitments to sell residential loans	\$28,198	\$ -	\$ -	\$ -	\$28,198
Total off balance sheet:	\$327,952	\$ -	\$ -	\$ -	\$327,952
Contractual Obligations:					
Operating Leases	\$1,265	\$2,245	\$1,486	\$2,409	\$7,405
Borrowed funds and subordinated Debentures	4,400	20,707	-	18,557	43,664
Certificates of deposit	\$96,091	53,853	17,040	-	166,984
Retirement benefit obligation	731	5,021			5,752
Total contractual obligations:	\$102,487	81,826	18,526	20,966	223,805
Total	\$430,439	\$81,826	\$18,526	\$20,966	\$551,757

Liquidity

At December 31, 2014, the amount of liquid assets held by the Company remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of its customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, deposits at the Federal Reserve Bank, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB which further supports and enhances liquidity. During 2010, FHLB replaced its Overnight Line of Credit and One-Month Overnight Repricing Line of Credit facilities available to member banks with a fully secured line of up to 50 percent of a bank's quarter-end total assets. Under the terms of this facility, the Bank's total credit exposure to FHLB cannot exceed 50 percent, or \$478.4 million, of its total assets at December 31, 2014. In addition, the aggregate outstanding principal amount of the Bank's advances, letters of credit, the dollar amount of the FHLB's minimum collateral requirement for off balance sheet financial contracts and advance commitments cannot exceed 30 percent of the Bank's total assets, unless the Bank obtains approval from FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member bank's ability to provide eligible collateral to support its obligations to FHLB as well as a member bank's ability to meet the FHLB's stock requirement. At December 31, 2014 and 2013, the Bank had collateral at FHLB-NY to support additional borrowing of \$108.2 million and \$76.3 million, respectively. The Bank also maintains an unsecured federal funds line of \$25.0 million with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At December 31, 2014, the balance of cash and cash equivalents was \$14.5 million.

Net cash provided by operating activities totaled \$16.4 million for the year ended December 31, 2014 compared to net cash provided by operating activities of \$36.5 million for the year ended December 31, 2013. The primary source of funds was net income from operations, adjusted for activity related to loans originated for sale, the provision for loan losses, depreciation expense and net amortization of premiums on securities. Cash was used in operations primarily for originating loans held for sale. The decline in net cash provided by operating activities was due to a lower net amount of cash generated from the origination and sale of loans held for sale.

Net cash used in investing activities totaled \$65.7 million for the year ended December 31, 2014 compared to net cash provided by investing activities of \$119.8 million for the year ended December 31, 2013. The increase in net cash used in investing activities for 2014 as compared to 2013 resulted from an increase in loans during 2014.

Net cash used in financing activities totaled \$5.5 million for the year ended December 31, 2014 compared to net cash used in financing activities of \$101.0 million for the year ended December 31, 2013. The net cash used in financing activities in 2014 came primarily from the net decrease in deposits, which was partially offset by an increase in borrowings. The net cash used in financing activities in 2013 came primarily from the net decrease in deposits and repayment of borrowings.

The securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the year ended December 31, 2014, repayments and maturities of investment securities totaled \$50.8 million. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

The Company believes that its liquidity position is adequate to service the needs of its borrowers and depositors and provide for its planned operations.

Interest Rate Sensitivity Analysis

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

The following table sets forth certain information relating to the Bank's financial instruments that are sensitive to changes in interest rates, categorized by expected maturity or repricing of such instruments at December 31, 2014.

