

PEAPACK GLADSTONE FINANCIAL CORP  
Form 10-Q  
November 09, 2011

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

FORM 10-Q

(MARK ONE)

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

For the Quarter Ended September 30, 2011

OR

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

For the transition period from to

Commission File No. 001-16197

PEAPACK-GLADSTONE FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

New Jersey  
(State or other jurisdiction of  
incorporation or organization)

22-3537895  
(I.R.S. Employer  
Identification No.)

500 Hills Drive, Suite 300  
Bedminster, New Jersey 07921-1538  
(Address of principal executive offices, including zip code)

(908) 234-0700  
(Registrant's telephone number, including area code)

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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 Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. 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  Accelerated filer   
Non-accelerated filer (do not check if a smaller reporting company)  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 .

Number of shares of Common Stock outstanding as of November 1, 2011:  
8,829,729

PEAPACK-GLADSTONE FINANCIAL CORPORATION  
PART 1 FINANCIAL INFORMATION

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## Item 1. Financial Statements (Unaudited)

PEAPACK-GLADSTONE FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CONDITION  
(Dollars in thousands)  
(Unaudited)

|   | September 30,<br>2011 | December 31,<br>2010 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Cash and due from banks   | \$ 8,135              | \$ 6,490             |
| Federal funds sold  | 100                   | 100                  |
| Interest-earning deposits   | 66,424                | 56,097               |
| Total cash and cash equivalents   | 74,659                | 62,687               |
| Investment securities held to maturity (approximate fair value \$121,725 in 2011 and \$138,438 in 2010) | 121,241               | 140,277              |
| Securities available for sale   | 311,927               | 275,076              |
| FHLB and FRB Stock, at cost   | 4,699                 | 4,624                |
| Loans Held for Sale, at fair value  | 722                   | -                    |
| Loans   | 973,193               | 932,497              |
| Less: Allowance for loan losses   | 13,843                | 14,282               |
| Net Loans   | 959,350               | 918,215              |
| Premises and equipment  | 32,497                | 33,820               |
| Other real estate owned   | 3,264                 | 4,000                |
| Accrued interest receivable   | 3,788                 | 4,231                |
| Bank owned life insurance   | 27,767                | 27,074               |
| Deferred tax assets, net  | 27,543                | 25,725               |
| Other assets  | 7,831                 | 9,696                |
| <b>TOTAL ASSETS</b>   | <b>\$ 1,575,288</b>   | <b>\$ 1,505,425</b>  |
| <b>LIABILITIES</b>  |                       |                      |
| Deposits:   |                       |                      |
| Noninterest-bearing demand deposits   | \$ 254,646            | \$ 228,764           |
| Interest-bearing deposits:  |                       |                      |
| Checking  | 337,900               | 290,322              |
| Savings   | 89,527                | 80,799               |
| Money market accounts   | 511,059               | 524,449              |
| Certificates of deposit \$100,000 and over  | 76,100                | 79,311               |
| Certificates of deposit less than \$100,000   | 127,778               | 147,901              |
| Total deposits  | 1,397,010             | 1,351,546            |
| Federal Home Loan Bank advances   | 20,793                | 24,126               |
| Capital lease obligation  | 6,396                 | 6,304                |
| Accrued expenses and other liabilities  | 30,406                | 5,733                |
| <b>TOTAL LIABILITIES</b>  | <b>1,454,605</b>      | <b>1,387,709</b>     |

**SHAREHOLDERS' EQUITY**

|   |                     |                     |
|---|---------------------|---------------------|
| Preferred stock (no par value; authorized 500,000 shares; issued 14,341 shares at September 30, 2011 and 21,513 at December 31, 2010; liquidation preference of \$1,000 per share)  | 13,938              | 20,746              |
| Common stock (no par value; \$0.83 per share; authorized 21,000,000 shares; issued shares, 9,237,907 at September 30, 2011 and 9,199,038 at December 31, 2010; outstanding shares 8,829,729 at September 30, 2011 and 8,790,860 at December 31, 2010) | 7,682               | 7,650               |
| Surplus   | 96,140              | 95,586              |
| Treasury stock at cost, 408,178 shares at September 30, 2011 and at December 31, 2010   | (8,988 )            | (8,988 )            |
| Retained earnings   | 12,002              | 4,693               |
| Accumulated other comprehensive loss, net of income tax   | (91 )               | (1,971 )            |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>   | <b>120,683</b>      | <b>117,716</b>      |
| <b>TOTAL LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>   | <b>\$ 1,575,288</b> | <b>\$ 1,505,425</b> |

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME  
(Dollars in thousands, except share data)  
(Unaudited)

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2011                                | 2010      | 2011                               | 2010      |
| <b>INTEREST INCOME</b>                                      |                                     |           |                                    |           |
| Interest and fees on loans                                  | \$ 11,563                           | \$ 12,455 | \$ 34,948                          | \$ 38,186 |
| Interest on investment securities:                          |                                     |           |                                    |           |
| Taxable   | 418                                 | 482       | 1,635                              | 1,538     |
| Tax-exempt  | 90                                  | 103       | 274                                | 367       |
| Interest on securities available for sale:                  |                                     |           |                                    |           |
| Taxable   | 1,344                               | 1,748     | 4,605                              | 5,607     |
| Tax-exempt  | 124                                 | 136       | 364                                | 415       |
| Interest on loans held for sale                             | 12                                  | -         | 33                                 | -         |
| Interest-earning deposits                                   | 43                                  | 50        | 91                                 | 102       |
| Total interest income                                       | 13,594                              | 14,974    | 41,950                             | 46,215    |
| <b>INTEREST EXPENSE</b>                                     |                                     |           |                                    |           |
| Interest on savings and interest-bearing deposit accounts   |                                     |           |                                    |           |
|   | 758                                 | 1,326     | 2,662                              | 4,446     |
| Interest on certificates of deposit over \$100,000          | 262                                 | 374       | 815                                | 1,298     |
| Interest on other time deposits                             | 422                                 | 612       | 1,357                              | 2,108     |
| Interest on borrowed funds                                  | 177                                 | 223       | 578                                | 838       |
| Interest on capital lease obligation                        | 80                                  | 77        | 239                                | 128       |
| Total interest expense                                      | 1,699                               | 2,612     | 5,651                              | 8,818     |
| <b>NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES</b> |                                     |           |                                    |           |
| Provision for loan losses                                   | 1,500                               | 2,000     | 5,500                              | 7,150     |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>  |                                     |           |                                    |           |
|   | 10,395                              | 10,362    | 30,799                             | 30,247    |
| <b>OTHER INCOME</b>   |                                     |           |                                    |           |
| Trust department income                                     | 2,555                               | 2,254     | 8,102                              | 7,303     |
| Service charges and fees                                    | 747                                 | 709       | 2,205                              | 2,057     |
| Bank owned life insurance                                   | 257                                 | 228       | 769                                | 644       |
| Securities gains/(losses), net                              | 248                                 | 126       | 721                                | 128       |
| Other-than-temporary impairment charge on equity securities | -                                   | (360)     | -                                  | (360)     |
| Other income  | 166                                 | 266       | 669                                | 709       |
| Total other income  | 3,973                               | 3,223     | 12,466                             | 10,481    |
| <b>OPERATING EXPENSES</b>                                   |                                     |           |                                    |           |
| Salaries and employee benefits                              | 5,789                               | 5,647     | 17,579                             | 17,060    |
| Premises and equipment                                      | 2,322                               | 2,416     | 7,058                              | 7,376     |
| FDIC insurance expense                                      | 253                                 | 586       | 1,254                              | 1,724     |
| Other expenses  | 2,209                               | 2,237     | 6,960                              | 6,261     |
| Total operating expenses                                    | 10,573                              | 10,886    | 32,851                             | 32,421    |
| <b>INCOME BEFORE INCOME TAX EXPENSE</b>                     |                                     |           |                                    |           |
| Income tax (benefit)/expense                                | (1,537)                             | 793       | 773                                | 2,520     |

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| NET INCOME  | 5,332     | 1,906     | 9,641     | 5,787     |
| Dividends on preferred stock and accretion              | 219       | 326       | 1,008     | 1,360     |
| NET INCOME AVAILABLE TO COMMON<br>SHAREHOLDERS          | \$5,113   | \$1,580   | \$8,633   | \$4,427   |
| EARNINGS PER COMMON SHARE                               |           |           |           |           |
| Basic   | \$0.58    | \$0.18    | \$0.98    | \$0.50    |
| Diluted   | \$0.58    | \$0.18    | \$0.98    | \$0.50    |
| WEIGHTED AVERAGE NUMBER OF COMMON<br>SHARES OUTSTANDING |           |           |           |           |
| Basic   | 8,827,680 | 8,786,782 | 8,823,997 | 8,783,083 |
| Diluted   | 8,827,790 | 8,786,863 | 8,825,617 | 8,783,439 |

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
(Dollars in thousands)  
(Unaudited)  
Nine Months Ended September 30, 2011

| (In Thousands, Except<br>Per Share Data)  | Preferred<br>Stock | Common<br>Stock | Surplus   | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Total      |
|---|--------------------|-----------------|-----------|-------------------|----------------------|--|------------|
| Balance at January 1,<br>2011   |                    |                 |           |                   |                      |  |            |
| 8,790,860 Common<br>Shares  |                    |                 |           |                   |                      |  |            |
| Outstanding   | \$ 20,746          | \$ 7,650        | \$ 95,586 | \$ (8,988 )       | \$ 4,693             | \$ (1,971 )  | \$ 117,716 |
| Comprehensive<br>Income:  |                    |                 |           |                   |                      |  |            |
| Net Income 2011   |                    |                 |           |                   | 9,641                |  | 9,641      |
| Unrealized Holding<br>Gains on<br>Securities Arising<br>During the<br>Period, Net of<br>Amortization<br>(Net of Income Tax<br>Expense of \$1,158) |                    |                 |           |                   |                      | 2,349  |            |
| Less: Reclassification<br>Adjustment for Gain<br>Included in Net<br>Income (Net<br>of Income Tax<br>Expense<br>of \$252)                          |                    |                 |           |                   |                      | 469  |            |
| Net Unrealized Holding<br>Gains on Securities<br>Arising<br>During the Period<br>(Net of<br>Income Tax Expense<br>of \$906)                       |                    |                 |           |                   |                      | 1,880  | 1,880      |
| Total Comprehensive<br>Income   |                    |                 |           |                   |                      |  | 11,521     |
| Issuance of Restricted<br>Stock   |                    |                 |           |                   |                      |  |            |
| 28,732 shares   |                    | 24              | (24 )     |                   |                      |  | -          |
|   |                    |                 | 191       |                   |                      |  | 191        |



|  |           |          |           |             |           |          |  |            |
|--|-----------|----------|-----------|-------------|-----------|----------|--|------------|
| Amortization of Restricted Stock                               |           |          |           |             |           |          |  |            |
| Redemption of Preferred Stock                                  |           |          |           |             |           |          |  |            |
| 7,172 shares   | (7,172 )  |          |           |             |           |          |  | (7,172 )   |
| Accretion of Discount on Preferred Stock                       | 364       |          |           | (364 )      |           |          |  | -          |
| Cash Dividends Declared on Common Stock (\$0.05 per share)     |           |          |           | (1,324 )    |           |          |  | (1,324 )   |
| Cash Dividends Declared on Preferred Stock                     |           |          |           | (644 )      |           |          |  | (644 )     |
| Common Stock Option Expense                                    |           | 273      |           |             |           |          |  | 273        |
| Sales of Shares (Dividend Reinvestment Program), 10,137 shares |           | 8        | 114       |             |           |          |  | 122        |
| Balance at September 30, 2011                                  |           |          |           |             |           |          |  |            |
| 8,829,729 Common Shares  |           |          |           |             |           |          |  |            |
| Outstanding  | \$ 13,938 | \$ 7,682 | \$ 96,140 | \$ (8,988 ) | \$ 12,002 | \$ (91 ) |  | \$ 120,683 |

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PEAPACK-GLADSTONE FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in thousands)  
(Unaudited)

|   | Nine Months Ended September<br>30, |                  |
|---|------------------------------------|------------------|
|   | 2011                               | 2010             |
| <b>OPERATING ACTIVITIES:</b>  |                                    |                  |
| Net income:   | \$ 9,641                           | \$ 5,787         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |                  |
| Depreciation  | 2,149                              | 2,420            |
| Amortization of premium and accretion of discount on securities, net              | 2,332                              | 175              |
| Amortization of restricted stock  | 191                                | 113              |
| Provision for loan losses   | 5,500                              | 7,150            |
| Provision for deferred taxes  | 622                                | (1,106 )         |
| Reversal of valuation allowance-deferred tax assets                               | (2,988 )                           | -                |
| Stock-based compensation  | 273                                | 228              |
| Gains on security sales, available for sale                                       | (721 )                             | (128 )           |
| Other-than-temporary impairment charge on equity securities                       | -                                  | 360              |
| Loans originated for sale   | (22,539 )                          | (43,567 )        |
| Proceeds from sales of loans  | 22,180                             | 44,046           |
| Gains on loans sold   | (363 )                             | (479 )           |
| Gains on sale of other real estate owned  | (47 )                              | (4 )             |
| Increase in cash surrender value of life insurance, net                           | (693 )                             | (585 )           |
| Increase in accrued interest receivable   | 452                                | (150 )           |
| Decrease in other assets  | 1,507                              | 219              |
| Increase in accrued expenses and other liabilities                                | 1,842                              | 5,358            |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                  | <b>19,338</b>                      | <b>19,837</b>    |
| <b>INVESTING ACTIVITIES:</b>  |                                    |                  |
| Proceeds from maturities of investment securities held to maturity                | 28,413                             | 17,123           |
| Proceeds from maturities of securities available for sale                         | 48,996                             | 29,202           |
| Proceeds from calls of investment securities held to maturity                     | 39,505                             | 48,158           |
| Proceeds from calls of securities available for sale                              | 41,755                             | 143,219          |
| Proceeds from sales of securities available for sale                              | 37,277                             | 10,016           |
| Purchase of investment securities held to maturity                                | (44,145 )                          | (77,943 )        |
| Purchase of securities available for sale   | (151,556 )                         | (154,109 )       |
| Net (increase)/decrease in loans  | (41,136 )                          | 31,829           |
| Proceeds from sales of other real estate owned                                    | 1,238                              | 364              |
| Purchases of premises and equipment   | (826 )                             | (2,313 )         |
| <b>NET CASH (USED IN)/PROVIDED BY INVESTING ACTIVITIES</b>                        | <b>(40,479 )</b>                   | <b>45,546</b>    |
| <b>FINANCING ACTIVITIES:</b>  |                                    |                  |
| Net increase/(decrease) in deposits   | 45,464                             | (29,250 )        |
| Repayments of Federal Home Loan Bank advances                                     | (3,333 )                           | (12,265 )        |
| Redemption of preferred stock   | (7,172 )                           | (7,172 )         |
| Cash dividends paid on preferred stock  | (644 )                             | (858 )           |
| Cash dividends paid on common stock   | (1,324 )                           | (1,317 )         |
| Sales of shares (DRIP Program)  | 122                                | 108              |
| <b>NET CASH USED IN FINANCING ACTIVITIES</b>                                      | <b>33,113</b>                      | <b>(50,754 )</b> |
| Net decrease in cash and cash equivalents   | 11,972                             | 14,629           |

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|  |           |           |
|--|-----------|-----------|
| Cash and cash equivalents at beginning of period   | 62,687    | 79,972    |
| Cash and cash equivalents at end of period         | \$ 74,659 | \$ 94,601 |
| Supplemental disclosures of cash flow information: |           |           |
| Cash paid during the period for:                   |           |           |
| Interest   | \$ 5,645  | \$ 9,310  |
| Income taxes                                       | 2,214     | 4,039     |
| Transfer of loans to other real estate owned       | 455       | 1,000     |
| Acquisition of leased premises                     | -         | 6,097     |
| Security purchases settled in subsequent period    | 22,923    | -         |

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Certain information and footnote disclosures normally included in the unaudited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the period ended December 31, 2010 for Peapack-Gladstone Financial Corporation (the "Corporation").

