

PARKE BANCORP, INC.  
Form 10-Q  
November 14, 2016

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

FORM 10-Q

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

For the quarterly period ended: September 30, 2016.

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. 000-51338

PARKE BANCORP, INC.  
(Exact name of registrant as specified in its charter)

New Jersey 65-1241959  
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

601 Delsea Drive, Washington Township, New Jersey 08080  
(Address of principal executive offices) (Zip Code)

856-256-2500  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

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

Large accelerated filer ☐      Accelerated filer ☐      Non-accelerated filer ☐      Smaller reporting company ☒

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

Yes ☐      No ☒

As of November 14, 2016, there were issued and outstanding 6,843,064 shares of the registrant's common stock.

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PARKE BANCORP, INC.

FORM 10-Q

FOR THE QUARTER ENDED September 30, 2016

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## Parke Bancorp, Inc. and Subsidiaries

## Consolidated Balance Sheets

(unaudited)

(in thousands except share and per share data)

|                                                                                                                                                                                  | September 30,<br>2016 | December 31,<br>2015 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| Assets                                                                                                                                                                           |                       |                      |
| Cash and due from financial institutions                                                                                                                                         | \$ 3,025              | \$ 3,131             |
| Federal funds sold and cash equivalents                                                                                                                                          | 49,122                | 24,298               |
| Total cash and cash equivalents                                                                                                                                                  | 52,147                | 27,429               |
| Investment securities available for sale, at fair value                                                                                                                          | 37,880                | 42,567               |
| Investment securities held to maturity (fair value of \$2,515 at September 30, 2016 and \$2,471 at December 31, 2015)                                                            | 2,213                 | 2,181                |
| Total investment securities                                                                                                                                                      | 40,093                | 44,748               |
| Loans held for sale                                                                                                                                                              | —                     | 2,640                |
| Loans, net of unearned income                                                                                                                                                    | 817,403               | 758,501              |
| Less: Allowance for loan losses                                                                                                                                                  | (14,874)              | (16,136)             |
| Net loans                                                                                                                                                                        | 802,529               | 742,365              |
| Accrued interest receivable                                                                                                                                                      | 2,904                 | 3,012                |
| Premises and equipment, net                                                                                                                                                      | 5,035                 | 4,591                |
| Other real estate owned (OREO)                                                                                                                                                   | 10,635                | 16,629               |
| Restricted stock, at cost                                                                                                                                                        | 4,208                 | 4,789                |
| Bank owned life insurance (BOLI)                                                                                                                                                 | 24,364                | 23,822               |
| Deferred tax asset                                                                                                                                                               | 10,606                | 10,928               |
| Other assets                                                                                                                                                                     | 2,077                 | 4,171                |
| Total Assets                                                                                                                                                                     | \$ 954,598            | \$ 885,124           |
| Liabilities and Equity                                                                                                                                                           |                       |                      |
| Liabilities                                                                                                                                                                      |                       |                      |
| Deposits                                                                                                                                                                         |                       |                      |
| Noninterest-bearing deposits                                                                                                                                                     | \$ 79,682             | \$ 52,773            |
| Interest-bearing deposits                                                                                                                                                        | 660,194               | 612,437              |
| Total deposits                                                                                                                                                                   | 739,876               | 665,210              |
| FHLB NY borrowings                                                                                                                                                               | 69,650                | 84,650               |
| Subordinated debentures                                                                                                                                                          | 13,403                | 13,403               |
| Accrued interest payable                                                                                                                                                         | 581                   | 494                  |
| Other liabilities                                                                                                                                                                | 5,891                 | 9,160                |
| Total liabilities                                                                                                                                                                | 829,401               | 772,917              |
| Equity                                                                                                                                                                           |                       |                      |
| Preferred stock, 1,000,000 shares authorized, \$1,000 liquidation value Series B - non-cumulative convertible; Issued: 20,000 shares at September 30, 2016 and December 31, 2015 | 20,000                | 20,000               |
| Common stock, \$.10 par value; authorized 15,000,000 shares; Issued: 6,843,159 shares at September 30, 2016 and 6,501,610 at December 31, 2015                                   | 713                   | 650                  |
| Additional paid-in capital                                                                                                                                                       | 62,094                | 53,984               |
| Retained earnings                                                                                                                                                                | 45,092                | 40,582               |

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|                                                                                                       |            |            |        |   |
|-------------------------------------------------------------------------------------------------------|------------|------------|--------|---|
| Accumulated other comprehensive income (loss)                                                         | 318        | (165       | )      |   |
| Treasury stock, 284,522 shares at September 30, 2016 and 280,354 shares at December 31, 2015, at cost | (3,015     | )          | (3,011 | ) |
| Total shareholders' equity                                                                            | 125,202    | 112,040    |        |   |
| Noncontrolling interest in consolidated subsidiaries                                                  | (5         | )          | 167    |   |
| Total equity                                                                                          | 125,197    | 112,207    |        |   |
| Total liabilities and equity                                                                          | \$ 954,598 | \$ 885,124 |        |   |
| See accompanying notes to consolidated financial statements                                           |            |            |        |   |

Parke Bancorp Inc. and Subsidiaries  
CONSOLIDATED STATEMENTS OF INCOME  
(unaudited)