Interest Rate Sensitivity Analysis at December 31, 2014

(\$ in millions)	Interest Sensitivity Period				Total Within One Year	One Year to Five Years	Over Five Years	Non-interest Sensitive	Total
	30 Day	90 Day	180 Day	365 Day					
Assets :									
Cash and due from banks	\$7	-	-	-	\$7	-	-	\$8	\$15
Federal funds sold	-	-	-	-	-	-	-	-	-
Investment securities	9	13	18	16	56	80	88	-	224
Loans held for sale	8	-	-	-	8	-	-	-	8
Loans, net of allowance for loan losses	366	20	21	35	442	189	23	(7)	647
Other assets	-	-	-	-	-	-	-	63	63
	\$390	\$33	\$39	\$51	\$513	\$269	\$111	\$64	\$957
Sources of Funds :									
Demand deposits - noninterest bearing	-	-	-	-	-	-	-	\$162	\$162
Demand deposits - interest bearing	128	-	-	-	128	138	32	-	298
Savings deposits	104	-	-	-	104	49	38	-	191
Time deposits	8	27	30	31	96	71	-	-	167
Borrowings	4	-	-	-	4	21	-	-	25
Redeemable subordinated debentures	-	19	-	-	19	-	-	-	19
Non-interest-bearing sources	-	-	-	-	-	-	-	95	95
	\$244	\$46	\$30	\$31	\$351	\$279	\$70	\$257	\$957
Asset (Liability) Sensitivity Gap :									
Period Gap	\$146	\$(13)	\$9	\$20	\$162	\$(10)	\$41	\$(193)	-
Cumulative Gap	\$146	\$133	\$142	\$162	\$162	\$152	\$193	-	-
Cumulative Gap to Total Assets	15.3 %	13.9 %	14.8 %	16.9 %	16.9 %	15.9 %	-	-	-

Under the Company's interest rate risk policy established by the Board of Directors, quantitative guidelines have been established with respect to the Company's interest rate risk and how interest rate shocks are projected to affect the Company's net interest income and economic value of equity ("EVE"). The Company engages the services of an outside consultant to assist with the measurement and analysis of interest rate risk. The Company uses a combination of analyses to monitor its exposure to changes in interest rates. The EVE analysis is a financial model that estimates the change in EVE over a range of instantaneously shocked interest rate scenarios. EVE is the discounted present value of expected cash flows from assets, liabilities, and off-balance sheet contracts. In calculating changes in EVE, assumptions estimating loan prepayment rates, reinvestment rates and deposit decay rates that seem most likely based on historical experience during prior interest rate changes are employed. The net interest income simulation uses data derived from an asset and liability analysis and applies several elements, including actual interest rate indices and margins, contractual limitations and the U.S. Treasury yield curve as of the balance sheet date. The financial model uses immediate parallel yield curve shocks (in both directions) to determine possible changes in net interest income, if the theoretical rate shocks occurred. The EVE analysis and net interest income simulation model results are presented to the Asset/Liability Committee of the Board quarterly.

Summarized below are the projected effects of a parallel shift of an increase of 200 and 300 basis points, respectively, in market rates on the Company's net interest income and EVE.

Change in Interest Rates Basis Point (bp) (1)	Economic Value of Equity (2)				Next 12 Months Net Interest Income	
	Dollar	Dollar	Percentage	Dollar	Dollar	Percentage
	Amount	Change	Change (Dollars in Thousands)	Amount	Change	Change
+300 bp	\$ 119,426	\$ 0	0.00%	\$ 39,274	\$ 2,854	7.80%
+200 bp	119,723	295	0.25%	38,019	1,599	4.40%
0 bp	119,428	—	—	36,420	—	—

(1) Assumes an instantaneous and parallel shift in interest rates at all maturities.

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

The table above indicates at December 31, 2014, in the event of a 200 basis point increase in interest rates, the Company would be expected to experience a 0.25% increase in EVE and a \$1.6 million, or 4.40%, increase in net interest income over the next twelve months. This data does not reflect any future actions management may take in response to changes in interest rates, such as changing the mix of assets and liabilities, which could change the results of the EVE and net interest income calculations.

Certain shortcomings are inherent in any methodology used in the above interest rate risk measurements. Modeling changes in EVE and net interest income require certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the estimated EVE and net interest income presented above assumes that composition of the Company's interest-rate sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and, accordingly, the data does not reflect any actions the Company may take in response to changes in interest rates. The estimates also assume a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or the repricing characteristics of specific assets and liabilities. Although the estimated EVE and net interest income provide an indication of the Company's sensitivity to interest rate changes at a particular point in time, such measurement is not intended to and does not provide a precise forecast of the effects of changes in market interest rates on the Company's EVE and net interest income and will differ from actual results.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

Item 8. Financial Statements and Supplementary Data.