**Principles of Consolidation:** The Corporation considers that all adjustments necessary for a fair presentation of the statement of the financial position and results of operations in accordance with U.S. generally accepted accounting principles for these periods have been made. Results for such interim periods are not necessarily indicative of results for a full year.

The consolidated financial statements of Peapack-Gladstone Financial Corporation are prepared on the accrual basis and include the accounts of the Corporation and its wholly owned subsidiary, Peapack-Gladstone Bank. All significant intercompany balances and transactions have been eliminated from the accompanying consolidated financial statements.

**Securities:** Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, Management considers the extent and duration of the unrealized loss and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) other-than-temporary impairment related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.



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Loans: Loans are considered past due when they are not paid in accordance with contractual terms. The accrual of income on loans, including impaired loans, is discontinued if, in the opinion of Management, principal or interest is not likely to be paid in accordance with the terms of the loan agreement, or when principal or interest is past 90 days or more and collateral, if any, is insufficient to cover principal and interest. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. A non-accrual loan is returned to accrual status only when interest and principal payments are brought current and future payments are reasonably assured. Commercial loans are generally charged off after an analysis is completed which indicates that collectability of the full principal balance is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments are credited to income only if collection of principal is not in doubt. If principal and interest payments are brought contractually current and future collectability is reasonably assured, loans are returned to accrual status. Mortgage loans are generally charged off when the value of the underlying collateral does not cover the outstanding principal balance. The majority of the Corporation's loans are secured by real estate in the State of New Jersey.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when Management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in Management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component of the allowance relates to loans that are individually classified as impaired.

A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and are evaluated for impairment. Factors considered by Management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

All loans are individually evaluated for impairment when loans are classified as substandard by Management. If a loan is considered impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral less estimated disposition costs if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment while they are performing assets. If and when a residential mortgage is placed on nonaccrual status and in the process of collection, such as through a foreclosure action, then they are evaluated for impairment on an individual basis and the loan is reported, net, at the fair value of the collateral less estimated disposition costs.

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A troubled debt restructuring is a renegotiated loan with concessions made by the lender to a borrower who is experiencing financial difficulty. Troubled debt restructurings are separately identified for impairment and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral, less estimated disposition costs. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component of the allowance covers un-impaired loans and is based primarily on the Bank's historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation on a weighted average basis over the previous two years. This actual loss experience is adjusted by other qualitative factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

In determining an appropriate amount for the allowance, the Bank segments and evaluates the loan portfolio based on Federal call report codes. The following portfolio segments have been identified:

- a) Primary residential mortgage – comprised of conventional 1-4 family residential mortgage loans and commercial loans or other consumer purpose loans secured by a residential mortgage.
- b) Home equity lines of credit.
- c) Junior lien loan on residence – comprised of loans secured by junior liens on residences of which the majority were for consumer purposes and the remaining were for commercial business purposes.
- d) Multifamily property – comprised of loans secured by apartment buildings.
- e) Owner-occupied commercial real estate – comprised of loans secured by primary commercial mortgages where the borrower used all or a majority of the property to conduct its own business or the business of a related entity.
- f) Investment commercial real estate – comprised of loans secured by primary commercial mortgages where all or most of the property was not being used by the borrower or a related entity. These properties consist of office buildings, retail stores, warehouses and mixed-use properties.
- g) Commercial and industrial – comprised of loans to business entities which were secured by the assets of the business.
- h) Commercial construction – comprised of construction loans for the development of commercial projects such as office buildings, retail shopping centers and apartments.
- i) Consumer and other – comprised of consumer loans, loans to government entities and loans to not-for-profit entities.

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Stock-Based Compensation: The Corporation has stock option plans that allow the granting of shares of the Corporation's common stock as incentive stock options, nonqualified stock options, restricted stock awards and stock appreciation rights to directors, officers, employees and independent contractors of the Corporation and its subsidiaries. The options granted under these plans are exercisable at a price equal to the fair market value of common stock on the date of grant and expire not more than ten years after the date of grant. Stock options may vest during a period of up to five years after the date of grant.

For the three months ended September 30, 2011 and 2010, the Corporation recorded total compensation cost for stock options of \$61 thousand and \$76 thousand respectively, with a recognized tax benefit of \$11 thousand for the quarter ended September 30, 2011 and \$12 thousand for the September 30, 2010 quarter. The Corporation recorded total compensation cost for stock options for the nine months ended September 30, 2011 and 2010, of \$273 thousand and \$228 thousand, respectively, with a recognized tax benefit of \$46 thousand for the nine months ended September 30, 2011 and \$37 thousand for the nine months ended September 30, 2010.

There was approximately \$824 thousand of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Corporation's stock incentive plans at September 30, 2011. That cost is expected to be recognized over a weighted average period of 1.3 years.

For the Corporation's stock option plans, changes in options outstanding during the nine months ended September 30, 2011 were as follows:

| (Dollars in thousands except share data) | Number of Shares | Exercise Price Per Share | Weighted Average Exercise Price | Aggregate Intrinsic Value |
|--|------------------|--------------------------|---------------------------------|---------------------------|
| Balance, January 1, 2011                 | 578,763          | \$ 10.83-\$31.43         | \$ 23.75                        |                           |
| Granted                                  | 70,600           | 10.01-13.62              | 13.06                           |                           |
| Expired                                  | (67,712 )        | 12.97-27.51              | 15.52                           |                           |
| Forfeited                                | (4,016 )         | 12.79-27.38              | 15.19                           |                           |
| Balance, September 30, 2011              | 577,635          | \$ 10.01-\$31.43         | \$ 23.74                        | \$ -                      |
| Vested and Expected to Vest (1)          | 540,203          | \$ 10.01-\$31.43         | \$ 24.09                        | \$ -                      |
| Exercisable at September 30, 2011        | 417,011          | \$ 11.05-\$31.43         | \$ 26.41                        | \$ -                      |

- (1) Does not include shares which are not expected to vest as a result of anticipated forfeitures.

The aggregate intrinsic value represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the third quarter of 2011 and the exercise price, multiplied by the number of in-the-money options). The Corporation's closing stock price on September 30, 2011 was \$9.91; therefore, there was no intrinsic value in the stock options outstanding at that date.

Of the total options granted in the table above, 12,200 options were granted during the third quarter of 2011. There were no stock options exercised during the nine months ended September 30, 2011 or 2010.



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For the third quarter of 2011, the per share weighted-average fair value of stock options granted was \$3.68 as compared to \$7.08 for the same quarter of 2010. The per share weighted-average fair value of stock options granted during the first nine months of 2011 and 2010 for all plans was \$3.88 and \$7.88, respectively, on the date of grant using the Black Scholes option-pricing model with the following weighted average assumptions:

|                         | Three Months Ended |         | Nine Months Ended |         |
|-------------------------|--------------------|---------|-------------------|---------|
|                         | September 30,      |         | September 30,     |         |
|                         | 2011               | 2010    | 2011              | 2010    |
| Dividend Yield          | 2.02 %             | 1.70 %  | 1.60 %            | 1.30 %  |
| Expected volatility     | 38 %               | 81 %    | 32 %              | 72 %    |
| Expected life           | 7 years            | 7 years | 7 years           | 7 years |
| Risk-free interest rate | 2.02 %             | 2.32 %  | 2.08 %            | 2.92 %  |

In January 2011 and 2010, the Corporation issued 28,732 and 55,993 restricted stock awards, respectively, at a fair value equal to the market price of the Corporation's common stock at the date of the grant. The awards fully vest on the fifth anniversary of the grant date. The Corporation recorded total compensation cost for restricted stock awards of \$67 thousand for the third quarter of 2011 and \$38 thousand for the same quarter of 2010. For the nine months ended September 30, 2011 and 2010, the Corporation recorded total compensation cost for restricted stock awards of \$191 thousand and \$113 thousand respectively.

As of September 30, 2011, there was approximately \$867 thousand of unrecognized compensation cost related to non-vested restricted stock awards granted under the Corporation's stock incentive plans. That cost is expected to be recognized over a weighted average period of 1.6 years.

Earnings per Common Share – Basic and Diluted: The following is a reconciliation of the calculation of basic and diluted earnings per share. Basic net income per common share is calculated by dividing net income to common shareholders by the weighted average common shares outstanding during the reporting period. Diluted net income per common share is computed similarly to that of basic net income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all common shares underlying potentially dilutive stock options were issued during the reporting period utilizing the Treasury stock method.

| (In Thousands, except per share data)              | Three Months Ended |           | Nine Months Ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | September 30,      |           | September 30,     |           |
|  | 2011               | 2010      | 2011              | 2010      |
| Net Income to Common Shareholders                  | \$ 5,113           | \$ 1,580  | \$ 8,633          | \$ 4,427  |
| Basic Weighted-Average Common Shares Outstanding   | 8,827,680          | 8,786,782 | 8,823,997         | 8,783,083 |
| Plus: Common Stock Equivalents                     | 110                | 81        | 1,620             | 356       |
| Diluted Weighted-Average Common Shares Outstanding | 8,827,790          | 8,786,863 | 8,825,617         | 8,783,439 |
| Net Income Per Common Share                        |                    |           |                   |           |
| Basic  | \$ 0.58            | \$ 0.18   | \$ 0.98           | \$ 0.50   |

|         |      |      |      |      |
|---------|------|------|------|------|
| Diluted | 0.58 | 0.18 | 0.98 | 0.50 |
|---------|------|------|------|------|

Stock options and warrants with an exercise price below the Corporation's market price equal to 750,343 and 754,457 shares were not included in the computation of diluted earnings per share in the third quarters of 2011 and 2010, respectively, because they were antidilutive to the earnings per share calculation. Stock options and warrants with an exercise price below the Corporation's market price equal to 722,289 and 737,441 shares were not included in the computation of diluted earnings per share in the nine months ended September 30, 2011 and 2010, respectively, because they were antidilutive to the earnings per share calculation.

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**Income Taxes:** The Corporation files a consolidated Federal income tax return and separate state income tax returns for each subsidiary based on current laws and regulations.

The Corporation is no longer subject to examination by the U.S. Federal tax authorities for years prior to 2007 or by New Jersey tax authorities for years prior to 2006.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest and penalties at September 30, 2011.

During 2008, the Corporation recorded a \$56.1 million other-than-temporary impairment on its trust preferred pooled securities. The impairment was recorded at the Bank level and resulted in a deferred state tax benefit of approximately \$3.0 million. At December 31, 2008, the Corporation concluded that it was more likely than not that it would not realize this state tax benefit before the expiration of the net operating loss carryforward period and recorded a full valuation allowance against the state tax benefit. At the time, the analysis was based on numerous factors, including the State of New Jersey tax statutes, the ongoing performance and related forecasts of the Corporation and the Bank and the status of the economy and its impact on the forecasts.

During the third quarter of 2011, the Corporation concluded that it was more likely than not that the 2008 state tax benefit was realizable and as such reversed the \$3.0 million valuation allowance, which resulted in an income tax benefit recognized in the third quarter. The determination was based on the trends in state taxable income of the Bank and the five-year earnings forecast that was completed during the third quarter of 2011.

**Comprehensive Income:** Comprehensive income consists of net income and the change during the period in the Corporation's net unrealized gains and losses on securities available for sale during the applicable period of time less adjustments for realized gains and losses, net amortization of the unrealized loss on securities transferred to held to maturity from available for sale and accretion of the non-credit component on certain held to maturity securities with other-than-temporary impairment charges in previous periods. Total comprehensive income for the third quarter of 2011 was \$5.9 million as compared to total comprehensive income of \$2.1 million for the same quarter in 2010. Total comprehensive income for the nine months ended September 30, 2011 was \$11.5 million and the total comprehensive income for the same period in 2010 was \$6.9 million.

**Reclassification:** Certain reclassifications have been made in the prior periods' financial statements in order to conform to the 2011 presentation.

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## 2. INVESTMENT SECURITIES HELD TO MATURITY

A summary of amortized cost and approximate fair value of investment securities held to maturity included in the consolidated statements of condition as of September 30, 2011 and December 31, 2010 follows:

| (In Thousands)                     | September 30, 2011 |                          |                           | Approximate Fair Value |
|------------------------------------|--------------------|--------------------------|---------------------------|------------------------|
|                                    | Carrying Amount    | Gross Unrecognized Gains | Gross Unrecognized Losses |                        |
| U.S. Government-Sponsored Entities | \$ 22,993          | \$ 16                    | \$ -                      | \$ 23,009              |
| Mortgage-Backed Securities -       |                    |                          |                           |                        |
| Residential                        | 67,768             | 1,471                    | -                         | 69,239                 |
| State and Political Subdivisions   | 21,772             | 91                       | -                         | 21,863                 |
| Trust Preferred Pooled Securities  | 8,708              | -                        | (1,094 )                  | 7,614                  |
| Total                              | \$ 121,241         | \$ 1,578                 | \$ (1,094 )               | \$ 121,725             |

| (In Thousands)                     | December 31, 2010 |                          |                           | Approximate Fair Value |
|------------------------------------|-------------------|--------------------------|---------------------------|------------------------|
|                                    | Carrying Amount   | Gross Unrecognized Gains | Gross Unrecognized Losses |                        |
| U.S. Government-Sponsored Entities | \$ 45,485         | \$ 11                    | \$ (790 )                 | \$ 44,706              |
| Mortgage-Backed Securities -       |                   |                          |                           |                        |
| Residential                        | 67,745            | 921                      | (494 )                    | 68,172                 |
| State and Political Subdivisions   | 17,671            | 184                      | (31 )                     | 17,824                 |
| Trust Preferred Pooled Securities  | 9,376             | -                        | (1,640 )                  | 7,736                  |
| Total                              | \$ 140,277        | \$ 1,116                 | \$ (2,955 )               | \$ 138,438             |

The following tables present the Corporation's investment securities held to maturity with continuous unrealized losses and the approximate fair value of these investments as of September 30, 2011 and December 31, 2010.

| (In Thousands)                    | September 30, 2011          |                     |                        |                     |                        |                     |
|-----------------------------------|-----------------------------|---------------------|------------------------|---------------------|------------------------|---------------------|
|                                   | Duration of Unrealized Loss |                     |                        |                     |                        |                     |
|                                   | Less Than 12 Months         |                     | 12 Months or Longer    |                     | Total                  |                     |
|                                   | Approximate Fair Value      | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses |
| Trust Preferred Pooled Securities | \$ -                        | \$ -                | \$ 1,934               | \$ (1,094 )         | \$ 1,934               | \$ (1,094 )         |
| Total                             | \$ -                        | \$ -                | \$ 1,934               | \$ (1,094 )         | \$ 1,934               | \$ (1,094 )         |

| (In Thousands)                    | December 31, 2010           |                     |                        |                     |                        |                     |
|-----------------------------------|-----------------------------|---------------------|------------------------|---------------------|------------------------|---------------------|
|                                   | Duration of Unrealized Loss |                     |                        |                     |                        |                     |
|                                   | Less Than 12 Months         |                     | 12 Months or Longer    |                     | Total                  |                     |
|                                   | Approximate Fair Value      | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses |
| Trust Preferred Pooled Securities | \$ -                        | \$ -                | \$ 1,934               | \$ (1,094 )         | \$ 1,934               | \$ (1,094 )         |
| Total                             | \$ -                        | \$ -                | \$ 1,934               | \$ (1,094 )         | \$ 1,934               | \$ (1,094 )         |

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| (In Thousands)               | Fair Value | Unrecognized Losses | Fair Value | Unrecognized Losses | Fair Value | Unrecognized Losses |
|------------------------------|------------|---------------------|------------|---------------------|------------|---------------------|
| U.S. Government-Sponsored    |            |                     |            |                     |            |                     |
| Entities                     | \$ 39,707  | \$ (790 )           | \$ -       | \$ -                | \$ 39,707  | \$ (790 )           |
| Mortgage-Backed Securities - |            |                     |            |                     |            |                     |
| Residential                  | 32,553     | (494 )              | -          | -                   | 32,553     | (494 )              |
| State & Political            |            |                     |            |                     |            |                     |
| Subdivisions                 | 9,667      | (31 )               | -          | -                   | 9,667      | (31 )               |
| Trust Preferred Pooled       |            |                     |            |                     |            |                     |
| Securities                   | -          | -                   | 1,782      | (1,640 )            | 1,782      | (1,640 )            |
| Total                        | \$ 81,927  | \$ (1,315 )         | \$ 1,782   | \$ (1,640 )         | \$ 83,709  | \$ (2,955 )         |

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The trust preferred pooled securities within the Corporation's held to maturity investment portfolio are collateralized by trust preferred securities issued primarily by individual bank holding companies, but also by insurance companies and real estate investment trusts. There has been little or no active trading in these securities for several years; therefore the Corporation believes in most cases it is more appropriate to estimate fair value using discounted cash flow analysis. As of December 31, 2008, to estimate fair value, and determine whether the securities were other-than-temporarily impaired, the Corporation retained and worked with a third party to review the issuers (the collateral) underlying each of the securities. Among the factors analyzed were the issuers' profitability, credit quality, asset mix, capital adequacy, leverage and liquidity position, as well as an overall assessment of credit, profitability and capital trends within the portfolio's issuer universe. These factors provided an assessment of the portion of the collateral of each security which was likely to default in future periods. The cash flows associated with the collateral likely to default, together with the cash flows associated with collateral which had already deferred or defaulted, were then eliminated. In addition, the Corporation assumed constant rates of default in excess of those based upon the historic performance of the underlying collateral. The resulting cash flows were then discounted to the current period to determine fair value for each security. The discount rate utilized was based on a risk-free rate (LIBOR) plus spreads appropriate for the product, which include consideration of liquidity and credit uncertainty.