|                                                                | For the three<br>months ended<br>September 30,<br>2016      2015<br>(in thousands except<br>share data) |          | For the nine months<br>ended<br>September 30,<br>2016      2015<br>(in thousands except<br>share data) |          |
|----------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|----------|--------------------------------------------------------------------------------------------------------|----------|
| Interest income:                                               |                                                                                                         |          |                                                                                                        |          |
| Interest and fees on loans                                     | \$10,012                                                                                                | \$ 9,532 | \$30,074                                                                                               | \$28,238 |
| Interest and dividends on investments                          | 293                                                                                                     | 365      | 966                                                                                                    | 950      |
| Interest on federal funds sold and cash equivalents            | 66                                                                                                      | 21       | 144                                                                                                    | 63       |
| Total interest income                                          | 10,371                                                                                                  | 9,918    | 31,184                                                                                                 | 29,251   |
| Interest expense:                                              |                                                                                                         |          |                                                                                                        |          |
| Interest on deposits                                           | 1,370                                                                                                   | 1,219    | 4,001                                                                                                  | 3,548    |
| Interest on borrowings                                         | 327                                                                                                     | 282      | 1,001                                                                                                  | 771      |
| Total interest expense                                         | 1,697                                                                                                   | 1,501    | 5,002                                                                                                  | 4,319    |
| Net interest income                                            | 8,674                                                                                                   | 8,417    | 26,182                                                                                                 | 24,932   |
| Provision for loan losses                                      | 700                                                                                                     | 1,450    | 762                                                                                                    | 3,040    |
| Net interest income after provision for loan losses            | 7,974                                                                                                   | 6,967    | 25,420                                                                                                 | 21,892   |
| Noninterest income:                                            |                                                                                                         |          |                                                                                                        |          |
| Gain on sale of SBA loans                                      | —                                                                                                       | 1,527    | 1,803                                                                                                  | 3,284    |
| Loan fees                                                      | 70                                                                                                      | 399      | 576                                                                                                    | 1,052    |
| Gain on Bank Owned Life Insurance                              | 184                                                                                                     | 90       | 542                                                                                                    | 267      |
| Service fees on deposit accounts                               | 87                                                                                                      | 73       | 231                                                                                                    | 209      |
| Loss on sale and write-down of real estate owned               | (718)                                                                                                   | (173)    | (1,760)                                                                                                | (1,296)  |
| Gain on sale of SBA related assets                             | —                                                                                                       | —        | 7,611                                                                                                  | —        |
| Other                                                          | 507                                                                                                     | 136      | 771                                                                                                    | 645      |
| Total noninterest income                                       | 130                                                                                                     | 2,052    | 9,774                                                                                                  | 4,161    |
| Noninterest expense:                                           |                                                                                                         |          |                                                                                                        |          |
| Compensation and benefits                                      | 1,687                                                                                                   | 1,872    | 5,552                                                                                                  | 5,781    |
| Professional services                                          | 386                                                                                                     | 395      | 1,212                                                                                                  | 1,269    |
| Occupancy and equipment                                        | 315                                                                                                     | 318      | 958                                                                                                    | 946      |
| Data processing                                                | 236                                                                                                     | 134      | 499                                                                                                    | 384      |
| FDIC insurance                                                 | 148                                                                                                     | 173      | 497                                                                                                    | 507      |
| OREO expense                                                   | 249                                                                                                     | 450      | 848                                                                                                    | 1,361    |
| Other operating expense                                        | 1,156                                                                                                   | 1,019    | 3,292                                                                                                  | 2,718    |
| Total noninterest expense                                      | 4,177                                                                                                   | 4,361    | 12,858                                                                                                 | 12,966   |
| Income before income tax expense                               | 3,927                                                                                                   | 4,658    | 22,336                                                                                                 | 13,087   |
| Income tax expense                                             | 51                                                                                                      | 1,730    | 6,751                                                                                                  | 4,638    |
| Net income attributable to Company and noncontrolling interest | 3,876                                                                                                   | 2,928    | 15,585                                                                                                 | 8,449    |
| Net income attributable to noncontrolling interest             | —                                                                                                       | (498)    | (452)                                                                                                  | (999)    |
| Net income attributable to Company                             | 3,876                                                                                                   | 2,430    | 15,133                                                                                                 | 7,450    |
| Preferred stock dividend and discount accretion                | 300                                                                                                     | 300      | 900                                                                                                    | 900      |
| Net income available to common shareholders                    | \$3,576                                                                                                 | \$ 2,130 | \$14,233                                                                                               | \$6,550  |
| Earnings per common share:                                     |                                                                                                         |          |                                                                                                        |          |
| Basic                                                          | \$0.52                                                                                                  | \$ 0.32  | \$2.08                                                                                                 | \$0.98   |

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|                                                             |           |           |           |           |
|-------------------------------------------------------------|-----------|-----------|-----------|-----------|
| Diluted                                                     | \$0.43    | \$ 0.28   | \$1.69    | \$0.87    |
| Weighted average shares outstanding:                        |           |           |           |           |
| Basic                                                       | 6,843,059 | 6,740,665 | 6,843,064 | 6,664,009 |
| Diluted                                                     | 8,967,972 | 8,651,581 | 8,960,040 | 8,572,858 |
| See accompanying notes to consolidated financial statements |           |           |           |           |

Parke Bancorp Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

|                                                             | For the three<br>months ended<br>September 30,<br>2016    2015<br>(in thousands) |         | For the nine<br>months ended<br>September 30,<br>2016    2015<br>(in thousands) |         |
|-------------------------------------------------------------|----------------------------------------------------------------------------------|---------|---------------------------------------------------------------------------------|---------|
| Net income attributable to Company                          | \$3,876                                                                          | \$2,430 | \$15,133                                                                        | \$7,450 |
| Unrealized gains (losses) on securities:                    |                                                                                  |         |                                                                                 |         |
| Non-credit related unrealized gains on securities with OTTI | 15                                                                               | —       | 24                                                                              | 26      |
| Unrealized (losses) gains on securities without OTTI        | (47 )                                                                            | 337     | 780                                                                             | (199 )  |
| Tax impact                                                  | 12                                                                               | (135 )  | (321 )                                                                          | 68      |
| Total unrealized gains (losses) on securities               | (20 )                                                                            | 202     | 483                                                                             | (105 )  |
| Total comprehensive income                                  | \$3,856                                                                          | \$2,632 | \$15,616                                                                        | \$7,345 |
| See accompanying notes to consolidated financial statements |                                                                                  |         |                                                                                 |         |