Reference is made to Item 15(a) (1) and (2) on page F-1 for a list of financial statements and supplementary data required to be filed pursuant to this Item 8. The information required by this Item 8 is provided beginning on page F-1 hereof.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

As previously disclosed by the Company in a Current Report on Form 8-K filed on July 2, 2013 with the SEC, on June 28, 2013 (the “Notification Date”), the Company, after review and recommendation of the Audit Committee of the Company’s Board of Directors, appointed BDO USA, LLP (“BDO”) as the Company’s new independent registered public accounting firm for and with respect to the year ended December 31, 2013, and dismissed ParenteBeard LLC (“ParenteBeard”) from that role. The Company’s principal audit personnel at ParenteBeard had resigned from ParenteBeard and joined BDO.

During the two years ended December 31, 2012, and from December 31, 2012 through the Notification Date, there were (i) no disagreements with ParenteBeard on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of ParenteBeard, would have caused it to make reference to the subject matter of the disagreements in its reports on the consolidated financial statements of the Company; and (ii) no “reportable events” (as such term is defined in Item 304(a)(1)(v) of Regulation S-K).

From the Notification Date through December 31, 2013 and for the year ended December 31, 2014, there were (i) no disagreements with BDO on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of BDO, would have caused it to make reference to the subject matter of the disagreements in its reports on the consolidated financial statements of the Company; and (ii) no “reportable events” (as such term is defined in Item 304(a)(1)(v) of Regulation S-K).

Item 9A. Controls and Procedures.

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

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

Management’s Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company’s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

The Company’s internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the receipts and expenditures of the Company are being made only in accordance with authorizations of its management and directors; and
-

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on its financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a control deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness; yet important enough to merit attention by those responsible for oversight of the Company's financial reporting.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2014. In making this assessment, management used the criteria set forth in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on their assessment using those criteria, management concluded that, as of December 31, 2014, the Company's internal control over financial reporting was effective.

The Company plans to adopt the Internal Control-Integrated Framework updated in 2013 by COSO for the purpose of assessing the effectiveness of the Company's internal control over financial reporting in 2015.

The Company's principal executive officer and principal financial officer have also concluded that there was no change in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to the exemption provided to issuers that are not "large accelerated filers" or "accelerated filers."

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this item is incorporated by reference to the Company's Proxy Statement for its 2015 Annual Meeting of Shareholders under the captions "Directors and Executive Officers," "Corporate Governance" and "Stock Ownership of Management and Principal Shareholders."

Item 11. Executive Compensation.

The information required by this item is incorporated by reference to the Company's Proxy Statement for its 2015 Annual Meeting of Shareholders under the caption "Executive Compensation" and "Director Compensation."

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters.

The information required by this item is incorporated by reference from the Company's Proxy Statement for its 2015 Annual Meeting of Shareholders under the captions "Equity Plans" and "Stock Ownership of Management and Principal Shareholders."

Item 13. Certain Relationships and Related Transactions, and Director Independence.

This information required by this item is incorporated by reference from the Company's Proxy Statement for its 2015 Annual Meeting of Shareholders under the captions "Certain Transactions With Management" and "Corporate Governance."

Item 14. Principal Accounting Fees and Services.

The information required by this item is incorporated by reference to the Company's Proxy Statement for its 2015 Annual Meeting of Shareholders under the caption "Principal Accounting Fees and Services."

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Financial Statements and Financial Statement Schedules

The following documents are filed as part of this Annual Report on Form 10-K:

Financial Statements of 1st Constitution Bancorp.

Consolidated Balance Sheets – December 31, 2014 and 2013.

Consolidated Statements of Income – For the Years Ended December 31, 2014 and 2013.

Consolidated Statements of Comprehensive Income – For the Years Ended December 31, 2014 and 2013

Consolidated Statements of Changes in Shareholders' Equity – For the Years Ended December 31, 2014 and 2013.

Consolidated Statements of Cash Flows – For the Years Ended December 31, 2014 and 2013.

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

These statements are incorporated by reference to the Company's Annual Report to Shareholders for the year ended December 31, 2014.

2. All schedules are omitted because they are either inapplicable or not required, or because the information required therein is included in the Consolidated Financial Statements and Notes thereto.