Each quarter since December 2008, to periodically assess the credit assumptions and related input data that could affect the fair value of each security, Management compared actual deferrals and defaults to the assumed deferrals and defaults included in the valuation model.

As of each year end since December 2008, the Corporation again worked with a third party to model the securities and review its valuation. The modeling process and related assumptions were similar to the process and related assumptions employed as of December 31, 2008. No additional impairment charges were recorded for the quarter or nine months ended September 30, 2011.

Further significant downturns in the real estate markets and/or the economy could cause additional issuers to defer paying dividends on these securities and/or ultimately default. Such occurrences, if beyond those assumed in the current valuation, could cause an additional write-down of the portfolio, with a negative impact on earnings; however, the Corporation has already recorded a substantial write-down of its trust preferred pooled securities portfolio. We do not expect that an additional write-down would have a material effect on the cash flows from the securities or on our liquidity position.

### 3. INVESTMENT SECURITIES AVAILABLE FOR SALE

A summary of amortized cost and approximate fair value of securities available for sale included in the consolidated statements of condition as of September 30, 2011 and December 31, 2010 follows:

| (In Thousands)                      | Amortized<br>Cost | September 30, 2011           |                               | Approximate<br>Fair<br>Value |
|-------------------------------------|-------------------|------------------------------|-------------------------------|------------------------------|
|                                     |                   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                              |
| <b>U.S. Government-Sponsored</b>    |                   |                              |                               |                              |
| Entities                            | \$ 38,745         | \$ 51                        | \$ (20 )                      | \$ 38,776                    |
| <b>Mortgage-Backed Securities -</b> |                   |                              |                               |                              |
| Residential                         | 238,067           | 5,692                        | (175 )                        | 243,584                      |
| State and Political Subdivisions    | 24,374            | 715                          | (53 )                         | 25,036                       |
| Other Securities                    | 4,999             | 51                           | (1,064 )                      | 3,986                        |
| Marketable Equity Securities        | 593               | 3                            | (51 )                         | 545                          |
| Total                               | \$ 306,778        | \$ 6,512                     | \$ (1,363 )                   | \$ 311,927                   |



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| (In Thousands)                                       | December 31, 2010 |                        |                         | Approximate Fair Value |
|--|-------------------|------------------------|-------------------------|------------------------|
|  | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses |                        |
| U.S. Treasury and U.S. Government-Sponsored Entities | \$ 50,926         | \$ 209                 | \$ -                    | \$ 51,135              |
| Mortgage-Backed Securities - Residential             | 199,099           | 4,179                  | (1,188 )                | 202,090                |
| State and Political Subdivisions                     | 16,418            | 243                    | (48 )                   | 16,613                 |
| Other Securities                                     | 5,499             | -                      | (999 )                  | 4,500                  |
| Marketable Equity Securities                         | 680               | 58                     | -                       | 738                    |
| Total  | \$ 272,622        | \$ 4,689               | \$ (2,235 )             | \$ 275,076             |

The following tables present the Corporation's available for sale securities with continuous unrealized losses and the approximate fair value of these investments as of September 30, 2011 and December 31, 2010.

| (In Thousands)                           | September 30, 2011          |                   |                        |                   |                        |                   |
|--|-----------------------------|-------------------|------------------------|-------------------|------------------------|-------------------|
|  | Duration of Unrealized Loss |                   |                        |                   |                        |                   |
|  | Less Than 12 Months         |                   | 12 Months or Longer    |                   | Total                  |                   |
|  | Approximate Fair Value      | Unrealized Losses | Approximate Fair Value | Unrealized Losses | Approximate Fair Value | Unrealized Losses |
| U.S. Government-Sponsored Entities       | \$ 11,407                   | \$ (20 )          | \$ -                   | \$ -              | \$ 11,407              | \$ (20 )          |
| Mortgage-Backed Securities - Residential | 16,550                      | (147 )            | 329                    | (28 )             | 16,879                 | (175 )            |
| State and Political Subdivisions         | 6,238                       | (53 )             | -                      | -                 | 6,238                  | (53 )             |
| Other Securities                         | -                           | -                 | 1,935                  | (1,064 )          | 1,935                  | (1,064 )          |
| Marketable Equity Securities             | 318                         | (50 )             | -                      | (1 )              | 318                    | (51 )             |
| Total                                    | \$ 34,513                   | \$ (270 )         | \$ 2,264               | \$ (1,093 )       | \$ 36,777              | \$ (1,363 )       |

| (In Thousands)                           | December 31, 2010           |                   |                        |                   |                        |                   |
|--|-----------------------------|-------------------|------------------------|-------------------|------------------------|-------------------|
|  | Duration of Unrealized Loss |                   |                        |                   |                        |                   |
|  | Less Than 12 Months         |                   | 12 Months or Longer    |                   | Total                  |                   |
|  | Approximate Fair Value      | Unrealized Losses | Approximate Fair Value | Unrealized Losses | Approximate Fair Value | Unrealized Losses |
| Mortgage-Backed Securities - Residential | 102,695                     | (984 )            | 2,211                  | (204 )            | 104,906                | (1,188 )          |



## State and Political

|                  |            |           |          |             |            |             |
|------------------|------------|-----------|----------|-------------|------------|-------------|
| Subdivisions     | 777        | (14 )     | 446      | (34 )       | 1,223      | (48 )       |
| Other Securities | 1,499      | (1 )      | 3,001    | (998 )      | 4,500      | (999 )      |
| Total            | \$ 104,971 | \$ (999 ) | \$ 5,658 | \$ (1,236 ) | \$ 110,629 | \$ (2,235 ) |

Management believes that the unrealized losses on investment securities available for sale are temporary and due to interest rate fluctuations and/or volatile market conditions rather than the creditworthiness of the issuers. The Corporation does not intend to sell these securities nor is it likely that it will be required to sell the securities before their anticipated recovery; however, Management also closely monitors market conditions and may sell the securities if it determines it would be beneficial to do so.

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At September 30, 2011, the unrealized loss on other securities, \$1.1 million, is primarily related to a debt security issued by a large bank holding company that has experienced declines in all its securities due to the turmoil in the financial markets and a merger. The security continues to be rated investment grade by Moody's. As the Corporation does not intend to sell this security nor is it likely that it will be required to sell the security before its anticipated recovery, the security is not considered other-than-temporarily impaired at September 30, 2011.

## 4. LOANS

Loans outstanding, by general ledger classification, as of September 30, 2011 and December 31, 2010, consisted of the following:

| (In Thousands)               | 2011       | % of Total<br>Loans | 2010       | % of Total<br>Loans |
|------------------------------|------------|---------------------|------------|---------------------|
| Residential Mortgage         | \$ 438,828 | 45.1 %              | \$ 419,653 | 45.0 %              |
| Commercial Mortgage          | 317,066    | 32.6                | 288,183    | 30.9                |
| Commercial Loans             | 129,039    | 13.2                | 131,408    | 14.1                |
| Construction Loans           | 14,893     | 1.5                 | 25,367     | 2.7                 |
| Home Equity Lines of Credit  | 51,458     | 5.3                 | 45,775     | 4.9                 |
| Consumer Loans, Including    |            |                     |            |                     |
| Fixed Rate Home Equity Loans | 20,345     | 2.1                 | 20,622     | 2.2                 |
| Other Loans                  | 1,564      | 0.2                 | 1,489      | 0.2                 |
| Total Loans                  | \$ 973,193 | 100.0 %             | \$ 932,497 | 100.0 %             |

Included in the totals above for September 30, 2011 are \$861 thousand of unamortized discount and \$2.5 million of deferred origination costs net of deferred origination fees as compared to \$1.4 million of unamortized discount and \$2.3 million of deferred origination costs net of deferred origination fees for December 31, 2010.

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The following tables present the loan balances by portfolio class, based on impairment method, and the corresponding balances in the allowance for loan losses as of September 30, 2011 and December 31, 2010:

| (In Thousands)                              | September 30, 2011                          |   |   |   |                |                |
|---|---|---|---|---|----------------|----------------|
|   | Total<br>Loans<br>Individually<br>Evaluated | Ending<br>ALLL<br>Attributable<br>to Loans<br>Individually<br>Evaluated | Total<br>Loans<br>Collectively<br>Evaluated | Ending<br>ALLL<br>Attributable<br>to Loans<br>Collectively<br>Evaluated for | Total<br>Loans | Ending<br>ALLL |
|   | for<br>Impairment                           | for<br>Impairment   | for<br>Impairment                           | Impairment  |                |                |
| Primary                                     |   |   |   |   |                |                |
| Residential                                 |   |   |   |   |                |                |
| Mortgage                                    | \$5,776                                     | \$ -  | \$447,901                                   | \$ 1,613  | \$453,677      | \$1,613        |
| Home Equity Lines<br>of Credit              | 124   | -   | 51,335                                      | 195   | 51,459         | 195            |
| Junior Lien Loan<br>On Residence            | 681   | -   | 13,234                                      | 198   | 13,915         | 198            |
| Multifamily<br>Property                     | 286   | -   | 93,420                                      | 632   | 93,706         | 632            |
| Owner-Occupied<br>Commercial<br>Real Estate | 9,882                                       | 1,456   | 102,645                                     | 2,086   | 112,527        | 3,542          |
| Investment Commercial<br>Real Estate        | 9,228                                       | 500   | 186,174                                     | 3,620   | 195,402        | 4,120          |
| Commercial and<br>Industrial                | 1,552                                       | 169   | 24,634                                      | 2,082   | 26,186         | 2,251          |
| Commercial<br>Construction                  | -   | -   | 14,509                                      | 551   | 14,509         | 551            |
| Consumer and<br>Other                       | -   | -   | 11,812                                      | 103   | 11,812         | 103            |
| Unallocated                                 | -   | -   | -   | 638   | -              | 638            |
| Total ALLL                                  | \$27,529                                    | \$ 2,125  | \$945,664                                   | \$ 11,718   | \$973,193      | \$13,843       |

| (In Thousands)    | December 31, 2010                           |   |   |   |                |                |
|-------------------|---|---|---|---|----------------|----------------|
|                   | Total<br>Loans<br>Individually<br>Evaluated | Ending<br>ALLL<br>Attributable<br>to Loans<br>Individually<br>Evaluated | Total<br>Loans<br>Collectively<br>Evaluated | Ending<br>ALLL<br>Attributable<br>to Loans<br>Collectively<br>Evaluated for | Total<br>Loans | Ending<br>ALLL |
|                   | for<br>Impairment                           | for<br>Impairment   | for<br>Impairment                           | Impairment  |                |                |
| Primary           |   |   |   |   |                |                |
| Residential       |   |   |   |   |                |                |
| Mortgage          | \$4,578                                     | \$ -  | \$428,466                                   | \$ 1,502  | \$433,044      | \$1,502        |
| Home Equity Lines |   |   |   |   |                |                |

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|                       |           |          |            |           |            |           |
|-----------------------|-----------|----------|------------|-----------|------------|-----------|
| of Credit             | 85        | -        | 45,730     | 160       | 45,815     | 160       |
| Junior Lien Loan      |           |          |            |           |            |           |
| On Residence          | 537       | -        | 14,981     | 228       | 15,518     | 228       |
| Multifamily           |           |          |            |           |            |           |
| Property              | 691       | 26       | 40,327     | 277       | 41,018     | 303       |
| Owner-Occupied        |           |          |            |           |            |           |
| Commercial            |           |          |            |           |            |           |
| Real Estate           | 7,972     | 504      | 114,634    | 2,740     | 117,685    | 3,244     |
| Investment Commercial |           |          |            |           |            |           |
| Real Estate           | 6,979     | 1,141    | 203,692    | 3,151     | 215,592    | 4,292     |
| Commercial and        |           |          |            |           |            |           |
| Industrial            | 2,330     | 308      | 25,448     | 2,411     | 27,778     | 2,719     |
| Commercial            |           |          |            |           |            |           |
| Construction          | 5,225     | 500      | 20,149     | 746       | 25,374     | 1,246     |
| Consumer and          |           |          |            |           |            |           |
| Other                 | -         | -        | 10,673     | 66        | 10,673     | 66        |
| Unallocated           | -         | -        | -          | 522       | -          | 522       |
| Total ALLL            | \$ 28,397 | \$ 2,479 | \$ 904,100 | \$ 11,803 | \$ 932,497 | \$ 14,282 |

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Impaired loans include non-accrual loans of \$22.1 million at September 30, 2011 and \$18.1 million at December 31, 2010. Impaired loans also includes performing commercial mortgage and commercial troubled debt restructured loans of \$5.4 million at September 30, 2011 and \$5.4 million at December 31, 2010. The allowance allocated to troubled debt restructured loans which are nonaccrual totaled \$2.1 million and \$268 thousand, as of September 30, 2011 and December 31, 2010, respectively. All accruing troubled debt restructured loans were paying in accordance with restructured terms as of September 30, 2011. The Corporation has not committed to lend additional amounts as of September 30, 2011 and December 31, 2010 to customers with outstanding loans that are classified as loan restructurings.