Parke Bancorp, Inc. and Subsidiaries  
**CONSOLIDATED STATEMENTS OF EQUITY**  
(unaudited)

|                                                             | Preferred<br>Stock | Shares of<br>Common<br>Stock | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss)<br>Income | Treasury<br>Stock | Total<br>Shareholders'<br>Equity | Non-Controlling<br>Interest | Total<br>Equity |
|-------------------------------------------------------------|--------------------|------------------------------|-----------------|----------------------------------|----------------------|-----------------------------------------------------------|-------------------|----------------------------------|-----------------------------|-----------------|
| (in thousands except share data)                            |                    |                              |                 |                                  |                      |                                                           |                   |                                  |                             |                 |
| Balance,<br>December 31,<br>2015                            | \$20,000           | 6,501,610                    | \$ 650          | \$53,984                         | \$40,582             | \$ (165 )                                                 | \$(3,011)         | \$112,040                        | \$ 167                      | \$112,207       |
| Capital<br>withdrawal by<br>non-controlling<br>interest     |                    |                              |                 |                                  |                      |                                                           |                   |                                  | (624 )                      | (624 )          |
| Net income                                                  |                    |                              |                 |                                  | 15,133               |                                                           |                   | 15,133                           | 452                         | 15,585          |
| Other<br>comprehensive<br>income                            |                    |                              |                 |                                  |                      | 483                                                       |                   | 483                              |                             | 483             |
| Stock<br>compensation                                       |                    |                              |                 | 48                               |                      |                                                           | (4 )              | 44                               |                             | 44              |
| Stock dividend<br>10%                                       |                    | 625,971                      | 63              | 8,062                            | (8,125 )             |                                                           |                   | —                                |                             | —               |
| Dividend on<br>preferred stock                              |                    |                              |                 |                                  | (900 )               |                                                           |                   | (900 )                           |                             | (900 )          |
| Dividend on<br>common stock                                 |                    |                              |                 |                                  | (1,598 )             |                                                           |                   | (1,598 )                         |                             | (1,598 )        |
| Balance,<br>September 30,<br>2016                           | \$20,000           | 7,127,581                    | \$ 713          | \$62,094                         | \$45,092             | \$ 318                                                    | \$(3,015)         | \$125,202                        | \$ (5 )                     | \$125,197       |
| See accompanying notes to consolidated financial statements |                    |                              |                 |                                  |                      |                                                           |                   |                                  |                             |                 |

Parke Bancorp Inc. and Subsidiaries  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited)

|                                                                                   | For the nine months ended |               |
|-----------------------------------------------------------------------------------|---------------------------|---------------|
|                                                                                   | September 30,             | September 30, |
|                                                                                   | 2016                      | 2015          |
|                                                                                   | (amounts in thousands)    |               |
| Cash Flows from Operating Activities:                                             |                           |               |
| Net income                                                                        | \$ 15,585                 | \$ 8,449      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |               |
| Depreciation and amortization                                                     | 181                       | 239           |
| Provision for loan losses                                                         | 762                       | 3,040         |
| Gain on Bank owned life insurance                                                 | (542 )                    | (267 )        |
| Gain on sale of SBA related assets                                                | (7,611 )                  | —             |
| Gain on sale of SBA loans                                                         | (1,803 )                  | (3,284 )      |
| SBA loans originated for sale                                                     | (14,041 )                 | (29,944 )     |
| Proceeds from sale of SBA loans originated for sale                               | 18,039                    | 34,136        |
| Loss on sale & write down of OREO                                                 | 1,760                     | 1,296         |
| Net accretion of purchase premiums and discounts on securities                    | 67                        | (639 )        |
| Deferred income tax benefit                                                       | 322                       | (70 )         |
| Changes in operating assets and liabilities:                                      |                           |               |
| Decrease (increase) in accrued interest receivable and other assets               | 2,214                     | (2,585 )      |
| Decrease in accrued interest payable and other accrued liabilities                | (3,182 )                  | (1,420 )      |
| Net cash provided by operating activities                                         | 11,751                    | 8,951         |
| Cash Flows from Investing Activities:                                             |                           |               |
| Purchases of investment securities available for sale                             | —                         | (20,476 )     |
| Redemptions (purchases) of restricted stock                                       | 581                       | (1,415 )      |
| Proceeds from maturities and principal payments on mortgage backed securities     | 5,392                     | 4,599         |
| Proceeds from sale of SBA related assets                                          | 50,348                    | —             |
| Donated OREO property                                                             | 31                        | —             |
| Proceeds from sale of OREO                                                        | 4,945                     | 3,936         |
| Capital improvements on OREO                                                      | 47                        | (179 )        |
| Net increase in loans                                                             | (104,452)                 | (45,320 )     |
| Purchases of bank premises and equipment                                          | (625 )                    | (226 )        |
| Net cash used in investing activities                                             | (43,733 )                 | (59,081 )     |
| Cash Flows from Financing Activities:                                             |                           |               |
| Payment of dividend on common & preferred stock                                   | (2,386 )                  | (1,927 )      |
| Purchase of treasury stock                                                        | (4 )                      | (713 )        |
| Minority interest capital withdrawal, net                                         | (624 )                    | (778 )        |
| Proceeds from exercise of stock options and warrants                              | —                         | 1,932         |
| Stock compensation                                                                | 48                        | —             |
| Net (decrease) increase in FHLBNY and short term borrowings                       | (15,000 )                 | 30,362        |
| Net increase in noninterest-bearing deposits                                      | 26,909                    | 3,535         |
| Net increase in interest-bearing deposits                                         | 47,757                    | 4,040         |
| Net cash provided by financing activities                                         | 56,700                    | 36,451        |

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|                                                             |          |           |
|-------------------------------------------------------------|----------|-----------|
| Net increase (decrease) in cash and cash equivalents        | 24,718   | (13,679 ) |
| Cash and Cash Equivalents, January 1,                       | 27,429   | 36,238    |
| Cash and Cash Equivalents, September 30,                    | \$52,147 | \$22,559  |
| Supplemental Disclosure of Cash Flow Information:           |          |           |
| Cash paid during the year for:                              |          |           |
| Interest on deposits and borrowed funds                     | \$4,916  | \$2,749   |
| Income taxes                                                | \$6,047  | \$5,994   |
| Supplemental Schedule of Noncash Activities:                |          |           |
| Real estate acquired in settlement of loans                 | \$789    | \$3,518   |
| Dividends accrued during the period                         | \$847    | \$665     |
| See accompanying notes to consolidated financial statements |          |           |

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. ORGANIZATION

Parke Bancorp, Inc. ("Parke Bancorp" or the "Company") is a bank holding company incorporated under the laws of the State of New Jersey in January 2005 for the sole purpose of becoming the holding company of Parke Bank (the "Bank").