3. Exhibits

Exhibit No.	Description
3 (i)(A)	Certificate of Incorporation of the Company (conformed copy) (incorporated by reference to Exhibit 3(i)(A) to the Company's Form 10-K (SEC File No. 000-32891) filed with the SEC on March 27, 2009)
3 (i)(B)	Certificate of Amendment to the Certificate of Incorporation increasing the number of shares designated as Series A Junior Participating Preferred Stock (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on December 23, 2008)
3 (i)(C)	Certificate of Amendment to the Certificate of Incorporation establishing the terms of the Fixed Rate Cumulative Perpetual Preferred Stock, Series B (incorporated by reference to Exhibit 3.2 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on December 23, 2008)
3 (ii)(A)	

By-laws, as amended, of the Company (conformed copy) (incorporated by reference to Exhibit 3(ii)(A) to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on October 22, 2007)

- 4.1 Specimen Share of Common Stock (incorporated by reference to Exhibit 4.1 to the Company's Form 10-KSB (SEC File No. 000-32891) filed with the SEC on March 22, 2002)
- 4.3 Subscription Agent Agreement, dated as of September 5, 2012, between the Company and Registrar and Transfer Company (incorporated by reference to Exhibit 4.4 to the Company's Current Report on Form 8-K filed with the SEC on September 6, 2012)

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Exhibit No.	Description
4.4	Warrant, dated November 23, 2011, to purchase shares of the Company's common stock (incorporated by reference to Exhibit 4.5 to the Company's Form 10-K filed with the SEC on March 22, 2013)
4.5	Warrant, dated November 23, 2011, to purchase shares of the Company's common stock (incorporated by reference to Exhibit 4.6 to the Company's Form 10-K filed with the SEC on March 22, 2013)
10.1	# 1st Constitution Bancorp Supplemental Executive Retirement Plan, dated as of October 1, 2002 (incorporated by reference to Exhibit 10.1 to the Company's Form 10-QSB (SEC File No. 000-32891) filed with the SEC on November 13, 2002)
10.2	# Amended and Restated 1st Constitution Bancorp Directors' Insurance Plan, effective as of June 16, 2005 (incorporated by reference to Exhibit No. 10 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on March 24, 2006)
10.3	# 1st Constitution Bancorp Form of Executive Life Insurance Agreement (incorporated by reference to Exhibit 10.4 to the Company's Form 10-QSB (SEC File No. 000-32891) filed with the SEC on November 13, 2002)
10.4	# 2000 Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit No. 6.3 to the Company's Form 10-SB (SEC File No. 000-32891) filed with the SEC on June 15, 2001)
10.5	# Directors Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit No. 6.4 to the Company's Form 10-SB (SEC File No. 000-32891) filed with the SEC on June 15, 2001)
10.6	# Amendment No. 1 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective January 1, 2004 (incorporated by reference to Exhibit 10.12 to the Company's Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 11, 2004)
10.7	# Change of Control Agreement, effective as of April 1, 2004, by and between the Company and Joseph M. Reardon (incorporated by reference to Exhibit 10.13 to the Company's Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 11, 2004)
10.8	# Form of Stock Option Agreement under the 1st Constitution Bancorp Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit 10.14 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on December 22, 2004)
10.9	# Form of Restricted Stock Agreement under the 1st Constitution Bancorp Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit 10.15 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on December 22, 2004)
10.10	# The 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Appendix A of the Company's proxy statement (SEC File No. 000-32891) filed with the SEC on April 15, 2005)

- 10.11 # Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.18 to the Company's Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 8, 2005)
- 10.12 # Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.19 to the Company's Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 8, 2005)
- 10.13 # Form of Incentive Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.20 to the Company's Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 8, 2005)
- 10.14 # 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on May 19, 2006)
- 10.15 # Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on May 19, 2006)
- 10.16 # Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on May 19, 2006)
- 10.17 Amended and Restated Declaration of Trust of 1st Constitution Capital Trust II, dated as of June 15, 2006, among 1st Constitution Bancorp, as sponsor, the Delaware and institutional trustee named therein, and the administrators named therein (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on June 16, 2006)
- 10.18 Indenture, dated as of June 15, 2006, between 1st Constitution Bancorp, as issuer, and the trustee named therein, relating to the Floating Rate Junior Subordinated Debt Securities due 2036 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on June 16, 2006)
- 10.19 Guarantee Agreement, dated as of June 15, 2006, between 1st Constitution Bancorp and the guarantee trustee named therein (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on June 16, 2006)
- 10.20 # Amendment No. 2 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective as of December 31, 2004 (incorporated by reference to Exhibit 10.24 to the Company's Form 10-K (SEC File No. 000-32891) filed with the SEC on April 15, 2008)
- 10.21 # 1st Constitution Bancorp 2005 Supplemental Executive Retirement Plan, effective as of January 1, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on December 28, 2006)
- 10.22 # Amended and Restated Employment Agreement between the Company and Robert F. Mangano dated as of July 1, 2010 (incorporated by reference to Exhibit 10 to the Company's Form 8-K filed with the SEC on July 14, 2010)