The following tables present loans individually evaluated for impairment by class of loans as of September 30, 2011 and December 31, 2010:

|  |  | September 30, 2011             |                        |                      |
|--|--|--------------------------------|------------------------|----------------------|
| (In Thousands)   |  | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Specific<br>Reserves |
| <b>With No Related Allowance Recorded:</b>                   |  |                                |                        |                      |
| Primary Residential Mortgage                                 |  | \$6,746                        | \$5,776                | \$-                  |
| Multifamily Property   |  | 312                            | 286                    | -                    |
| Owner-Occupied Commercial Real Estate                        |  | 5,758                          | 5,237                  | -                    |
| Investment Commercial Real Estate                            |  | 6,118                          | 5,728                  | -                    |
| Commercial and Industrial                                    |  | 2,163                          | 1,330                  | -                    |
| Home Equity Lines of Credit                                  |  | 198                            | 124                    | -                    |
| Junior Lien Loan on Residence                                |  | 820                            | 681                    | -                    |
| <b>Total Loans with No Related Allowance</b>                 |  | <b>\$22,115</b>                | <b>\$19,162</b>        | <b>\$-</b>           |
| <b>With Related Allowance Recorded:</b>                      |  |                                |                        |                      |
| Primary Residential Mortgage                                 |  | -                              | -                      | -                    |
| Owner-Occupied Commercial Real Estate                        |  | 6,399                          | 4,645                  | 1,456                |
| Investment Commercial Real Estate                            |  | 4,420                          | 3,500                  | 500                  |
| Commercial and Industrial                                    |  | 577                            | 222                    | 169                  |
| <b>Total Loans with Related Allowance</b>                    |  | <b>\$11,396</b>                | <b>\$8,367</b>         | <b>\$2,125</b>       |
| <b>Total Loans Individually Evaluated for<br/>Impairment</b> |  | <b>\$33,511</b>                | <b>\$27,529</b>        | <b>\$2,125</b>       |

|  |  | December 31, 2010              |                        |                      |
|--|--|--------------------------------|------------------------|----------------------|
| (In Thousands)                               |  | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Specific<br>Reserves |
| <b>With No Related Allowance Recorded:</b>   |  |                                |                        |                      |
| Primary Residential Mortgage                 |  | \$5,080                        | \$4,578                | \$-                  |
| Home Equity Lines of Credit                  |  | 100                            | 85                     | -                    |
| Junior Lien Loan on Residence                |  | 660                            | 537                    | -                    |
| <b>Total Loans with No Related Allowance</b> |  | <b>\$5,840</b>                 | <b>\$5,200</b>         | <b>\$-</b>           |
| <b>With Related Allowance Recorded:</b>      |  |                                |                        |                      |
| Multifamily Property                         |  | 713                            | 691                    | 26                   |
| Owner-Occupied Commercial Real Estate        |  | 8,238                          | 7,972                  | 505                  |
| Investment Commercial Real Estate            |  | 6,979                          | 6,979                  | 1,141                |
| Commercial and Industrial                    |  | 3,464                          | 2,330                  | 307                  |

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|   |          |          |         |
|---|----------|----------|---------|
| Commercial Construction                           | 8,199    | 5,225    | 500     |
| Total Loans with Related Allowance                | \$27,593 | \$23,197 | \$2,479 |
| Total Loans Individually Evaluated for Impairment | \$33,433 | \$28,397 | \$2,479 |

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The average impaired loans for the three months ended September 30, 2011 was \$25.3 million, while the average for the nine months ended September 30, 2011 was \$26.3 million.

The table below presents the income recognized on accruing impaired loans by class for the three months ended September 30, 2011:

| (In Thousands)                            | Income<br>Recognized |
|---|----------------------|
| Owner-Occupied Commercial Real Estate     | \$ 2                 |
| Investment Commercial Real Estate         | 22                   |
| Commercial and Industrial                 | 9                    |
| Total Income Recognized on Impaired Loans | 33                   |

The table below presents the income recognized on accruing impaired loans by class for the nine months ended September 30, 2011:

| (In Thousands)                            | Income<br>Recognized |
|---|----------------------|
| Owner-Occupied Commercial Real Estate     | \$ 75                |
| Investment Commercial Real Estate         | 119                  |
| Commercial and Industrial                 | 26                   |
| Total Income Recognized on Impaired Loans | 220                  |

There is no cash received into income on nonaccruing impaired loans for the three and nine months ended September 30, 2011.

The following tables present the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of September 30, 2011 and December 31, 2010:

| (In Thousands)                        | September 30, 2011 |   |
|---------------------------------------|--------------------|---|
|                                       | Nonaccrual         | Loans Past Due<br>Over 90 Days<br>And Still<br>Accruing<br>Interest |
| Primary Residential Mortgage          | \$ 5,776           | \$ 340  |
| Home Equity Lines of Credit           | 124                | 19  |
| Junior Lien Loan on Residence         | 681                | -   |
| Multifamily Property                  | 264                | -   |
| Owner-Occupied Commercial Real Estate | 9,756              | -   |
| Investment Commercial Real Estate     | 4,537              | -   |
| Commercial and Industrial             | 965                | 443   |
| Consumer and Other                    | -                  | 34  |
| Total                                 | \$ 22,103          | \$ 836  |





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December 31, 2010

| (In Thousands)                        | Nonaccrual | Loans Past Due<br>Over 90 Days<br>And Still<br>Accruing<br>Interest |
|---------------------------------------|------------|---|
| Primary Residential Mortgage          | \$ 4,578   | \$ -  |
| Home Equity Lines of Credit           | 85         | -   |
| Junior Lien Loan on Residence         | 537        | -   |
| Multifamily Property                  | 378        | 361   |
| Owner-Occupied Commercial Real Estate | 1,594      | 305   |
| Investment Commercial Real Estate     | 3,966      | -   |
| Commercial and Industrial             | 1,751      | -   |
| Commercial Construction               | 5,225      | -   |
| Total                                 | \$ 18,114  | \$ 666  |

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables present the aging of the recorded investment in past due loans as of September 30, 2011 and December 31, 2010 by class of loans, excluding nonaccrual loans:

| (In Thousands)                           | September 30, 2011        |                           |                                     |                   |
|--|---------------------------|---------------------------|-------------------------------------|-------------------|
|  | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total<br>Past Due |
| Primary Residential Mortgage             | \$4,776                   | \$504                     | \$ 340                              | \$5,620           |
| Home Equity Lines of Credit              | 98                        | -                         | 19                                  | 117               |
| Junior Lien Loan on Residence            | -                         | -                         | -                                   | -                 |
| Multifamily Property                     | 397                       | -                         | -                                   | 397               |
| Owner-Occupied Commercial<br>Real Estate | 2,951                     | 3                         | -                                   | 2,954             |
| Investment Commercial<br>Real Estate     | 624                       | -                         | -                                   | 624               |
| Commercial and Industrial                | 91                        | -                         | 443                                 | 534               |
| Commercial Construction                  | 250                       | -                         | -                                   | 250               |
| Consumer and Other                       | 11                        | 1                         | 34                                  | 46                |
| Total                                    | \$9,198                   | \$508                     | \$ 836                              | \$10,542          |

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| (In Thousands)                | December 31, 2010         |                           |                                     |                   |
|-------------------------------|---------------------------|---------------------------|-------------------------------------|-------------------|
|                               | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total<br>Past Due |
| Primary Residential Mortgage  | \$3,490                   | \$162                     | \$ -                                | \$3,652           |
| Junior Lien Loan on Residence | -                         | -                         | -                                   | -                 |
| Multifamily Property          | -                         | -                         | 361                                 | 361               |
| Owner-Occupied Commercial     |                           |                           |                                     |                   |
| Real Estate                   | 820                       | -                         | 305                                 | 1,125             |
| Investment Commercial         |                           |                           |                                     |                   |
| Real Estate                   | 728                       | -                         | -                                   | 728               |
| Commercial and Industrial     | 274                       | -                         | -                                   | 274               |
| Consumer and Other            | 1                         | -                         | -                                   | 1                 |
| Total                         | \$5,313                   | \$162                     | \$ 666                              | \$6,141           |

## Credit Quality Indicators:

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes all commercial loans with an outstanding balance of \$150 thousand or more. The risk rating analysis of loans is performed (i) when the loan is initially underwritten, (ii) annually for loans in excess of \$500,000, (iii) on a random quarterly basis from either internal reviews with the Senior Credit Officer or externally through an independent loan review firm, or (iv) whenever management otherwise identifies a potentially negative trend or issue relating to a borrower. The Corporation uses the following definitions for risk ratings:

**Special Mention:** Loans subject to special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loans or of the institution's credit position at some future date.

**Substandard:** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful:** Loans classified as doubtful have all the weakness inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of September 30, 2011, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (In Thousands)                | Pass       | Special<br>Mention | Substandard | Doubtful |
|-------------------------------|------------|--------------------|-------------|----------|
| Primary Residential Mortgage  | \$ 441,273 | \$ 6,487           | \$ 5,917    | \$ -     |
| Home Equity Lines of Credit   | 50,937     | -                  | 522         | -        |
| Junior Lien Loan on Residence | 13,097     | 137                | 681         | -        |
| Multifamily Property          | 92,546     | 164                | 996         | -        |
| Owner-Occupied Commercial     |            |                    |             |          |
| Real Estate                   | 82,887     | 11,099             | 18,541      | -        |
| Investment Commercial         |            |                    |             |          |
| Real Estate                   | 165,692    | 6,293              | 23,417      | -        |
| Commercial and Industrial     | 23,406     | 822                | 1,843       | 115      |
| Commercial Construction       | 14,259     | 250                | -           | -        |
| Consumer and Other Loans      | 11,312     | 500                | -           | -        |
| Total                         | \$ 895,409 | \$ 25,752          | \$ 51,917   | \$ 115   |

As of December 31, 2010, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (In Thousands)                | Pass       | Special<br>Mention | Substandard | Doubtful |
|-------------------------------|------------|--------------------|-------------|----------|
| Primary Residential Mortgage  | \$ 422,972 | \$ 5,495           | \$ 4,578    | \$ -     |
| Home Equity Lines of Credit   | 45,730     | -                  | 85          | -        |
| Junior Lien Loan on Residence | 14,877     | 104                | 537         | -        |
| Multifamily Property          | 39,709     | 166                | 1,142       | -        |
| Owner-Occupied Commercial     |            |                    |             |          |
| Real Estate                   | 89,136     | 14,722             | 13,827      | -        |
| Investment Commercial         |            |                    |             |          |
| Real Estate                   | 187,201    | 14,468             | 13,923      | -        |
| Commercial and Industrial     | 23,284     | 1,864              | 2,630       | -        |
| Commercial Construction       | 20,149     | -                  | 5,225       | -        |
| Consumer and Other Loans      | 10,673     | -                  | -           | -        |
| Total                         | \$ 853,731 | \$ 36,819          | \$ 41,947   | \$ -     |

At September 30, 2011, \$27.5 million of the \$52.0 million of the classified loans were also considered impaired as compared to December 31, 2010, when \$28.4 million of the \$41.9 million of the classified loans were also considered impaired.

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loans, the Corporation also evaluated credit quality based on the aging status of the loan, which was previously presented.

A summary of the allowance for loan losses for the quarterly periods indicated follows (in thousands):

| September<br>30, | June 30, | March 31, | December<br>31, | September<br>30, |
|------------------|----------|-----------|-----------------|------------------|
|------------------|----------|-----------|-----------------|------------------|

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|   | 2011      | 2011      | 2011      | 2010      | 2010      |
|---|-----------|-----------|-----------|-----------|-----------|
| Allowance for loan losses:                              |           |           |           |           |           |
| Beginning of period                                     | \$ 14,056 | \$ 14,386 | \$ 14,282 | \$ 14,025 | \$ 13,856 |
| Provision for loan losses                               | 1,500     | 2,000     | 2,000     | 2,850     | 2,000     |
| Charge-offs, net  | (1,713 )  | (2,330 )  | (1,896 )  | (2,593 )  | (1,831 )  |
| End of period   | \$ 13,843 | \$ 14,056 | \$ 14,386 | \$ 14,282 | \$ 14,025 |
| Allowance for loan losses as a % of total loans         |           |           |           |           |           |
|   | 1.42 %    | 1.46 %    | 1.51 %    | 1.53 %    | 1.49 %    |
| Allowance for loan losses as a % of nonperforming loans |           |           |           |           |           |
|   | 60.35 %   | 91.54 %   | 73.79 %   | 76.05 %   | 78.02 %   |

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The activity in the allowance for loan losses for the three months ended September 30, 2011 is summarized below:

| (In Thousands)                       | July 1,<br>2011<br>Ending<br>ALLL | Charge-Offs | Recoveries | Provision | September<br>30,<br>2011<br>Ending<br>ALLL |
|--------------------------------------|-----------------------------------|-------------|------------|-----------|--|
| Primary                              |                                   |             |            |           |  |
| Residential                          |                                   |             |            |           |  |
| Mortgage                             | \$1,662                           | \$ (240 )   | \$-        | \$191     | \$ 1,613                                   |
| Home Equity Lines<br>of Credit       | 186                               | -           | -          | 9         | 195  |
| Junior Lien Loan<br>On Residence     | 209                               | -           | -          | (11 )     | 198  |
| Multifamily<br>Property              | 521                               | -           | -          | 169       | 690  |
| Owner-Occupied<br>Commercial         |                                   |             |            |           |  |
| Real Estate                          | 3,522                             | (563 )      | 1          | 582       | 3,542                                      |
| Investment Commercial<br>Real Estate | 4,041                             | (920 )      | -          | 941       | 4,062                                      |
| Commercial and<br>Industrial         | 2,399                             | (61 )       | 72         | (159 )    | 2,251                                      |
| Commercial<br>Construction           | 794                               | -           | -          | (243 )    | 551  |
| Consumer and<br>Other                | 98                                | (2 )        | -          | 7         | 103  |
| Unallocated                          | 624                               | -           | -          | 14        | 638  |
| Total ALLL                           | \$14,056                          | \$ (1,786 ) | \$73       | \$1,500   | \$ 13,843                                  |

The activity in the allowance for loan losses for the nine months ended September 30, 2011 is summarized below:

| (In Thousands)                   | January 1,<br>2010<br>Ending<br>ALLL | Charge-Offs | Recoveries | Provision | September<br>30,<br>2011<br>Ending<br>ALLL |
|----------------------------------|--------------------------------------|-------------|------------|-----------|--|
| Primary                          |                                      |             |            |           |  |
| Residential                      |                                      |             |            |           |  |
| Mortgage                         | \$1,502                              | \$ (528 )   | \$-        | \$639     | \$ 1,613                                   |
| Home Equity Lines<br>of Credit   | 160                                  | (60 )       | -          | 95        | 195  |
| Junior Lien Loan<br>On Residence | 228                                  | (13 )       | 14         | (31 )     | 198  |
| Multifamily<br>Property          | 303                                  | (26 )       | 8          | 405       | 690  |
| Owner-Occupied<br>Commercial     |                                      |             |            |           |  |
| Real Estate                      | 2,777                                | (2,117 )    | 40         | 2,842     | 3,542                                      |

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|                           |          |             |       |         |           |
|---------------------------|----------|-------------|-------|---------|-----------|
| Investment Commercial     |          |             |       |         |           |
| Real Estate               | 4,759    | (2,610 )    | 1     | 1,912   | 4,062     |
| Commercial and Industrial | 2,719    | (157 )      | 98    | (409 )  | 2,251     |
| Commercial Construction   | 1,246    | (586 )      | 11    | (120 )  | 551       |
| Consumer and Other        | 66       | (14 )       | -     | 51      | 103       |
| Unallocated               | 522      | -           | -     | 116     | 638       |
| Total ALLL                | \$14,282 | \$ (6,111 ) | \$172 | \$5,500 | \$ 13,843 |

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## Troubled Debt Restructurings:

The Corporation has allocated \$54 thousand and \$324 thousand of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2011 and December 31, 2010, respectively. There were no unfunded commitments to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

During the period ending September 30, 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three month period ending September 30, 2011:

|                              | Number of | Pre-Modification | Post-Modification |
|------------------------------|-----------|------------------|-------------------|
|                              | Contracts | Outstanding      | Outstanding       |
|                              |           | Recorded         | Recorded          |
|                              |           | Investment       | Investment        |
| Troubled Debt Restructurings |           |                  |                   |
| Primary Residential Mortgage | 1         | \$ 162           | \$ 162            |
| Owner-Occupied Commercial    |           |                  |                   |
| Real Estate                  | 1         | 412              | 412               |
| Total                        | 2         | \$ 574           | \$ 574            |

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine month period ending September 30, 2011:

|                              | Number of | Pre-Modification | Post-Modification |
|------------------------------|-----------|------------------|-------------------|
|                              | Contracts | Outstanding      | Outstanding       |
|                              |           | Recorded         | Recorded          |
|                              |           | Investment       | Investment        |
| Troubled Debt Restructurings |           |                  |                   |
| Primary Residential Mortgage | 2         | \$ 394           | \$ 394            |
| Owner-Occupied Commercial    |           |                  |                   |
| Real Estate                  | 1         | 412              | 412               |
| Investment Commercial        |           |                  |                   |
| Real Estate                  | 1         | 4,427            | 4,427             |
| Total                        | 4         | \$ 5,233         | \$ 5,233          |

The residential mortgages were modified by extending the maturities longer than six months. Both of the commercial real estate loans were modified to an interest only basis pending the sale of the underlying collateral. The Bank did not forgive any principal or interest on any of these loans and expects to collect the full amount that is contractually owed.