The Bank is a commercial bank which commenced operations on January 28, 1999. The Bank is chartered by the New Jersey Department of Banking and Insurance (the "Department") and insured by the Federal Deposit Insurance Corporation ("FDIC"). Parke Bancorp and the Bank maintain their principal offices at 601 Delsea Drive, Washington Township, New Jersey. The Bank also conducts business through branches in Galloway Township, Northfield and Washington Township, New Jersey and Philadelphia, Pennsylvania.

The Bank competes with other banking and financial institutions in its primary market areas. Commercial banks, savings banks, savings and loan associations, credit unions and money market funds actively compete for savings and time certificates of deposit and all types of loans. Such institutions, as well as consumer financial and insurance companies, may be considered competitors of the Bank with respect to one or more of the services it renders.

The Bank is subject to the regulations of certain state and federal agencies, and accordingly, the Bank is periodically examined by such regulatory authorities. As a consequence of the regulation of commercial banking activities, the Bank's business is particularly susceptible to future state and federal legislation and regulations.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statement Presentation: The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP") and predominant practices within the banking industry.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary the Bank. Also included are the accounts of 44 Business Capital LLC, a joint venture formed in 2009 to originate and service SBA loans. The assets of 44 Business Capital were sold on April 28, 2016. The Bank had a 51% ownership interest in the joint venture. Parke Capital Trust I, Parke Capital Trust II and Parke Capital Trust III are wholly-owned subsidiaries but are not consolidated because they do not meet the requirements for consolidation under applicable accounting guidance. All significant inter-company balances and transactions have been eliminated.

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 since they do not include all of the information and footnotes required by GAAP. The accompanying interim financial statements for the nine months ended September 30, 2016 and 2015 are unaudited. The balance sheet as of December 31, 2015, was derived from the audited financial statements. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair statement of the results for such interim periods. Results of operations for the nine months ended September 30, 2016 are not necessarily indicative of the results for the full year. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings or shareholders' equity.

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the

reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the allowance for loan losses, other than temporary impairment losses on investment securities, the valuation of deferred income taxes, servicing assets and carrying value of OREO.

Recently Issued Accounting Pronouncements:

During August 2016, the FASB issued Accounting Standards Update ASU 2016-15, new guidance related to the Statement of Cash Flows. The new guidance clarifies the classification within the statement of cash flows for certain transactions, including debt extinguishment costs, zero-coupon debt, and contingent consideration related to business combinations, insurance proceeds, equity method distributions and beneficial interests in securitizations. The guidance also clarifies that cash flows with aspects of multiple classes of cash flows or that cannot be separated by source or use should be classified based on the activity that is likely to be the predominant source or use of cash flows for the item. This guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The adoption of this guidance is not expected to be material to the consolidated financial statements.

During June 2016, the FASB issued Accounting Standards Update ASU 2016-13, Financial Instruments Credit Losses. ASU 2016-13 (Topic 326), replaces the incurred loss impairment methodology in current GAAP with an expected credit loss methodology and requires consideration of a broader range of information to determine credit loss estimates. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit impaired loans will receive an allowance account at the acquisition date that represents a component of the purchase price allocation. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses, with such allowance limited to the amount by which fair value is below amortized cost. This guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

On January 5, 2016, the FASB issued Accounting Standards Update 2016-01, Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (the ASU). The ASU's changes to the current GAAP model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. ASU 2016-01 is effective for public business entities for fiscal years beginning after December 17, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of these amendments.

On February 25, 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842). ASU No. 2016-02 includes a lessee accounting model that recognizes two types of leases - finance leases and operating leases. The standard requires that a lessee recognize on the balance sheet assets and liabilities for leases with lease terms of more than 12 months. Leases with terms of less than 12 months are exempt from the new standard. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as finance or operating lease. New disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases are also required. These disclosures include qualitative and quantitative requirements, providing information about the amounts recorded in the financial statements. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; that is, for a calendar year-end public entity, the changes take effect beginning January 1, 2019. The Company is currently evaluating the impact of these amendments.

During March 2016, the FASB issued Accounting Standards Update No. 2016-09, Stock Compensation. ASU No. 2016-09(Topic 718) eliminates the concept of additional paid in capital pools for stock-based awards and requires that the related excess tax benefits and tax deficiencies be classified as an operating activity in the statement of cash flows. The new guidance also allows entities to make a one-time policy election to account for forfeitures when they occur, instead of accruing compensation cost based on the number of awards expected to vest. Additionally, the new guidance changes the requirement for an award to qualify for equity classification by permitting tax withholding up to the maximum statutory tax rate instead of the minimum statutory tax rate. Cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity in the statement of cash flows. This guidance is effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. The adoption of this guidance is not expected to be material to the consolidated financial statements.

During May 2014, the FASB issued Accounting Standards No. 2014-09, Revenue from Contracts with Customers. ASU No.2014-09 (Topic 606) supersedes the revenue recognition requirements in Accounting Standards Codification Topic 606, Revenue Recognition, and most industry-specific guidance throughout the Accounting Standards Codification. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. During August 2015, the FASB provided a one-year deferral of the effective date; therefore, the guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The FASB has

also issued clarification guidance as it relates to principal versus agent considerations for revenue recognition purposes and clarification guidance on other various considerations related to the new revenue recognition guidance. Additionally, during April 2016, the FASB issued further clarification guidance related to identifying performance obligations and licensing. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