10.23	#	1st Constitution Bancorp 2013 Equity Incentive Plan (incorporated by reference to the Company's proxy statement filed with the SEC on April 11, 2013)
10.24		Agreement and Plan of Merger, dated as of August 14, 2013, by and between the Company, 1st Constitution Bank and Rumson-Fair Haven Bank & Trust Company (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed with the SEC on August 15, 2013).
10.25		First Amendment to Agreement and Plan of Merger, dated September 19, 2013, by and among the Company, 1st Constitution Bank and Rumson-Fair Haven Bank & Trust Company (incorporated by reference to Exhibit 2.2 to the Company's Form 10-Q filed with the SEC on November 12, 2013).
10.26	#	Letter Agreement, dated January 31, 2014, between 1st Constitution Bank and Stephen J. Gilhooly (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on April 1, 2014)
10.27	#	Amendment to the Amended and Restated Employment Agreement, dated April 4, 2014, between 1st Constitution Bancorp and Robert F. Mangano (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on April 8, 2014)
21	*	Subsidiaries of the Company
23.1	*	Consent of BDO USA, LLP as Independent Registered Public Accounting Firm
31.1	*	Certification of the principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
31.2	*	Certification of the principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
32	*	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by the principal executive officer and the principal financial officer of the Company
101.INS	*	XBRL Instance Document
101.SCH	*	XBRL Taxonomy Extension Schema Document
101.CAL	*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	*	XBRL Taxonomy Extension Presentation Linkbase Document

- * Filed herewith.
- # Management contract or compensatory plan or arrangement.

(b) Exhibits.

Exhibits required by Section 601 of Regulation S-K (see (a) above)

(c) Financial Statement Schedules

See the notes to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

58

1st CONSTITUTION BANCORP

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets – December 31, 2014 and 2013</u>	F-3
<u>Consolidated Statements of Income – For the Years Ended December 31, 2014 and 2013</u>	F-4
<u>Consolidated Statements of Comprehensive Income – For the Years Ended December 31, 2014 and 2013</u>	F-5
<u>Consolidated Statements of Changes in Shareholders' Equity – For the Years Ended December 31, 2014 and 2013</u>	F-6
<u>Consolidated Statements of Cash Flows – For the Years Ended December 31, 2014 and 2013</u>	F-7
<u>Notes to Consolidated Financial Statements</u>	F-8

F-1

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
1st Constitution Bancorp
Cranbury, New Jersey

We have audited the accompanying consolidated balance sheets of 1st Constitution Bancorp (the “Company”) and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders’ equity and cash flows for the years then ended. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of 1st Constitution Bancorp as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania
March 25, 2015

1st CONSTITUTION BANCORP
CONSOLIDATED BALANCE SHEETS
December 31, 2014 and 2013
(Dollars in Thousands, except share data)

	2014	2013
ASSETS		
CASH AND DUE FROM BANKS	\$ 14,545	\$ 69,267
FEDERAL FUNDS SOLD / SHORT TERM INVESTMENTS	-	11
Total cash and cash equivalents	14,545	69,278
INVESTMENT SECURITIES		
Investment securities available for sale, at fair value	80,161	99,199
Investment securities held to maturity (fair value of \$148,476 and \$153,631 at December 31, 2014 and 2013, respectively)	143,638	152,817
Total securities	223,799	252,016
LOANS HELD FOR SALE		
	8,372	10,924
LOANS		
Less- Allowance for loan losses	(6,925)	(7,039)
Net loans	647,372	366,297
PREMISES AND EQUIPMENT, net	11,373	10,044
ACCRUED INTEREST RECEIVABLE	3,096	2,543
BANK-OWNED LIFE INSURANCE	21,218	16,184
OTHER REAL ESTATE OWNED	5,710	2,136
GOODWILL AND INTANGIBLE ASSETS	13,711	4,889
OTHER ASSETS		
Total assets	\$ 956,779	\$ 742,325
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits		
Non-interest bearing	\$ 162,281	\$ 121,892
Interest bearing	655,480	516,660
Total deposits	817,761	638,552
BORROWINGS		
REDEEMABLE SUBORDINATED DEBENTURES	25,107	10,000
	18,557	18,557