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The following table presents loans by class modified as troubled debt restructurings on accrual as of September 30, 2011:

| Troubled Debt Restructurings on<br>Accrual | Number of<br>Contracts | Pre-Modification                      | Post-Modification                     | Specific<br>Reserves |
|--|------------------------|---------------------------------------|---------------------------------------|----------------------|
|  |                        | Outstanding<br>Recorded<br>Investment | Outstanding<br>Recorded<br>Investment |                      |
| Primary Residential Mortgage               | 1                      | \$ 162                                | \$ 162                                | \$ -                 |
| Owner-Occupied Commercial Real<br>Estate   | 1                      | 412                                   | 412                                   | -                    |
| Investment Commercial Real Estate          | 1                      | 4,427                                 | 4,427                                 | -                    |
| Commercial and Industrial                  | 3                      | 518                                   | 518                                   | 54                   |
| Total                                      | 6                      | \$ 5,519                              | \$ 5,519                              | \$ 54                |

There are five loans totaling \$3.9 million that have been categorized as troubled debt restructurings that are also included in loans that are on nonaccrual. Three of these loans consist of owner-occupied commercial real estate and total \$3.4 million. One is a residential first mortgage totaling \$232 thousand and one is a commercial mortgage totaling \$299 thousand on a mixed use investment property.

The following table presents loans by class modified as troubled debt restructurings during the twelve months ended September 30, 2011 for which there was a payment default during the same period:

| Troubled Debt Restructurings That<br>Subsequently Defaulted | Number of<br>Contracts | Recorded<br>Investment |
|---|------------------------|------------------------|
| Owner-Occupied Commercial Real Estate                       | 1                      | \$ 412                 |
| Investment Commercial Real Estate                           | 1                      | 299                    |
| Total   | 2                      | \$ 711                 |

The terms of certain other loans were modified during the period ending September 30, 2011 that did not meet the definition of a troubled debt restructuring. These loans have a total recorded investment as September 30, 2011 of \$2.7 million. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Corporation's internal underwriting policy.



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## 5. FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

Advances from the Federal Home Loan Bank of New York (FHLB) totaled \$20.8 million and \$24.1 million at September 30, 2011 and December 31, 2010, respectively, with a weighted average interest rate of 3.38 percent and 3.54 percent, respectively. Advances totaling \$20.0 million at September 30, 2011, have fixed maturity dates, while advances totaling \$793 thousand were amortizing advances with monthly payments of principal and interest. These advances are secured by blanket pledges of certain 1-4 family residential mortgages totaling \$71.8 million at September 30, 2011.

There were no overnight borrowings at September 30, 2011 or at December 31, 2010. Overnight borrowings from the FHLB averaged \$1.2 million with a weighted average interest rate of 0.35 percent for the nine months ended September 30, 2011.

The final maturity dates of the advances and other borrowings are scheduled as follows:

(In thousands)

|              |           |
|--------------|-----------|
| 2011         | 113       |
| 2012         | 5,462     |
| 2013         | 218       |
| 2014         | -         |
| 2015         | 3,000     |
| Over 5 years | 12,000    |
| Total        | \$ 20,793 |

## 6. BUSINESS SEGMENTS

The Corporation assesses its results among two operating segments, Banking and PGB Trust and Investments. Management uses certain methodologies to allocate income and expense to the business segments. A funds transfer pricing methodology is used to assign interest income and interest expense. Certain indirect expenses are allocated to segments. These include support unit expenses such as technology and operations and other support functions. Taxes are allocated to each segment based on the effective rate for the period shown.

## Banking

The Banking segment includes commercial, commercial real estate, residential and consumer lending activities; deposit generation; operation of ATMs; telephone and internet banking services; merchant credit card services and customer support and sales.

## PGB Trust &amp; Investments

PGB Trust & Investments includes asset management services provided for individuals and institutions; personal trust services, including services as executor, trustee, administrator, custodian and guardian; corporate trust services including services as trustee for pension and profit sharing plans; and other financial planning and advisory services.

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The following table presents the statements of income and total assets for the Corporation's reportable segments for the three months ended September 30, 2011 and 2010.

| (in thousands)                   | Three Months Ended September 30, 2011 |             |           |
|----------------------------------|---------------------------------------|-------------|-----------|
|                                  | PGB Trust<br>&                        |             | Total     |
|                                  | Banking                               | Investments |           |
| Net interest income              | \$ 11,028                             | \$ 867      | \$ 11,895 |
| Noninterest income               | 1,354                                 | 2,619       | 3,973     |
| Total income                     | 12,382                                | 3,486       | 15,868    |
| Provision for loan losses        | 1,500                                 | -           | 1,500     |
| Salaries and benefits            | 4,587                                 | 1,202       | 5,789     |
| Premises and equipment expense   | 2,169                                 | 153         | 2,322     |
| Other noninterest expense        | 1,587                                 | 875         | 2,462     |
| Total noninterest expense        | 9,843                                 | 2,230       | 12,073    |
| Income before income tax expense | 2,539                                 | 1,256       | 3,795     |
| Income tax expense/(benefit)     | (2,021 )                              | 484         | (1,537 )  |
| Net income                       | \$ 4,560                              | \$ 772      | \$ 5,332  |

| (in thousands)                   | Three Months Ended September 30, 2010 |             |           |
|----------------------------------|---------------------------------------|-------------|-----------|
|                                  | PGB Trust<br>&                        |             | Total     |
|                                  | Banking                               | Investments |           |
| Net interest income              | \$ 11,442                             | \$ 920      | \$ 12,362 |
| Noninterest income               | 940                                   | 2,283       | 3,223     |
| Total income                     | 12,382                                | 3,203       | 15,585    |
| Provision for loan losses        | 2,000                                 | -           | 2,000     |
| Salaries and benefits            | 4,549                                 | 1,098       | 5,647     |
| Premises and equipment expense   | 2,234                                 | 182         | 2,416     |
| Other noninterest expense        | 1,847                                 | 976         | 2,823     |
| Total noninterest expense        | 10,630                                | 2,256       | 12,886    |
| Income before income tax expense | 1,752                                 | 947         | 2,699     |
| Income tax expense               | 514                                   | 279         | 793       |
| Net income                       | \$ 1,238                              | \$ 668      | \$ 1,906  |

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The following table presents the statements of income and total assets for the Corporation's reportable segments for the nine months ended September 30, 2011 and 2010.

| (in thousands)                   | Nine Months Ended September 30, 2011 |             |              |
|----------------------------------|--------------------------------------|-------------|--------------|
|                                  | PGB Trust<br>&                       |             |              |
|                                  | Banking                              | Investments | Total        |
| Net interest income              | \$ 33,669                            | \$ 2,630    | \$ 36,299    |
| Noninterest income               | 4,166                                | 8,300       | 12,466       |
| Total income                     | 37,835                               | 10,930      | 48,765       |
| Provision for loan losses        | 5,500                                | -           | 5,500        |
| Salaries and benefits            | 13,968                               | 3,611       | 17,579       |
| Premises and equipment expense   | 6,561                                | 497         | 7,058        |
| Other noninterest expense        | 5,153                                | 3,061       | 8,214        |
| Total noninterest expense        | 31,182                               | 7,169       | 38,351       |
| Income before income tax expense | 6,653                                | 3,761       | 10,414       |
| Income tax expense/(benefit)     | (585 )                               | 1,358       | 773          |
| Net income                       | \$ 7,238                             | \$ 2,403    | \$ 9,641     |
| Total assets at period end       | \$ 1,574,000                         | \$ 1,288    | \$ 1,575,288 |

| (in thousands)                   | Nine Months Ended September 30, 2010 |             |              |
|----------------------------------|--------------------------------------|-------------|--------------|
|                                  | PGB Trust<br>&                       |             |              |
|                                  | Banking                              | Investments | Total        |
| Net interest income              | \$ 34,703                            | \$ 2,694    | \$ 37,397    |
| Noninterest income               | 3,073                                | 7,408       | 10,481       |
| Total income                     | 37,776                               | 10,102      | 47,878       |
| Provision for loan losses        | 7,150                                | -           | 7,150        |
| Salaries and benefits            | 13,403                               | 3,657       | 17,060       |
| Premises and equipment expense   | 6,797                                | 579         | 7,376        |
| Other noninterest expense        | 5,121                                | 2,864       | 7,985        |
| Total noninterest expense        | 32,471                               | 7,100       | 39,571       |
| Income before income tax expense | 5,305                                | 3,002       | 8,307        |
| Income tax expense               | 1,609                                | 911         | 2,520        |
| Net income                       | \$ 3,696                             | \$ 2,091    | \$ 5,787     |
| Total assets at period end       | \$ 1,478,813                         | \$ 1,448    | \$ 1,480,261 |

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7. FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods and significant assumptions to estimate the fair value:

**Investment Securities:** The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used, if available, to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

**Impaired Loans:** The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

**Other Real Estate Owned:** Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

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The following table summarizes, for the periods indicated, assets measured at fair value on a recurring basis, including financial assets for which the Corporation has elected the fair value option:

## Assets Measured on a Recurring Basis

| (In Thousands)   | September<br>30,<br>2011 | Fair Value Measurements Using   |   |  |
|--|--------------------------|---|---|--|
|  |                          | Quoted<br>Prices in<br>Active<br>Markets<br>For<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>   |                          |   |   |  |
| Available for Sale:  |                          |   |   |  |
| U.S. Government-Sponsored<br>Entities                      | \$38,776                 | \$-   | \$38,776  | \$ -   |
| Mortgage-Backed Securities -<br>Residential                | 243,584                  | -   | 243,584   | -  |
| State and Political Subdivisions                           | 25,036                   | -   | 25,036  | -  |
| Other Securities   | 1,935                    | -   | 1,935   | -  |
| CRA Investment Fund  | 2,051                    | -   | 2,051   | -  |
| Marketable Equity Securities                               | 545                      | 545   | -   | -  |
| <b>Total</b>   | <b>\$311,927</b>         | <b>\$545</b>  | <b>\$311,382</b>  | <b>\$ -</b>  |
|  |                          |   |   |  |
| December<br>31,<br>2010                                    |                          |   |   |  |
| <b>Assets:</b>   |                          |   |   |  |
| Available for Sale:  |                          |   |   |  |
| U.S. Treasury and U.S.<br>Government-Sponsored<br>Entities | \$51,135                 | \$-   | \$51,135  | \$ -   |
| Mortgage-Backed Securities -<br>Residential                | 202,090                  | -   | 202,090   | -  |
| State and Political Subdivisions                           | 16,613                   | -   | 16,613  | -  |
| Other Securities   | 3,001                    | -   | 3,001   | -  |
| CRA Investment Fund  | 1,499                    | -   | 1,499   | -  |
| Marketable Equity Securities                               | 738                      | 738   | -   | -  |
| <b>Total</b>   | <b>\$275,076</b>         | <b>\$738</b>  | <b>\$274,338</b>  | <b>\$ -</b>  |

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The following table summarizes, for the periods indicated, assets measured at fair value on a non-recurring basis:

## Assets Measured on a Non-Recurring Basis

| (In Thousands)       |                          | Fair Value Measurements Using   |   |  |
|----------------------|--------------------------|---|---|--|
|                      |                          | Quoted<br>Prices in<br>Active<br>Markets<br>For<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|                      | September<br>30,<br>2011 |   |   |  |
| Assets:              |                          |   |   |  |
| Impaired Loans:      |                          |   |   |  |
| Residential Mortgage | \$ 3,189                 | \$-   | \$-   | \$ 3,189   |
| Commercial Mortgage  | 3,000                    | -   | -   | 3,000  |
| Commercial           | 53                       | -   | -   | 53   |
|                      | December 31,<br>2010     |   |   |  |
| Assets:              |                          |   |   |  |
| Impaired Loans:      |                          |   |   |  |
| Commercial Mortgage  | \$ 10,452                | \$-   | \$-   | \$ 10,452  |
| Commercial           | 3,346                    | -   | -   | 3,346  |

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a recorded investment of \$8.4 million, with a valuation allowance of \$2.1 million at September 30, 2011. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a recorded investment of \$23.2 million, with a valuation allowance of \$2.5 million at December 31, 2010.

The carrying amounts and estimated fair values for financial instruments at September 30, 2011 and December 31, 2010 are as follows:

| (In Thousands)                          | September 30, 2011 |               | December 31, 2010  |               |
|---|--------------------|---------------|--------------------|---------------|
|   | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| Financial Assets:                       |                    |               |                    |               |
| Cash and Cash Equivalents               | \$74,659           | \$74,659      | \$62,687           | \$62,687      |
| Investment Securities, Held to Maturity | 121,241            | 121,725       | 140,277            | 138,438       |
| Securities Available for Sale           | 311,927            | 311,927       | 275,076            | 275,076       |
| FHLB and FRB Stock                      | 4,699              | N/A           | 4,624              | N/A           |
| Loans Held for Sale                     | 722                | 722           | -                  | -             |
| Loans, Net of Allowance for             |                    |               |                    |               |
| Loan Losses                             | 959,350            | 959,216       | 918,215            | 917,257       |
| Accrued Interest Receivable             | 3,788              | 3,788         | 4,231              | 4,231         |
| Financial Liabilities:                  |                    |               |                    |               |

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|                                 |           |           |           |           |
|---------------------------------|-----------|-----------|-----------|-----------|
| Deposits                        | 1,397,010 | 1,400,040 | 1,351,546 | 1,353,834 |
| Federal Home Loan Bank Advances | 20,793    | 22,452    | 24,126    | 25,330    |
| Accrued Interest Payable        | 483       | 483       | 716       | 716       |

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The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

The carrying amount is the estimated fair value for cash and cash equivalents, interest-earning deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable-rate loans or deposits that repriced frequently and fully. For fixed-rate loans or deposits and for variable-rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk, including consideration of credit spreads. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB or FRB stock due to restrictions placed on its transferability. The fair value of off-balance sheet items is not considered material or is based on the current fees or cost that would be charged to enter into or terminate such arrangements.

8. PREFERRED STOCK

On January 9, 2009, as part of the U.S. Department of the Treasury (the “Treasury”) Troubled Asset Relief Program (“TARP”) Capital Purchase Program (“CPP”), the Corporation sold 28,685 shares of the Corporation’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of \$1,000 per share, and a ten-year warrant to purchase up to 150,295 shares of the Corporation’s common stock, no par value at an exercise price of \$28.63 per share, after adjusting for the five percent stock dividend declared on June 18, 2009, for an aggregate purchase price of \$28.7 million in cash. The aggregate purchase price was allocated \$1.6 million to warrants and \$27.1 million to preferred stock.

Cumulative dividends on the Preferred Shares will accrue on the liquidation preference at a rate of 5 percent per annum for the first five years, and at a rate of 9 percent per annum thereafter. Subject to the approval of the Board of Governors of the Federal Reserve System, the Preferred Shares are redeemable at the option of the Corporation at 100 percent of their liquidation preference. If the Corporation redeems the Preferred Stock and the Treasury still owns the warrant, the Corporation could repurchase the Warrant from the Treasury for its fair market value. Unless both the holder and the Corporation agree otherwise, the exercise of the Warrant will be a net exercise (i.e., the holder does not pay cash but gives up shares with a market value at the time of exercise equal to the exercise price, resulting in a net settlement with significantly fewer than the 150,295 shares of Common Stock being issued).

The Securities Purchase Agreement, pursuant to which the Preferred Shares and the Warrant were sold, contains limitations on the payment of dividends on the Common Stock, including with respect to the payment of cash dividends in excess of \$0.16 per share, which was the amount of the last regular dividend declared by the Corporation prior to October 14, 2008 and on the Corporation’s ability to repurchase its Common Stock. The Corporation is also subject to certain executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (the “EESA”).