## NOTE 3. INVESTMENT SECURITIES

The following is a summary of the Company's investments in available for sale and held to maturity securities as of September 30, 2016 and December 31, 2015:

| As of September 30, 2016               | Amortized<br>cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Other-than-<br>temporary<br>impairments<br>in AOCI | Fair<br>value |
|----------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------------------------------|---------------|
| (amounts in thousands)                 |                   |                              |                               |                                                    |               |
| Available for sale:                    |                   |                              |                               |                                                    |               |
| Corporate debt obligations             | \$ 1,000          | \$ 21                        | \$ —                          | \$ —                                               | \$ 1,021      |
| Residential mortgage-backed securities | 35,412            | 833                          | 12                            | —                                                  | 36,233        |
| Collateralized mortgage obligations    | 177               | 8                            | —                             | —                                                  | 185           |
| Collateralized debt obligations        | 761               | —                            | —                             | 320                                                | 441           |
| Total available for sale               | \$37,350          | \$ 862                       | \$ 12                         | \$ 320                                             | \$37,880      |
| Held to maturity:                      |                   |                              |                               |                                                    |               |
| States and political subdivisions      | \$2,213           | \$ 302                       | \$ —                          | \$ —                                               | \$2,515       |
| As of December 31, 2015                |                   |                              |                               |                                                    |               |
| (amounts in thousands)                 |                   |                              |                               |                                                    |               |
| Available for sale:                    |                   |                              |                               |                                                    |               |
| Corporate debt obligations             | \$ 1,000          | \$ 31                        | \$ —                          | \$ —                                               | \$ 1,031      |
| Residential mortgage-backed securities | 40,788            | 451                          | 418                           | —                                                  | 40,821        |
| Collateralized mortgage obligations    | 246               | 7                            | —                             | —                                                  | 253           |
| Collateralized debt obligations        | 806               | —                            | —                             | 344                                                | 462           |
| Total available for sale               | \$42,840          | \$ 489                       | \$ 418                        | \$ 344                                             | \$42,567      |
| Held to maturity:                      |                   |                              |                               |                                                    |               |
| States and political subdivisions      | \$2,181           | \$ 290                       | \$ —                          | \$ —                                               | \$2,471       |

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The amortized cost and fair value of debt securities classified as available for sale and held to maturity, by contractual maturity as of September 30, 2016 are as follows:

|                                                                                | Amortized Cost         | Fair Value |
|--------------------------------------------------------------------------------|------------------------|------------|
|                                                                                | (amounts in thousands) |            |
| Available for sale:                                                            |                        |            |
| Due within one year                                                            | \$—                    | \$—        |
| Due after one year through five years                                          | —                      | —          |
| Due after five years through ten years                                         | 500                    | 500        |
| Due after ten years                                                            | 1,261                  | 962        |
| Residential mortgage-backed securities and collateralized mortgage obligations | 35,589                 | 36,418     |
| Total available for sale                                                       | \$37,350               | \$37,880   |
| Held to maturity:                                                              |                        |            |
| Due within one year                                                            | \$—                    | \$—        |
| Due after one year through five years                                          | —                      | —          |
| Due after five years through ten years                                         | 1,213                  | 1,268      |
| Due after ten years                                                            | 1,000                  | 1,247      |
| Total held to maturity                                                         | \$2,213                | \$2,515    |

Expected maturities will differ from contractual maturities for mortgage related securities because the issuers of certain debt securities do have the right to call or prepay their obligations without any penalty.

Securities with a carrying value of \$25.0 million and \$15.0 million were pledged to secure public deposits at September 30, 2016 and December 31, 2015, respectively.

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other than temporarily impaired ("OTTI"), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2016 and December 31, 2015:

| As of September 30, 2016               | Less Than 12 Months    | 12 Months or Greater | Total      |
|----------------------------------------|------------------------|----------------------|------------|
| Description of Securities              | Fair Value             | Unrealized Losses    | Fair Value |
|                                        | (amounts in thousands) |                      |            |
| Available for sale:                    |                        |                      |            |
| Residential mortgage-backed securities | \$7                    | \$—                  | \$1,171    |
| Total available for sale               | \$7                    | \$—                  | \$1,171    |
|                                        |                        |                      |            |
| As of December 31, 2015                | Less Than 12 Months    | 12 Months or Greater | Total      |
| Description of Securities              | Fair Value             | Unrealized Losses    | Fair Value |
|                                        | (amounts in thousands) |                      |            |
| Available for sale:                    |                        |                      |            |
| Residential mortgage-backed securities | \$19,191               | \$ 343               | \$3,221    |
|                                        |                        |                      |            |

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|                          |          |        |         |       |          |        |
|--------------------------|----------|--------|---------|-------|----------|--------|
| Total available for sale | \$19,191 | \$ 343 | \$3,221 | \$ 75 | \$22,412 | \$ 418 |
|--------------------------|----------|--------|---------|-------|----------|--------|

The unrealized losses on the Company's investment in mortgage-backed securities relates to four securities at September 30, 2016 versus three securities at December 31, 2015. The losses were caused by movement in interest rates. The securities were issued by FNMA, a government sponsored entity. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investment in these securities to be OTTI at September 30, 2016.

## Other Than Temporarily Impaired Debt Securities

We assess whether we intend to sell or it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered OTTI and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

We have a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. On a quarterly basis, we review all securities to determine whether an OTTI exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity.

The credit loss component of credit-impaired debt securities was \$171,000. This impairment was taken in a prior year and no OTTI was realized in the current year.

The Company did not sell any securities during the nine months ended September 30, 2016.

## NOTE 4. LOANS

The portfolio of loans outstanding consists of the following:

|                           | September 30, 2016     |                                 |   | December 31, 2015 |                                 |   |
|---------------------------|------------------------|---------------------------------|---|-------------------|---------------------------------|---|
|                           | Amount                 | Percentage<br>of Total<br>Loans |   | Amount            | Percentage<br>of Total<br>Loans |   |
|                           | (amounts in thousands) |                                 |   |                   |                                 |   |
| Commercial and Industrial | \$24,224               | 3.0                             | % | \$27,140          | 3.6                             | % |
| Real Estate Construction: |                        |                                 |   |                   |                                 |   |
| Residential               | 8,929                  | 1.1                             |   | 7,750             | 1.0                             |   |
| Commercial                | 59,283                 | 7.2                             |   | 45,245            | 6.0                             |   |

Real Estate Mortgage:

|                                 |           |       |   |           |         |
|---------------------------------|-----------|-------|---|-----------|---------|
| Commercial – Owner Occupied     | 127,603   | 15.6  |   | 172,040   | 22.7    |
| Commercial – Non-owner Occupied | 266,111   | 32.6  |   | 256,471   | 33.8    |
| Residential – 1 to 4 Family     | 278,581   | 34.1  |   | 213,266   | 28.1    |
| Residential – Multifamily       | 36,282    | 4.4   |   | 18,113    | 2.4     |
| Consumer                        | 16,390    | 2.0   |   | 18,476    | 2.4     |
| Total Loans                     | \$817,403 | 100.0 | % | \$758,501 | 100.0 % |