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

ACCRUED INTEREST PAYABLE	907	884
ACCRUED EXPENSES AND OTHER LIABILITIES	7,337	5,975
Total liabilities	869,669	673,968
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; 7,165,084 and 6,033,683 shares issued and 7,134,174 and 6,016,845 shares outstanding as of December 31, 2014 and 2013, respectively	61,448	49,403
Retained earnings	25,730	21,374
Treasury Stock 30,910 shares and, 16,838 shares at December 31, 2014 and 2013, respectively	(316)	(172)
Accumulated other comprehensive income (loss)	248	(2,248)
Total shareholders' equity	87,110	68,357
Total liabilities and shareholders' equity	\$ 956,779	\$ 742,325

The accompanying notes are an integral part of these financial statements

1st CONSTITUTION BANCORP
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2014 and 2013
(Dollars in thousands, except per share data)

	2014	2013
INTEREST INCOME:		
Loans, including fees	\$30,879	\$22,568
Securities:		
Taxable	4,022	3,915
Tax-exempt	2,310	2,209
Federal funds sold and short-term investments	150	300
Total interest income	37,361	28,992
INTEREST EXPENSE:		
Deposits	3,798	3,488
Borrowings	516	415
Redeemable subordinated debentures	344	352
Total interest expense	4,658	4,255
Net interest income	32,703	24,737
PROVISION FOR LOAN LOSSES	5,750	1,077
Net interest income after provision for loan losses	26,953	23,660
NON-INTEREST INCOME:		
Service charges on deposit accounts	988	920
Loss on sales of securities available for sale	(1)	-
Gain on sales of loans	2,052	2,064
Income on Bank-owned life insurance	564	457
Other income	2,160	2,386
Total other income	5,763	5,827
NON-INTEREST EXPENSES:		
Salaries and employee benefits	15,066	12,709
Occupancy expense	3,355	2,575
Data processing expenses	1,264	1,112
FDIC insurance expense	715	346
Other real estate owned expenses	236	353
Merger-related expenses	1,532	326
Other operating expenses	5,119	4,001
Total other expenses	27,287	21,422
Income before income taxes	5,429	8,065
INCOME TAXES	1,073	2,285

Net income	\$4,356	\$5,780
NET INCOME PER COMMON SHARE		
Basic	\$0.62	\$0.97
Diluted	\$0.61	\$0.95
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	7,016,148	5,973,323
Diluted	7,146,654	6,102,043

The accompanying notes are an integral part of these financial statements

1st Constitution Bancorp
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2014 and 2013
(Dollars in thousands)

	2014	2013
Net income	\$4,356	\$5,780
Other comprehensive (loss) income, net of tax		
Unrealized gains (losses) on securities available for sale	3,418	(4,800)
Tax effect	(1,210)	1,632
Net of tax amount	2,208	(3,168)
Reclassification adjustment for realized loss included in income (1)	1	-
Tax effect (2)	-	-
Net of tax amount	1	-
Pension liability	488	453
Tax effect	(195)	(181)
Net of tax amount	293	272
Reclassification adjustment for actuarial gains included in income (3)	(10)	(260)
Tax effect (2)	4	104
Net of tax amount	(6)	(156)
Total other comprehensive income (loss)	2,496	(3,052)
Comprehensive income	\$6,852	\$2,728

(1) Included in loss on sales of securities available for sale

(2) Included in income taxes

(3) Included in salaries and benefits expense

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

1st CONSTITUTION BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2014 and 2013
(Dollars in thousands)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
BALANCE, January 1, 2013	\$48,716	\$15,594	\$(61)	\$ 804	\$ 65,053
Exercise of stock options, and issuance of vested shares under employee benefit programs (45,093 shares)	603				603
Share-based compensation	84				84
Treasury Stock purchased (9,837 shares)			(111)		(111)
Net Income for the year ended December 31, 2013		5,780			5,780
Other comprehensive (loss)				(3,052)	(3,052)
BALANCE, December 31, 2013	\$49,403	\$21,374	\$(172)	\$ (2,248)	\$ 68,357