On January 6, 2010, the Corporation redeemed 25 percent of the preferred shares issued under the Treasury’s CPP, repaying approximately \$7.2 million to the Treasury, including accrued and unpaid dividends of approximately \$51 thousand. The Corporation’s redemption of the shares was not subject to additional conditions or stipulations from the Treasury. As a result of the repurchase, the accretion related to the preferred stock was accelerated and approximately \$330 thousand was recorded as a reduction to retained earnings in the first quarter of 2010.

On March 2, 2011, the Corporation redeemed an additional 25 percent of the original preferred shares issued under the Treasury’s CPP, repaying approximately \$7.2 million to the Treasury, including accrued and unpaid dividends of approximately \$15 thousand. The Corporation’s redemption of the shares was not subject to additional conditions or stipulations from the Treasury. As a result of the repurchase, the accretion related to the preferred stock was accelerated and approximately \$246 thousand was recorded as a reduction to retained earnings in the first quarter of 2011.





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Item 2

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS

GENERAL: The following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management’s view of future interest income and net loans, management’s confidence and strategies and management’s expectations about new and existing programs and products, relationships, opportunities and market conditions. These statements may be identified by such forward-looking terminology as “expect”, “look”, “believe”, “anticipate”, “may”, “will”, or similar statements or variations of such terms. Actual results may differ materially from such forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, those risk factors identified in the Corporation’s Form 10-K for the year ended December 31, 2010 and the following:

- a continued or unexpected decline in the economy, in particular in our New Jersey market area;
  - declines in value in our investment portfolio;
  - higher than expected increases in our allowance for loan losses;
- higher than expected increases in loan losses or in the level of nonperforming loans;
  - unexpected changes in interest rates;
  - inability to successfully grow our business;
  - inability to manage our growth;
- a continued or unexpected decline in real estate values within our market areas;
- legislative and regulatory actions (including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and related regulations) subject us to additional regulatory oversight which may result in increased compliance costs;
  - higher than expected FDIC insurance premiums;
  - lack of liquidity to fund our various cash obligations;
- repurchase of our preferred shares issued under the Treasury’s Capital Purchase Program which will impact net income available to our common shareholders and our earnings per share;
  - reduction in our lower-cost funding sources;
  - our inability to adapt to technological changes;
- claims and litigation pertaining to fiduciary responsibility, environmental laws and other matters; and
  - other unexpected material adverse changes in our operations or earnings.

The Corporation assumes no responsibility to update such forward-looking statements in the future even if experience shows that the indicated results or events will not be realized. Although we believe that the expectations reflected in the forward-looking statements are reasonable, the Corporation cannot guarantee future results, levels of activity, performance, or achievements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES: Management’s Discussion and Analysis of Financial Condition and Results of Operations is based upon the Corporation’s consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Corporation’s Audited Consolidated Financial Statements for the year ended December 31, 2010, contains a summary of the Corporation’s significant accounting policies.



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Management believes that the Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often requires assumptions or estimates about highly uncertain matters. Changes in these judgments, assumption or estimates could materially impact results of operations. This critical policy and its 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 fair value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, 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 Corporation's allowance for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Corporation'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 Corporation's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values continue to decline or New Jersey experiences continuing adverse economic conditions. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation's control.

The Corporation accounts for its securities in accordance with "Accounting for Certain Investments in Debt and Equity Securities," which was codified into ASC 320. Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity due to changes in interest rates, prepayment, risk, liquidity or other factors. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

For declines in the fair value of securities below their cost that are other-than-temporary, the amount of impairment is split into two components – other-than-temporary impairment related to other factors, which is recognized in other comprehensive income and other-than-temporary impairment related to credit loss, which must be recognized in the income statement. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. In estimating other-than-temporary losses on a quarterly basis, management considers the length of time and extent that fair value has been less than cost; the financial condition and near-term prospects of the issuer; and whether the Corporation has the intent to sell these securities or it is likely that it will be required to sell the securities before their anticipated recovery.

Securities are evaluated on at least a quarterly basis to determine whether a decline in their values is other-than-temporary. To determine whether a loss in value is other-than-temporary, management utilizes criteria such as the reasons underlying the decline, the magnitude and the duration of the decline and whether the Corporation intends to sell or is likely to be required to sell the security before its anticipated recovery. "Other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. The Corporation recognized no other-than-temporary impairment charges in the third quarters of 2011 and 2010.



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EXECUTIVE SUMMARY: For the third quarter of 2011, the Corporation recorded net income of \$5.3 million, an increase of \$3.4 million, compared to the same quarter of 2010. Diluted earnings per common share, after giving effect for the preferred dividend, were \$0.58 and \$0.18 in the third quarters of 2011 and 2010, respectively. For the three months ended September 30, 2011, annualized return on average assets was 1.39 percent and annualized return on average common equity was 19.87 percent. The increase in 2011 earnings per share was due to a decline in the provision for loan losses, an increase in noninterest income, a decrease in operating expenses and a decline in the dividends and accretion on preferred stock as a result of the 2011 redemption of 25 percent of the preferred shares issued under the Treasury's CPP, offset by a decline in net interest income.

In addition, the results for the third quarter 2011 include the reversal of a previously recorded valuation allowance that was established against deferred state tax assets of \$3.0 million, or \$0.34 per diluted earnings per common share. Excluding the reversal, net income for the third quarter of 2011 was \$2.3 million, an increase of \$438 thousand or 23.0 percent from the same quarter of 2010. The Corporation believes that comparing net income without considering the reversal of the state tax valuation allowance provides a better analysis of net income trends.

On a fully tax-equivalent basis, net interest income for the third quarter of 2011 was \$12.1 million as compared to \$12.5 million for the same quarter of 2010, a decline of \$465 thousand or 3.7 percent. For the third quarters of 2011 and 2010, the net interest margin, on a fully tax-equivalent basis, was 3.37 percent and 3.64 percent, respectively.

For the third quarter of 2011, average loans totaled \$964.4 million, increasing \$15.1 million or 1.6 percent from \$949.3 million for the same quarter of 2010. The yield on loans was 4.81 percent and 5.26 percent for the three months ended September 30, 2011 and 2010, respectively, reflecting a decline of 45 basis points from the 2010 quarter to the 2011 quarter.

Average deposits were \$1.38 billion for the third quarter of 2011, as compared to \$1.32 billion for the same quarter of 2010, rising \$62.9 million or 4.8 percent. The average costs of interest-bearing deposits declined 33 basis points to 0.51 percent for the three months ended September 30, 2011 from 0.84 percent for the same quarter in 2010.

For the nine months ended September 30, 2011 net income was \$9.6 million as compared to \$5.8 million, respectively, an increase of \$3.9 million. Diluted earnings per common share, after giving effect for the preferred dividend, were \$0.98 for the first nine months of 2011 as compared to \$0.50 for the same period in 2010. In addition to the \$3.0 million reversal of valuation allowance against deferred state tax assets noted above, the increase in 2011 year-to-date earnings per share was due to a decline in the provision for loan losses, an increase in noninterest income and a decline in the dividends and accretion on preferred stock as a result of the redemption of a portion of the preferred shares in 2010 and 2011 offset by an increase in operating expenses. Annualized return on average assets for the nine months ended September 30, 2011, was 0.85 percent and annualized return on average common equity was 11.50 percent.

The net income, excluding the reversal of the state tax valuation allowance, for the nine months ended September 30, 2011, was \$6.7 million, an increase of \$866 thousand or 15.0 percent for the prior year period. The Corporation believes that comparing net income without considering the reversal of the state tax valuation allowance provides a better analysis of net income trends.

For the nine months ended September 30, 2011, net interest income, on a fully tax-equivalent basis, was \$36.8 million as compared to \$37.9 million for the same period in 2010. The net interest margin was 3.46 percent and 3.65 percent for the nine months ended September 30, 2011 and 2010, respectively.



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Loans averaged \$956.7 million and \$963.8 million for the nine months ended September 30, 2011 and 2010, respectively, a decline of \$7.2 million or 0.7 percent from the 2010 period to the 2011 period. The yield on loans was 4.88 percent for the first nine months of 2011 and 5.29 percent for the same period in 2010.

For the nine months ended September 30, 2011, deposits averaged \$1.36 billion, an increase of \$38.4 million or 2.9 percent from the same period in 2010. The average costs of interest-bearing deposits was 0.57 percent for the nine months ended September 30, 2011 as compared to 0.94 percent for the nine months ended September 30, 2010, a decrease of 37 basis points.

**CONTRACTUAL OBLIGATIONS:** For a discussion of our contractual obligations, see the information set forth in the Corporation's 2010 Annual Report under the heading "Management's Discussion and Analysis – Contractual Obligations" which is incorporated herein by reference.

**OFF-BALANCE SHEET ARRANGEMENTS:** For a discussion of our off-balance sheet arrangements, see the information set forth in the Corporation's 2010 Annual Report under the heading "Management's Discussion and Analysis – Off-Balance Sheet Arrangements" which is incorporated herein by reference.

**EARNINGS ANALYSIS**

**NET INTEREST INCOME:** The Corporation recorded net interest income, on a tax-equivalent basis, of \$12.1 million for the three months ended September 30, 2011 as compared to \$12.5 million for the same quarter of 2010, a decline of \$465 thousand or 3.7 percent. For the third quarter of 2011, the net interest margin was 3.37 percent, a decrease of 27 basis points when compared to the third quarter of 2010. During the third quarter of 2011, rates were lower on new loans, compared to the rates on loans that are maturing or paying down. Additionally, growth in lower yielding, but shorter duration investment securities contributed to the reduced margin. At the same time, the Corporation continued to lower funding costs due to growth in core deposits, as well as certificates of deposits repricing at lower market rates or transferred to other, lower-costing deposit products.

Average investments, federal funds sold and interest-earning deposits totaled \$465.6 million for the quarter ended September 30, 2011, increasing \$40.1 million, or 9.4 percent, from the \$425.5 million recorded for the same period in 2010. The growth in these categories is primarily the result of deposit inflows, principally demand deposits.

Loans averaged \$964.4 million for the third quarter of 2011, rising \$15.1 million, or 1.6 percent, when compared to average loans of \$949.3 for the third quarter of 2010. The average commercial mortgage portfolio increased \$38.4 million or 13.8 percent from the third quarter of 2010 to \$316.6 million for the third quarter of 2011 due to an increased emphasis on multi-family lending. Home equity loans averaged \$49.8 million and \$42.2 million for the third quarters of 2011 and 2010, respectively, rising \$7.6 million or 18.0 percent, due to the Corporation's focus on the origination of these shorter-duration loans. The average residential mortgage portfolio rose \$6.0 million or 1.4 percent from an average of \$428.4 million for the third quarter of 2010 to an average of \$434.4 million for the same period in 2011. The commercial construction portfolio declined \$29.8 million, or 66.5 percent, to \$15.1 million, due to the conversion of some loans to permanent loans and also due to the resolution of some problem loans. For the third quarters of 2011 and 2010, the commercial loan portfolio averaged \$127.7 million and \$131.2 million, respectively, declining \$3.5 million, or 2.7 percent, from the third quarter of 2010, while the installment loan portfolio averaged \$20.1 million for the third quarter of 2011, a decline of \$3.5 million or 14.8 percent. The Corporation seeks to lend to quality borrowers in all loan categories; however, in the past several years, loan demand from quality borrowers has been scarce and loan pay downs have outpaced originations in many loan categories.





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For the third quarters of 2011 and 2010, total deposits averaged \$1.38 billion and \$1.32 billion, respectively, increasing \$62.9 million, or 4.8 percent, when comparing the 2011 period to the 2010 period. Interest-bearing checking accounts for the third quarter of 2011 averaged \$321.4 million as compared to \$259.8 million for the same 2010 quarter, an increase of \$61.6 million, or 23.7 percent. Non-interest bearing demand deposits averaged \$246.7 million for the third quarter of 2011, as compared to \$211.4 million for the same quarter of 2010, an increase of \$35.3 million, or 16.7 percent. Checking growth is attributable to the Corporation's continual focus on business and personal core deposit growth coupled with the Corporation's recent focus on select municipalities within its branch market areas. Money market accounts increased \$4.2 million to an average of \$519.9 million for the three months ended September 30, 2011 as compared to an average of \$515.7 million for the same period in 2010. Savings accounts averaged \$87.9 million for the third quarter of 2011, increasing \$9.8 million or 12.6 percent from the third quarter of 2010. In a lower or uncertain interest rate environment, certain customers tend to deposit funds in savings and money market accounts to wait for higher or a more certain rate environment, resulting in increases to the savings and money market balances. Certificates of deposit averaged \$203.6 million for the third quarter of 2011, declining \$47.9 million, or 19.0 percent, from the average of \$251.5 million for the same quarter of 2010. The Corporation has opted not to pay higher rates on maturing certificates of deposit, resulting in the decline in this type of deposit. The Corporation believes it has ample liquidity from core deposits, principal pay downs on loans and maturing or called investments. Average borrowings at the Federal Home Loan Bank decreased \$4.7 million to \$20.8 million for the third quarter of 2011 as compared to the same period a year ago, as borrowings continue to mature and are not replaced.

Average yields on interest-earning assets, on a tax-equivalent basis, declined 55 basis points to 3.85 percent for the third quarter of 2011, from 4.40 percent for the same quarter of 2010. For the third quarter of 2011, average yields earned on investment securities declined 84 basis points to 2.18 percent as compared to the same period in the prior year. Average yields on the loan portfolio were 4.81 percent and 5.26 percent, for the third quarters of 2011 and 2010, respectively, reflecting a 45 basis point decline.

The cost of funds, including the effect of noninterest-bearing demand deposits, was 0.48 percent and 0.78 percent for the third quarters of 2011 and 2010, respectively, decreasing 30 basis points. The average cost of interest-bearing checking deposits was 0.33 percent for the third quarter of 2011, declining 30 basis points from the same period in 2010. For the third quarter of 2011, the cost of money market products averaged 0.34 percent, declining 31 basis points, while certificates of deposit costs averaged 1.34 percent, declining 23 basis points, each as compared to the third quarter of 2010.

For the first nine months of 2011 and 2010, the Corporation recorded net interest income, on a tax-equivalent basis, of \$36.8 million and \$37.9 million, respectively, a decrease of \$1.1 million or 3.0 percent. On a fully tax-equivalent basis, the net interest margin, was 3.46 percent for the nine months ended September 30, 2011 as compared to 3.65 percent for the same year-to-date period in 2010, a decline of 19 basis points. The decrease in net interest income is primarily the result of lower rates earned on interest-earning assets partially offset by a lower cost of funds.

Average investments, federal funds sold and interest-earning deposits totaled \$457.4 million and \$420.0 million for the first nine months of 2011 and 2010, respectively, increasing \$37.3 million or 8.9 percent. The growth in these categories is primarily the result of deposit inflows and loan pay downs which exceeded loan demand.

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Average loans totaled \$956.7 million for the nine months ended September 30, 2011, declining \$7.2 million, or 0.7 percent, from the same period in 2010. The commercial construction portfolio averaged \$18.5 million for the first nine months of 2011, declining \$32.7 million from the same 2010 period. For the first nine months of 2011 and 2010, the commercial mortgage loan portfolio averaged \$305.2 million and \$280.0 million, respectively, an increase of \$25.1 million, or 9.0 percent due to growth in the multi-family portfolio. The average residential mortgage loan portfolio totaled \$434.2 million and \$437.8 million for the nine months ended September 30, 2011 and 2010, respectively, declining \$3.6 million or 0.8 percent, as loan payments have outpaced originations put into the portfolio for the 2011 year to date period. The commercial loan portfolio averaged \$130.2 million for the first nine months of 2011 as compared to \$129.0 million for the same period of 2010, increasing \$1.2 million. The average home equity portfolio totaled \$48.0 million for the nine months ended September 30, 2011, an increase of \$7.2 million or 17.8 percent, over the same period of 2010. As noted above, the Corporation has focused on the origination of these higher-yielding, shorter-maturity loans during the past year.