**Loan Origination/Risk Management:** In the normal course of business the Company is exposed to a variety of operational, reputational, legal, regulatory, and credit risks that could adversely affect our financial performance. Most of our asset risk is primarily tied to credit (lending) risk. The Company has lending policies, guidelines and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Board of Directors reviews and approves these policies, guidelines and procedures. When we originate a loan we make certain subjective judgments about the borrower's ability to meet the loan's terms and conditions. We also make objective and subjective value assessments on the assets we finance. The borrower's ability to repay can be adversely affected by economic changes. Likewise, changes in market conditions and other external factors can affect asset valuations. The Company actively monitors the quality of its loan portfolio. A reporting system supplements the credit review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit risk, loan delinquencies, troubled debt restructures, nonperforming and potential problem loans. Diversification in the loan portfolio is another means of managing risk associated with fluctuations in economic conditions.

**Commercial and Industrial Loans:** The Company originates secured loans for business purposes. Loans are made to provide working capital to businesses in the form of lines of credit, which may be secured by accounts receivable, inventory, equipment or other assets. The financial condition and cash flow of commercial borrowers are closely monitored by means of corporate financial statements, personal financial statements and income tax returns. The frequency of submissions of required financial information depends on the size and complexity of the credit and the collateral that secures the loan. The Company's general policy is to obtain personal guarantees from the principals of the commercial loan borrowers. Such loans are made to businesses located in the Company's market area.

**Construction Loans:** With respect to construction loans to developers and builders that are secured by non-owner occupied properties, loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analyses of the developers and property owners. Construction loans are also generally underwritten based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risk than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

**Commercial Real Estate:** Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. Commercial real estate loans may be riskier than loans for one-to-four family residences and are typically larger in dollar size. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. The repayment of these loans is generally largely dependent on the successful operation and management of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location within our market area. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. The Company also monitors economic conditions and trends affecting the market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

**Residential Mortgage:** The Company originates adjustable and fixed-rate residential mortgage loans. Such mortgage loans are generally originated under terms, conditions and documentation acceptable to the secondary mortgage market. Although the Company has placed all of these loans into its portfolio, a substantial majority of such loans can be sold in the secondary market or pledged for potential borrowings.

Consumer Loans: Consumer loans may carry a higher degree of repayment risk than residential mortgage loans. Repayment is typically dependent upon the borrower's financial stability which is more likely to be adversely affected by job loss, illness, or personal bankruptcy. To monitor and manage consumer loan risk, policies and procedures have been developed and modified as needed. This activity, coupled with the relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. Historically the Company's losses on consumer loans have been negligible.

The Company maintains an outsourced independent loan review program that reviews and validates the credit risk assessment program on a periodic basis. Results of these external independent reviews are presented to management. The external independent

loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit risk management personnel.

**Non-accrual and Past Due Loans:** Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when a loan is 90 days past due, unless the loan is well secured and in the process of collection, as required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

An age analysis of past due loans by class at September 30, 2016 and December 31, 2015 follows:

| September 30, 2016              | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days and<br>Not<br>Accruing | Total<br>Past<br>Due | Current   | Total<br>Loans |
|---------------------------------|------------------------------|------------------------------|---------------------------------------------------|----------------------|-----------|----------------|
|                                 | (amounts in thousands)       |                              |                                                   |                      |           |                |
| Commercial and Industrial       | \$—                          | \$ —                         | \$ 243                                            | \$243                | \$23,981  | \$24,224       |
| Real Estate Construction:       |                              |                              |                                                   |                      |           |                |
| Residential                     | —                            | —                            | —                                                 | —                    | 8,929     | 8,929          |
| Commercial                      | —                            | —                            | 3,891                                             | 3,891                | 55,392    | 59,283         |
| Real Estate Mortgage:           |                              |                              |                                                   |                      |           |                |
| Commercial – Owner Occupied     | —                            | —                            | 874                                               | 874                  | 126,729   | 127,603        |
| Commercial – Non-owner Occupied | —                            | —                            | 3,891                                             | 3,891                | 262,220   | 266,111        |
| Residential – 1 to 4 Family     | 1,275                        | —                            | 2,026                                             | 3,301                | 275,280   | 278,581        |
| Residential – Multifamily       | —                            | —                            | 308                                               | 308                  | 35,974    | 36,282         |
| Consumer                        | 72                           | 59                           | 36                                                | 167                  | 16,223    | 16,390         |
| Total Loans                     | \$1,347                      | \$ 59                        | \$ 11,269                                         | \$ 12,675            | \$804,728 | \$817,403      |
| December 31, 2015               | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days and<br>Not<br>Accruing | Total<br>Past<br>Due | Current   | Total<br>Loans |
|                                 | (amounts in thousands)       |                              |                                                   |                      |           |                |
| Commercial and Industrial       | \$—                          | \$ —                         | \$ 740                                            | \$740                | \$26,400  | \$27,140       |
| Real Estate Construction:       |                              |                              |                                                   |                      |           |                |
| Residential                     | —                            | —                            | —                                                 | —                    | 7,750     | 7,750          |
| Commercial                      | —                            | —                            | 5,204                                             | 5,204                | 40,041    | 45,245         |
| Real Estate Mortgage:           |                              |                              |                                                   |                      |           |                |
| Commercial – Owner Occupied     | 812                          | —                            | 358                                               | 1,170                | 170,870   | 172,040        |
| Commercial – Non-owner Occupied | —                            | —                            | 4,002                                             | 4,002                | 252,469   | 256,471        |
| Residential – 1 to 4 Family     | —                            | —                            | 3,255                                             | 3,255                | 210,011   | 213,266        |
| Residential – Multifamily       | 357                          | —                            | —                                                 | 357                  | 17,756    | 18,113         |
| Consumer                        | 31                           | 32                           | —                                                 | 63                   | 18,413    | 18,476         |

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|             |         |       |          |          |           |           |
|-------------|---------|-------|----------|----------|-----------|-----------|
| Total Loans | \$1,200 | \$ 32 | \$13,559 | \$14,791 | \$743,710 | \$758,501 |
|-------------|---------|-------|----------|----------|-----------|-----------|

Impaired Loans: Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments.