Average deposits totaled \$1.36 billion and \$1.32 billion, for the nine months ended September 30, 2011 and 2010, respectively, an increase of \$38.4 million, or 2.9 percent from the prior year period. The Corporation continues to focus on core deposit growth, resulting in increases in average interest-bearing checking accounts for the first nine months of 2011 of \$58.9 million or 23.5 percent from the same period in 2010. In addition, average money market accounts grew \$12.6 million, or 2.5 percent, to \$519.7 million for the nine months ended September 30, 2011 as compared to the same period of 2010 as certain customers tend to “park” funds in money market accounts in a lower interest rate environment. For the first nine months of 2011 and 2010, average savings accounts totaled \$85.4 million and \$76.5 million, respectively, increasing \$9.0 million or 11.7 percent since the 2010 period. When compared to the first nine months of 2010, average non-interest bearing demand deposits increased \$24.4 million, or 11.6 percent to \$235.7 million for the same period of 2011. For the nine months ended September 30, 2011, certificates of deposit averaged \$210.5 million, declining \$66.4 million or 24.0 percent because the Corporation has opted not to pay higher rates on maturing certificates of deposit, higher costing certificates of deposit have declined. Average borrowings at the Federal Home Loan Bank totaled \$23.9 million for the nine months ended September 30, 2011, as compared to \$31.4 million for the same nine months of 2010, a decline of \$7.5 million, or 23.8 percent, as borrowings continue to mature and are not replaced.

Average yields, on a fully tax-equivalent basis, on interest-earning assets declined 50 basis points to 4.00 percent for the first nine months of 2011, from 4.50 percent for the same period of 2010. For the nine months ended September 30, 2011, average yields earned on investment securities declined 76 basis points to 2.39 percent as compared to 3.15 percent for the same prior year period. Average yields on the loan portfolio were 4.88 percent and 5.29 percent for the first nine months of 2011 and 2010, respectively, a 41 basis point decline.

The cost of funds, including the effect of noninterest-bearing demand deposits, was 0.54 percent and 0.87 percent for the nine months ended September 30, 2011 and 2010, respectively, decreasing 33 basis points. The average cost of interest-bearing checking deposits was 0.37 percent for the first nine months of 2011, declining 29 basis points from the same 2010 period. The cost of money market products averaged 0.42 percent for the nine months ended September 30, 2011, declining 36 basis points, while certificates of deposit costs averaged 1.38 percent, declining 26 basis points from 1.64 percent, each as compared to the same period of 2010.

The effect of the sustained low rate environment on market rates and the Corporation’s repricing of its assets and liabilities contributed to the decline in yields and costs of the Corporation’s interest-bearing assets and liabilities.



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The following tables reflect the components of net interest income for the periods indicated:

Average Balance Sheet  
Unaudited  
Three Months Ended  
(Tax-Equivalent Basis, Dollars in Thousands)

|  | September 30, 2011 |                    |        | September 30, 2010 |                    |        |
|--|--------------------|--------------------|--------|--------------------|--------------------|--------|
|  | Average<br>Balance | Income/<br>Expense | Yield  | Average<br>Balance | Income/<br>Expense | Yield  |
| <b>ASSETS:</b>                         |                    |                    |        |                    |                    |        |
| Interest-earnings assets:              |                    |                    |        |                    |                    |        |
| Investments:                           |                    |                    |        |                    |                    |        |
| Taxable (1)                            | \$350,946          | \$1,762            | 2.01 % | \$314,213          | \$2,230            | 2.84 % |
| Tax-exempt (1) (2)                     | 37,238             | 353                | 3.79   | 32,545             | 384                | 4.72   |
| Loans held for sale                    | 610                | 12                 | 8.37   | N/A                | N/A                | N/A    |
| Loans (2) (3)                          | 964,400            | 11,589             | 4.81   | 949,301            | 12,473             | 5.26   |
| Federal funds sold                     | 100                | -                  | 0.25   | 193                | -                  | 0.22   |
| Interest-earning deposits              | 77,295             | 43                 | 0.22   | 78,501             | 50                 | 0.26   |
| Total interest-earning assets          | 1,430,589          | \$13,759           | 3.85 % | 1,374,753          | \$15,137           | 4.40 % |
| Noninterest -earning assets:           |                    |                    |        |                    |                    |        |
| Cash and due from banks                | 8,458              |                    |        | 8,314              |                    |        |
| Allowance for loan losses              | (14,592 )          |                    |        | (14,180 )          |                    |        |
| Premises and equipment                 | 32,876             |                    |        | 34,589             |                    |        |
| Other assets                           | 72,428             |                    |        | 70,056             |                    |        |
| Total noninterest-earning assets       | 99,170             |                    |        | 98,779             |                    |        |
| Total assets                           | \$1,529,759        |                    |        | \$1,473,532        |                    |        |
| <b>LIABILITIES:</b>                    |                    |                    |        |                    |                    |        |
| Interest-bearing deposits:             |                    |                    |        |                    |                    |        |
| Checking                               | \$321,368          | \$269              | 0.33 % | \$259,816          | \$409              | 0.63 % |
| Money markets                          | 519,918            | 438                | 0.34   | 515,734            | 839                | 0.65   |
| Savings                                | 87,863             | 51                 | 0.23   | 78,058             | 78                 | 0.40   |
| Certificates of deposit                | 203,612            | 684                | 1.34   | 251,511            | 986                | 1.57   |
| Total interest-bearing deposits        | 1,132,761          | 1,442              | 0.51   | 1,105,119          | 2,312              | 0.84   |
| Borrowings                             | 20,831             | 177                | 3.40   | 25,532             | 223                | 3.49   |
| Capital lease obligation               | 6,406              | 80                 | 4.99   | 6,177              | 77                 | 4.98   |
| Total interest-bearing liabilities     | 1,159,998          | 1,699              | 0.59   | 1,136,828          | 2,612              | 0.92   |
| Noninterest bearing liabilities        |                    |                    |        |                    |                    |        |
| Demand deposits                        | 246,665            |                    |        | 211,390            |                    |        |
| Accrued expenses and other liabilities | 6,287              |                    |        | 8,216              |                    |        |
| Total noninterest-bearing liabilities  | 252,952            |                    |        | 219,606            |                    |        |
| Shareholders' equity                   | 116,809            |                    |        | 117,098            |                    |        |
| Total liabilities and                  |                    |                    |        |                    |                    |        |

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|                           |              |      |   |              |   |
|---------------------------|--------------|------|---|--------------|---|
| shareholders' equity      | \$ 1,529,759 |      |   | \$ 1,473,532 |   |
| Net Interest income       |              |      |   |              |   |
| (tax-equivalent basis)    | 12,060       |      |   | 12,525       |   |
| Net interest spread       |              | 3.26 | % | 3.48         | % |
| Net interest margin (4)   |              | 3.37 | % | 3.64         | % |
| Tax equivalent adjustment | (165 )       |      |   | (163 )       |   |
| Net interest income       | \$ 11,895    |      |   | \$ 12,362    |   |

- (1) Average balances for available-for sale securities are based on amortized cost.
- (2) Interest income is presented on a tax-equivalent basis using a 35 percent federal tax rate.
- (3) Loans are stated net of unearned income and include nonaccrual loans.
- (4) Net interest income on a tax-equivalent basis as a percentage of total average interest-earning assets.

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Average Balance Sheet  
Unaudited  
Nine Months Ended  
(Tax-Equivalent Basis, Dollars in Thousands)

|  | September 30, 2011 |                    |       | September 30, 2010 |                    |          |      |   |
|--|--------------------|--------------------|-------|--------------------|--------------------|----------|------|---|
|  | Average<br>Balance | Income/<br>Expense | Yield | Average<br>Balance | Income/<br>Expense | Yield    |      |   |
| <b>ASSETS:</b>                             |                    |                    |       |                    |                    |          |      |   |
| Interest-earnings assets:                  |                    |                    |       |                    |                    |          |      |   |
| Investments:                               |                    |                    |       |                    |                    |          |      |   |
| Taxable (1)                                | \$369,960          | \$6,240            | 2.25  | %                  | \$320,452          | \$7,145  | 2.97 | % |
| Tax-exempt (1) (2)                         | 36,566             | 1,053              | 3.84  |                    | 35,133             | 1,253    | 4.76 |   |
| Loans held for sale                        | 617                | 33                 | 7.22  |                    | N/A                | N/A      | N/A  |   |
| Loans (2) (3)                              | 956,651            | 35,011             | 4.88  |                    | 963,840            | 38,242   | 5.29 |   |
| Federal funds sold                         | 100                | -                  | 0.26  |                    | 198                | -        | 0.21 |   |
| Interest-earning deposits                  | 50,736             | 91                 | 0.24  |                    | 64,237             | 102      | 0.21 |   |
| Total interest-earning assets              | 1,414,630          | \$42,428           | 4.00  | %                  | 1,383,860          | \$46,742 | 4.50 | % |
| Noninterest -earning assets:               |                    |                    |       |                    |                    |          |      |   |
| Cash and due from banks                    | 8,191              |                    |       |                    | 8,375              |          |      |   |
| Allowance for loan losses                  | (14,869 )          |                    |       |                    | (14,011 )          |          |      |   |
| Premises and equipment                     | 33,300             |                    |       |                    | 31,110             |          |      |   |
| Other assets                               | 71,970             |                    |       |                    | 69,234             |          |      |   |
| Total noninterest-earning assets           | 98,592             |                    |       |                    | 94,708             |          |      |   |
| Total assets                               | \$1,513,222        |                    |       |                    | \$1,478,568        |          |      |   |
| <b>LIABILITIES:</b>                        |                    |                    |       |                    |                    |          |      |   |
| Interest-bearing deposits:                 |                    |                    |       |                    |                    |          |      |   |
| Checking                                   | \$309,646          | \$865              | 0.37  | %                  | \$250,785          | \$1,234  | 0.66 | % |
| Money markets                              | 519,700            | 1,638              | 0.42  |                    | 507,075            | 2,977    | 0.78 |   |
| Savings                                    | 85,415             | 159                | 0.25  |                    | 76,456             | 235      | 0.41 |   |
| Certificates of deposit                    | 210,498            | 2,172              | 1.38  |                    | 276,937            | 3,406    | 1.64 |   |
| Total interest-bearing deposits            | 1,125,259          | 4,834              | 0.57  |                    | 1,111,253          | 7,852    | 0.94 |   |
| Borrowings                                 | 23,890             | 578                | 3.23  |                    | 31,369             | 838      | 3.56 |   |
| Capital lease obligation                   | 6,384              | 239                | 4.99  |                    | 2,754              | 128      | 6.18 |   |
| Total interest-bearing liabilities         | 1,155,533          | 5,651              | 0.65  |                    | 1,145,376          | 8,818    | 1.03 |   |
| Noninterest bearing liabilities            |                    |                    |       |                    |                    |          |      |   |
| Demand deposits                            | 235,666            |                    |       |                    | 211,223            |          |      |   |
| Accrued expenses and other liabilities     | 6,552              |                    |       |                    | 6,665              |          |      |   |
| Total noninterest-bearing liabilities      | 242,218            |                    |       |                    | 217,888            |          |      |   |
| Shareholders' equity                       | 115,471            |                    |       |                    | 115,304            |          |      |   |
| Total liabilities and shareholders' equity | \$1,513,222        |                    |       |                    | \$1,478,568        |          |      |   |
| Net Interest income                        |                    |                    |       |                    |                    |          |      |   |

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|                           |          |      |   |          |   |
|---------------------------|----------|------|---|----------|---|
| (tax-equivalent basis)    | 36,777   |      |   | 37,924   |   |
| Net interest spread       |          | 3.35 | % | 3.47     | % |
| Net interest margin (4)   |          | 3.46 | % | 3.65     | % |
| Tax equivalent adjustment | (478 )   |      |   | (527 )   |   |
| Net interest income       | \$36,299 |      |   | \$37,397 |   |

- (1) Average balances for available-for sale securities are based on amortized cost.
- (2) Interest income is presented on a tax-equivalent basis using a 35 percent federal tax rate.
- (3) Loans are stated net of unearned income and include nonaccrual loans.
- (4) Net interest income on a tax-equivalent basis as a percentage of total average interest-earning assets.



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**OTHER INCOME:** Other income, excluding fee income from PGB Trust and Investments, totaled \$1.4 million for the third quarter of 2011, as compared to \$969 thousand for the same quarter in 2010. In the third quarter of 2010, the Corporation recorded an other-than-temporary, non-cash impairment charge on its equity portfolio totaling \$360 thousand, since the fair value for certain securities had been below book value for an extended period of time. Net securities gains of \$248 thousand and \$126 thousand were recorded for the third quarters of 2011 and 2010, respectively. Service charges and fees increased \$38 thousand or 5.4 percent from \$709 thousand in the third quarter of 2010 to \$747 thousand in the same quarter of 2011, due principally to increased activity from checking customers. For the third quarter of 2011, income earned on bank owned life insurance was \$257 thousand, an increase of \$29 thousand or 12.7 percent, from the income earned in the same quarter of 2010, which was attributable to higher yields in 2011.

The Corporation recorded other income, excluding fee income from PGB Trust and Investments, of \$4.4 million and \$3.2 million for the nine months ended September 30, 2011 and 2010, respectively, an increase of \$1.2 million or 37.3 percent. Net securities gains totaled \$721 thousand for the nine months ended September 30, 2011 as compared to \$128 thousand in the same nine months of 2010. For the first nine months of 2011, service charges and fees increased \$148 thousand or 7.2 percent from the same period last year to \$2.2 million, due principally to increased activity from checking customers. Income earned on bank owned life insurance for the nine months ended September 30, 2011 was \$769 thousand as compared to \$644 thousand for the nine months ended September 30, 2010, an increase of \$125 thousand or 19.4 percent, which was attributable to higher yields in 2011.

**OPERATING EXPENSES:** For the third quarters of 2011 and 2010, the Corporation recorded operating expenses of \$10.6 million and \$10.9 million, respectively. Salary and benefit expense was \$5.8 million for the quarter ended September 30, 2011, as compared to \$5.6 million in the same quarter of 2010, an increase of \$142 thousand or 2.5 percent. Premises and equipment expense totaled \$2.3 million and \$2.4 million, for the third quarters of 2011 and 2010, respectively, a decrease of \$94 thousand or 3.9 percent, as the prior year period included various move-related expenses. FDIC expense decreased \$333 thousand to \$253 thousand for the third quarter of 2011 as compared to \$586 thousand for the third quarter of 2010 due to a regulatory change in the calculation of the assessment. Professional and legal fees declined approximately \$69 thousand or 21.8 percent from \$317 thousand in the third quarter of 2010 to \$248 thousand in the same quarter of 2011. Expenses for problem loans increased loan expense by approximately \$95 thousand of the \$152 thousand increase in that line item from the third quarter of 2010 to the third quarter of 2011.

The Corporation recorded operating expenses of \$32.9 million and \$32.4 million for the nine months ended September 30, 2011 and 2010, respectively, an increase of \$430 thousand or 1.3 percent. Salary and benefit expense was \$17.6 million for the first nine months of 2011 as compared to \$17.1 million for the same period a year ago, an increase of \$519 thousand or 3.0 percent, in part due to salary increases and additional benefit costs, offset in part by a decline in commissions paid to mortgage originators. Premises and equipment expense for the nine months ended September 30, 2011 and 2010, was \$7.1 million and \$7.4 million, respectively, a decrease of \$318 thousand or 4.3 percent. Last year's premises and equipment expense included some one-time expenses due to the move to a new administration building as well as some branch-related maintenance projects. For the nine months ended September 30, 2011, FDIC expense was \$1.3 million, a decrease of \$470 thousand or 27.3 percent, from the \$1.7 million recorded in the same period of 2010, due to the calculation change described above. Professional and legal fees recorded for the nine months ended September 30, 2011 was \$821 thousand, declining \$197 thousand or 19.4 percent from the same period a year ago and was due to one-time expenses due to the major system upgrade in our Trust Division in May 2010. Loan expense increased by \$291 thousand from \$385 thousand for the nine months ended September 30, 2010 to \$676 thousand for the same period in 2011, a 75.6 percent increase resulting from higher expenses associated with problem loans. The Corporation recorded trust department expense for the nine months ended September 30, 2011 of \$1.2 million, an increase of \$310 thousand or 34.0 percent from the same nine month period in 2010 due to increased recurring costs of the system upgrade implemented last year. Other operating

expenses were \$2.5 million and \$2.2 million for

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the nine months ended September 30, 2011 and 2010, respectively, an increase of \$227 thousand or 10.2 percent, which includes increases to other real estate owned expense of \$57 thousand and expense of our debit card program, including fraud-related chargebacks, of \$82 thousand.

The following table presents the components of other expense for the periods indicated:

| (In thousands)                 | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                | 2011                                | 2010      | 2011                               | 2010      |
| Salaries and employee benefits | \$ 5,789                            | \$ 5,647  | \$ 17,579                          | \$ 17,060 |
| Premises and equipment         | 2,322                               | 2,416     | 7,058                              | 7,376     |
| FDIC assessment                | 253                                 | 586       | 1,254                              | 1,724     |
| Trust department expense       | 291                                 | 350       | 1,223                              | 913       |
| Professional and legal fees    | 248                                 | 317       | 821                                | 1,018     |
| Loan Expense                   | 384                                 | 232       | 676                                | 385       |
| Telephone                      | 175                                 | 279       | 622                                | 580       |
| Advertising                    | 163                                 | 143       | 575                                | 531       |
| Stationery and supplies        | 101                                 | 118       | 292                                | 323       |
| Postage                        | 92                                  | 84        | 289                                | 276       |
| Other expense                  | 755                                 | 714       | 2,462                              | 2,235     |
| Total other expense            | \$ 10,573                           | \$ 10,886 | \$ 32,851                          | \$ 32,421 |

**PGB TRUST AND INVESTMENTS:** PGB Trust and Investments, a division of the Bank, has served in the roles of executor and trustee while providing investment management, custodial, tax, retirement and financial services to its growing client base. Officers from PGB Trust and Investments are available to provide trust and investment services at the Bank's new corporate headquarters in Bedminster, New Jersey, and its Clinton, Morristown and Summit, New Jersey branches as well as at an office located in Bethlehem, Pennsylvania.

The market value of trust assets under administration for PGB Trust and Investments was approximately \$1.86 billion at September 30, 2011 as compared to \$1.93 billion at September 30, 2010.

PGB Trust and Investments generated fee income of \$2.6 million for the third quarter of 2011 as compared to \$2.3 million for the same quarter of 2010, an increase of \$301 thousand or 13.4 percent. For the first nine months of 2011 and 2010, PGB Trust and Investments generated fee income of \$8.1 million and \$7.3 million, respectively, an increase of \$799 thousand or 10.9 percent. The increase reflects increased customers and profitable relationships.

While the "Operating Expenses" section above offers an overall discussion of the Corporation's expenses including the Trust Division, other expenses relative to PGB Trust and Investments totaled \$2.2 million and \$2.3 million for the third quarters of 2011 and 2010, respectively, a decrease of \$26 thousand or 1.2 percent. For the third quarter of 2011, salaries and benefits expense increased \$104 thousand, or 9.5 percent when compared to the same period in 2010.

PGB Trust and Investments recorded other expenses of \$7.2 million for the nine months ended September 30, 2011 as compared to \$7.1 million for the same period of 2010, an increase of \$69 thousand, or 1.0 percent. Salaries and benefits expense was \$3.6 million and \$3.7 million for the first nine months of 2011 and 2010, respectively, a decrease of \$46 thousand, or 1.3 percent. Other expenses totaled \$3.6 million for the nine months ended September 30, 2011, an increase of \$115 thousand, or 3.3 percent when compared to the same 2010 period. A portion of the increased expenses related to a new operating system, which the Division began using in May 2010.

The Trust Division currently generates adequate revenue to support the salaries, benefits and other expenses of the Division; however, Management believes that the Bank generates adequate liquidity to support the expenses of the Division should it be necessary.

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NONPERFORMING ASSETS: Other real estate owned (OREO), loans past due in excess of 90 days and still accruing, and nonaccrual loans are considered nonperforming assets. These assets totaled \$26.2 million and \$22.8 million at September 30, 2011 and December 31, 2010 respectively. Nonperforming loans have increased during the third quarter of 2011 due to two commercial mortgage loans totaling \$6.4 million.

The following table sets forth asset quality data on the dates indicated (in thousands):

|   | September<br>30,<br>2011 | June 30,<br>2011 | March 31,<br>2011 | December<br>31,<br>2010 | September<br>30,<br>2010 |
|---|--------------------------|------------------|-------------------|-------------------------|--------------------------|
| Loans past due over 90 days<br>and still accruing                             | \$ 836                   | \$412            | \$323             | \$ 666                  | \$ 442                   |
| Nonaccrual loans  | 22,103                   | 14,943           | 19,173            | 18,114                  | 17,535                   |
| Other real estate owned   | 3,264                    | 3,000            | 3,000             | 4,000                   | 1,000                    |
| Total nonperforming assets  | \$ 26,203                | \$18,355         | \$22,496          | \$ 22,780               | \$ 18,977                |
| Accruing TDR's  | \$ 5,519                 | \$8,171          | \$3,787           | \$ 5,680                | \$ 7,468                 |
| Loans past due 30 through 89 days<br>and still accruing                       | \$ 9,706                 | \$8,200          | \$5,419           | \$ 5,475                | \$ 9,487                 |
| Classified loans (A)  | \$ 52,031                | \$51,586         | \$51,186          | \$ 41,979               | \$ 36,521                |
| Impaired Loans (A)  | \$ 27,529                | \$23,115         | \$26,056          | \$ 28,397               | \$ 36,521                |
| Nonperforming loans as a % of<br>total loans                                  | 2.36                     | % 1.59           | % 2.05            | % 2.01                  | % 1.90                   |
| Nonperforming assets as a % of<br>total assets                                | 1.66                     | % 1.21           | % 1.48            | % 1.51                  | % 1.28                   |
| Nonperforming assets as a % of<br>total loans plus other real<br>estate owned | 2.68                     | % 1.89           | % 2.36            | % 2.43                  | % 2.01                   |

(A) At September 30, 2011, \$27.5 million, June 30, 2011, \$23.1 million, at March 31, 2011 \$26.1 million and at December 31, 2010, \$28.4 million of the classified loans were also considered impaired. In periods prior to December 31, 2010, all loans classified substandard were also considered impaired.

We do not hold, have not made nor invested in subprime loans or "Alt-A" type mortgages.

PROVISION FOR LOAN LOSSES: The provision for loan losses was \$1.5 million and \$2.0 million for the third quarters of 2011 and 2010, respectively. The provision for loan losses was \$5.5 million for the first nine months of 2011 as compared to \$7.2 million for the same 2010 period. The amount of the loan loss provision and the level of the allowance for loan losses are based upon a number of factors including Management's evaluation of probable losses inherent in the portfolio, after consideration of appraised collateral values, financial condition and past credit history of the borrowers as well as prevailing economic conditions. Commercial credits carry a higher risk profile, which is reflected in Management's determination of the proper level of the allowance for loan losses.

The provision for loan losses was primarily made for the changes in the specific reserves on impaired loans, net charge-offs and for the impact of the net charge-off trends and environmental factors on the general reserve.

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Of the \$1.5 million quarterly provision for loan losses, \$1.4 million was made for net charge-offs as approximately \$359 thousand of the \$1.8 million in net charge-offs was specifically reserved on impaired loans at June 30, 2011. In addition, approximately \$770 thousand was added for specific reserves on impaired loans due to new loans being added to the impaired category and additional information surfacing during the quarter on existing impaired loans. This increase in the specific reserves of the allowance was offset by the decline in the general reserves, which declined by \$630 thousand during the quarter. The decline in the general reserves was primarily related to a slight shift in the loan portfolio composition resulting from the \$14.7 million decline in non-impaired commercial real estate, commercial and construction loans that carry a higher general allowance allocation. This decline was offset by loans with lower allowance allocations as the Corporation experienced \$14.7 million growth in the multi-family, residential mortgage and home equity loan portfolios. The \$5.5 million year-to-date provision for loan losses was primarily made for net charge-offs.

The overall allowance for loan losses was \$13.8 million as of September 30, 2011 as compared to \$14.3 million at December 31, 2010. As a percentage of loans, the allowance for loan losses was 1.42 percent as of September 30, 2011 as compared to 1.53 percent at December 31, 2010. The decline in the allowance as a percentage of loans is primarily due to the charge-off of specific reserves on impaired loans. The specific reserves on impaired loans have decreased to \$2.1 million at September 30, 2011 as compared to \$2.5 million as of December 31, 2010. Total impaired loans were \$27.5 million and \$28.4 million as of September 30, 2011 and December 31, 2010, respectively. The general component of the allowance also declined from \$11.8 million at December 31, 2010 to \$11.7 million at September 30, 2011. As a percentage of non-impaired loans, the general reserve was 1.24 percent and 1.30 percent at September 30, 2011 and December 31, 2010, respectively. Based on its analysis, Management believes the allowance for loan loss is a reasonable estimate for probable incurred losses in the portfolio as of September 30, 2011.

**INCOME TAXES:** In the third quarter of 2011, the Corporation reversed a previously recorded valuation allowance that was established against the deferred state tax assets of \$3.0 million. Income tax expense, without considering the reversal, as a percentage of pre-tax income was 38 percent for the third quarter of 2011 as compared to 29 percent for the third quarter of 2010. Pre-tax income totaled \$3.8 million and \$2.7 million for the third quarters of 2011 and 2010, respectively. Income tax expense, without considering the 2011 valuation allowance reversal, as a percentage of pre-tax income was 36 percent and 30 percent for the nine months ended September 30, 2011 and 2010, respectively. Pre-tax income totaled \$10.4 million for the first nine months of 2011 as compared to \$8.3 million for the same 2010 period. The increase in the effective tax rate, ignoring the reversal of the valuation allowance, for the three and nine months ended September 30, 2011 as compared to the same periods in 2010 was due to increased income at the Bank level due to the dissolution of the Bank's investment company subsidiary.

**CAPITAL RESOURCES:** At September 30, 2011, the Corporation's total shareholders' equity was \$120.7 million as compared to \$117.7 million at December 31, 2010. The primary reason for the increase is due to a one-time state tax benefit of \$2.9 million applied during the third quarter. This tax benefit is related to the reversal of a previously recorded valuation allowance against net state tax benefits related to security impairment charges recorded in the year ended December 31, 2008.

The Corporation through the Bank is subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation and the Bank's consolidated financial statements.





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Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. At year-end 2010 and 2009, the Bank's capital ratios met or exceeded the minimum to be categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that Management believes have changed the institution's category.

Tier 1 Capital consists of common stock, retained earnings, minority interests in the equity accounts of consolidated subsidiaries non-cumulative preferred stock, and cumulative preferred stock issued to the U.S. Treasury in the Capital Purchase Program, less goodwill and certain other intangibles. The remainder of capital may consist of other preferred stock, certain other instruments and a portion of the allowance for loan loss. At September 30, 2011, the Bank's Tier 1 Capital and Total Capital ratios to risk-weighted assets were 12.40 percent and 13.65 percent, respectively, both in excess of the well-capitalized standards of 6.0 percent and 10.0 percent, respectively.

In addition, the Federal Reserve Board has established minimum leverage ratio guidelines. The Bank's leverage ratio at September 30, 2011, was 7.66 percent, in excess of the well-capitalized standard of 5.0 percent.

At September 30, 2011, the Corporation's Tier 1 Capital and Total Capital ratios to risk-weighted assets were 12.73 percent and 13.98 percent, respectively, while the Corporation's leverage ratio was 7.86 percent.

**LIQUIDITY:** Liquidity refers to an institution's ability to meet short-term requirements in the form of loan requests, deposit withdrawals and maturing obligations. Principal sources of liquidity include cash, temporary investments and securities available for sale.

Management believes that the Corporation's liquidity position is sufficient to meet future needs. Cash and cash equivalents, interest earning deposits and federal funds sold totaled \$74.7 million at September 30, 2011. In addition, the Corporation has \$311.9 million in securities designated as available for sale. These securities can be sold in response to liquidity concerns or pledged as collateral for borrowings as discussed below. Carrying value as of September 30, 2011, of investment securities and securities available for sale maturing within one year totaled \$21.8 million.

The primary source of funds available to meet liquidity needs is the Corporation's core deposit base, which excludes certificates of deposit greater than \$100 thousand. As of September 30, 2011, core deposits equaled \$1.31 billion.

Another source of liquidity is borrowing capacity. The Corporation has a variety of sources of short-term liquidity available, including federal funds purchased from correspondent banks, short-term and long-term borrowings from the Federal Home Loan Bank of New York, access to the Federal Reserve Bank discount window and loan participations of sales of loans. The Corporation also generates liquidity from the regular principal payments made on its mortgage-backed securities and loan portfolios.

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RECENT ACCOUNTING PRONOUNCEMENTS:

The FASB has issued Accounting Standards Update (ASU) No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU amends the FASB Accounting Standards Codification<sup>TM</sup> (Codification) to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments to the Codification in the ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The provisions of this update are not expected to have a material impact on the Corporation's consolidated financial position, results of operations or cash flows.

The FASB has issued Accounting Standards Update (ASU) No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification<sup>TM</sup> (Codification) in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The provisions of this update are not expected to have a material impact on the Corporation's consolidated financial position, results of operations or cash flows.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to information required regarding quantitative and qualitative disclosures about market risk from the end of the preceding fiscal year to the date of the most recent interim financial statements (September 30, 2011).

ITEM 4. Controls and Procedures

The Corporation's Chief Executive Officer and Chief Financial Officer, with the assistance of other members of the Corporation's management, have evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives. Based on such evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures are effective.

The Corporation's Chief Executive Officer and Chief Financial Officer have also concluded that there have not been any changes in the Corporation's internal control over financial reporting during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.



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The Corporation's management, including the CEO and CFO, does not expect that our disclosure controls and procedures of our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, provides reasonable, not absolute, assurance that the objectives of the control system are met. The design of a control system reflects resource constraints; the benefits of controls must be considered relative to their costs. Because there are inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been or will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty that breakdowns occur because of simple error or mistake. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all future conditions; over time, control may become inadequate because of changes in conditions or deterioration in the degree of compliance with the policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

ITEM 1A. Risk Factors

There were no material changes in the Corporation's risk factors during the nine months ended September 30, 2011 from the risk factors disclosed in Part I, Item 1A of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010.

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

There were no repurchases or unregistered sales of the Corporation's stock during the quarter.

ITEM 6. Exhibits

- 3 Articles of Incorporation and By-Laws:
  - A. Certificate of Incorporation of the Registrant, as amended, as incorporated herein by reference to the Registrant's Form 10-Q Quarterly Report filed on November 9, 2009.
  - B. By-Laws of the Registrant, incorporated herein by reference to the Registrant's Current Report on Form 8-K filed on April 23, 2007.
- 31.1 Certification of Frank A. Kissel, Chief Executive Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).
- 31.2 Certification of Jeffrey J. Carfora, Chief Financial Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).
- 32 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002, signed by Frank A. Kissel, Chief Executive Officer of the Corporation, and Jeffrey J. Carfora, Chief Financial Officer of the Corporation.
- 101 Interactive Data File \*

\* As provided in Rule 406T of Regulation S-T, this information is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933 and is deemed not filed for the

purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURES

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

PEAPACK-GLADSTONE FINANCIAL CORPORATION  
(Registrant)

DATE: November 9, 2011

By: /s/ Frank A. Kissel  
Frank A. Kissel  
Chairman of the Board and Chief Executive Officer

DATE: November 9, 2011

By: /s/ Jeffrey J. Carfora  
Jeffrey J. Carfora  
Executive Vice President and Chief Financial Officer and  
Chief Accounting Officer

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EXHIBIT INDEX

| Number | Description  |
|--------|--|
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