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All impaired loans have are assessed for recoverability based on an independent third-party full appraisal to determine the net realizable value ("NRV") based on the fair value of the underlying collateral, less cost to sell and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an "as-is" valuation and will follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are generally updated every 12 months or sooner if we have identified possible further deterioration in value. Prior to receiving the updated appraisal, we will establish a specific reserve for any estimated deterioration, based upon our assessment of market conditions, adjusted for estimated costs to sell and other identified costs. If the NRV is greater than the loan amount, then no impairment loss exists. If the NRV is less than the loan amount, the shortfall is recognized by a specific reserve. If the borrower fails to pledge additional collateral in the ninety day period, a charge-off equal to the difference between the loan's carrying value and NRV will occur. In certain circumstances, however, a direct charge-off may be taken at the time that the NRV calculation reveals a shortfall. All impaired loans are evaluated based on the criteria stated above on a quarterly basis and any change in the reserve requirements are recorded in the period identified. All partially charged-off loans remain on nonaccrual status until they are brought current as to both principal and interest and have at least nine months of payment history and future collectability of principal and interest is assured.

Impaired loans at September 30, 2016 and December 31, 2015 are set forth in the following tables:

| September 30, 2016                  | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|-------------------------------------|---------------------|--------------------------|-------------------|
| (amounts in thousands)              |                     |                          |                   |
| With no related allowance recorded: |                     |                          |                   |
| Commercial and Industrial           | \$243               | \$1,499                  | \$ —              |
| Real Estate Construction:           |                     |                          |                   |
| Residential                         | —                   | —                        | —                 |
| Commercial                          | 1,161               | 1,161                    | —                 |
| Real Estate Mortgage:               |                     |                          |                   |
| Commercial – Owner Occupied         | —                   | —                        | —                 |
| Commercial – Non-owner Occupied     | 3,426               | 3,670                    | —                 |
| Residential – 1 to 4 Family         | 1,963               | 2,026                    | —                 |
| Residential – Multifamily           | 308                 | 354                      | —                 |
| Consumer                            | 30                  | 30                       | —                 |
|                                     | 7,131               | 8,740                    | —                 |
| With an allowance recorded:         |                     |                          |                   |
| Commercial and Industrial           | —                   | —                        | —                 |
| Real Estate Construction:           |                     |                          |                   |
| Residential                         | —                   | —                        | —                 |
| Commercial                          | 7,929               | 11,830                   | 163               |
| Real Estate Mortgage:               |                     |                          |                   |
| Commercial – Owner Occupied         | 4,886               | 4,915                    | 319               |
| Commercial – Non-owner Occupied     | 15,637              | 17,231                   | 228               |
| Residential – 1 to 4 Family         | 1,617               | 1,633                    | 39                |
| Residential – Multifamily           | —                   | —                        | —                 |
| Consumer                            | 6                   | 6                        | 6                 |
|                                     | 30,075              | 35,615                   | 755               |
| Total:                              |                     |                          |                   |
| Commercial and Industrial           | 243                 | 1,499                    | —                 |
| Real Estate Construction:           |                     |                          |                   |
| Residential                         | —                   | —                        | —                 |
| Commercial                          | 9,090               | 12,991                   | 163               |
| Real Estate Mortgage:               |                     |                          |                   |
| Commercial – Owner Occupied         | 4,886               | 4,915                    | 319               |
| Commercial – Non-owner Occupied     | 19,063              | 20,901                   | 228               |
| Residential – 1 to 4 Family         | 3,580               | 3,659                    | 39                |
| Residential – Multifamily           | 308                 | 354                      | —                 |
| Consumer                            | 36                  | 36                       | 6                 |
|                                     | \$37,206            | \$44,355                 | \$ 755            |

| December 31, 2015                   | Recorded Investment    | Unpaid Principal Balance | Related Allowance |
|-------------------------------------|------------------------|--------------------------|-------------------|
|                                     | (amounts in thousands) |                          |                   |
| With no related allowance recorded: |                        |                          |                   |
| Commercial and Industrial           | \$680                  | \$1,934                  | \$ —              |
| Real Estate Construction:           |                        |                          |                   |
| Residential                         | —                      | —                        | —                 |
| Commercial                          | 1,420                  | 1,517                    | —                 |
| Real Estate Mortgage:               |                        |                          |                   |
| Commercial – Owner Occupied         | 358                    | 358                      | —                 |
| Commercial – Non-owner Occupied     | 1,281                  | 1,281                    | —                 |
| Residential – 1 to 4 Family         | 1,858                  | 1,910                    | —                 |
| Residential – Multifamily           | —                      | —                        | —                 |
| Consumer                            | —                      | —                        | —                 |
|                                     | 5,597                  | 7,000                    | —                 |
| With an allowance recorded:         |                        |                          |                   |
| Commercial and Industrial           | 503                    | 504                      | 67                |
| Real Estate Construction:           |                        |                          |                   |
| Residential                         | —                      | —                        | —                 |
| Commercial                          | 5,696                  | 8,420                    | 1,149             |
| Real Estate Mortgage:               |                        |                          |                   |
| Commercial – Owner Occupied         | 4,341                  | 4,370                    | 73                |
| Commercial – Non-owner Occupied     | 23,303                 | 24,988                   | 486               |
| Residential – 1 to 4 Family         | 2,426                  | 3,200                    | 709               |
| Residential – Multifamily           | 356                    | 356                      | 5                 |
| Consumer                            | —                      | —                        | —                 |
|                                     | 36,625                 | 41,838                   | 2,489             |
| Total:                              |                        |                          |                   |
| Commercial and Industrial           | 1,183                  | 2,438                    | 67                |
| Real Estate Construction:           |                        |                          |                   |
| Residential                         | —                      | —                        | —                 |
| Commercial                          | 7,116                  | 9,937                    | 1,149             |
| Real Estate Mortgage:               |                        |                          |                   |
| Commercial – Owner Occupied         | 4,699                  | 4,728                    | 73                |
| Commercial – Non-owner Occupied     | 24,584                 | 26,269                   | 486               |
| Residential – 1 to 4 Family         | 4,284                  | 5,110                    | 709               |
| Residential – Multifamily           | 356                    | 356                      | 5                 |
| Consumer                            | —                      | —                        | —                 |
|                                     | \$42,222               | \$48,838                 | \$ 2,489          |

The following table presents by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the three and nine months ended September 30, 2016 and 2015:

|                                 | Three Months Ended September 30, |        |                           |        |
|---------------------------------|----------------------------------|--------|---------------------------|--------|
|                                 | 2016                             |        | 2015                      |        |
|                                 | Average Interest Recorded        |        | Average Interest Recorded |        |
|                                 | Investment Recognized            |        | Investment Recognized     |        |
|                                 | (amounts in thousands)           |        |                           |        |
| Commercial and Industrial       | \$351                            | \$ —   | \$4,161                   | \$ 10  |
| Real Estate Construction:       |                                  |        |                           |        |
| Residential                     | —                                | —      | —                         | —      |
| Commercial                      | 9,233                            | 59     | 11,701                    | 20     |
| Real Estate Mortgage:           |                                  |        |                           |        |
| Commercial – Owner Occupied     | 4,978                            | 49     | 5,822                     | 53     |
| Commercial – Non-owner Occupied | 19,168                           | 190    | 26,426                    | 242    |
| Residential – 1 to 4 Family     | 3,616                            | 25     | 5,938                     | 30     |
| Residential – Multifamily       | 308                              | —      | 360                       | 6      |
| Consumer                        | 37                               | 1      | 65                        | —      |
| Total                           | \$37,691                         | \$ 324 | \$54,473                  | \$ 361 |

|                                 | Nine Months Ended September 30, |        |                           |          |
|---------------------------------|---------------------------------|--------|---------------------------|----------|
|                                 | 2016                            |        | 2015                      |          |
|                                 | Average Interest Recorded       |        | Average Interest Recorded |          |
|                                 | Investment Recognized           |        | Investment Recognized     |          |
|                                 | (amounts in thousands)          |        |                           |          |
| Commercial and Industrial       | \$390                           | \$ 1   | \$4,409                   | \$ 61    |
| Real Estate Construction:       |                                 |        |                           |          |
| Residential                     | —                               | —      | —                         | —        |
| Commercial                      | 9,658                           | 178    | 11,747                    | 100      |
| Real Estate Mortgage:           |                                 |        |                           |          |
| Commercial – Owner Occupied     | 5,044                           | 137    | 5,855                     | 154      |
| Commercial – Non-owner Occupied | 19,281                          | 562    | 26,541                    | 737      |
| Residential – 1 to 4 Family     | 3,635                           | 87     | 5,956                     | 86       |
| Residential – Multifamily       | 324                             | 8      | 361                       | 20       |
| Consumer                        | 37                              | 2      | 65                        | —        |
| Total                           | \$38,369                        | \$ 975 | \$54,934                  | \$ 1,158 |

Troubled debt restructurings: Periodically management evaluates our loans in order to determine the appropriate risk rating, interest accrual status and potential classification as a troubled debt restructuring (TDR), some of which are performing and accruing interest. A TDR is a loan on which we have granted a concession due to a borrower's financial difficulty. These are concessions that would not otherwise be considered. The terms of these modified loans may include extension of maturity, renewals, changes in interest rate, additional collateral requirements or infusion of additional capital into the project by the borrower to reduce debt or to support future debt service. On construction and land development loans we may modify the loan as a result of delays or other project issues such as slower than anticipated sell-outs, insufficient leasing activity and/or a decline in the value of the underlying collateral securing the loan. Management believes that working with a borrower to restructure a loan provides us with a better likelihood of collecting our loan. It is our policy not to renegotiate the terms of a commercial loan simply because of a delinquency

status. However, we will use our Troubled Debt Restructuring Program to work with delinquent borrowers when the delinquency is temporary. The Bank considers all TDRs to be impaired.

At the time a loan is modified in a TDR, we consider the following factors to determine whether the loan should accrue interest:

- Whether there is a period of current payment history under the current terms, typically 6 months;
- Whether the loan is current at the time of restructuring; and
- Whether we expect the loan to continue to perform under the restructured terms with a debt coverage ratio that complies with the Bank's credit underwriting policy of 1.25 times debt service.

We also review the financial performance of the borrower over the past year to be reasonably assured of repayment and performance according to the modified terms. This review consists of an analysis of the borrower's historical results; the borrower's projected results over the next four quarters; current financial information of the borrower and any guarantors. The projected repayment source needs to be reliable, verifiable, quantifiable and sustainable. In addition, all TDRs are reviewed quarterly to determine the amount of any impairment. At the time of restructuring, the amount of the loan principal for which we are not reasonably assured of repayment is charged-off, but not forgiven.

A borrower with a restructured loan must make a minimum of six consecutive monthly payments at the restructured level and be current as to both interest and principal to be returned to accrual status.

Performing TDRs (not reported as non-accrual loans) totaled \$25.9 million and \$28.7 million with related allowances of \$402,403 and \$530,000 as of September 30, 2016 and December 31, 2015, respectively. Nonperforming TDRs were \$3.0 million with no related allowances as of September 30, 2016 and 603,000 as of December 31, 2015, respectively. All TDRs are classified as impaired loans and are included in the impaired loan disclosures above. There were no new loans modified as a TDR during the three and nine month periods ended September 30, 2016 and 2015. Also, there were no loans that were modified and deemed a TDR that subsequently defaulted during the three and nine month period ended September 30, 2016 and 2015.

Some loans classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall allowance for loan losses estimate. The level of any re-defaults will likely be affected by future economic conditions. Once a loan becomes a TDR, it will continue to be reported as a TDR until it is repaid in full, foreclosed, sold or it meets the criteria to be removed from TDR status.

**Credit Quality Indicators:** As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grades of loans, the level of classified loans, net charge-offs, nonperforming loans (see details above) and the general economic conditions in the region.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 7. Grades 1 through 4 are considered "Pass". A description of the general characteristics of the seven risk grades is as follows:

1. Good: Borrower exhibits the strongest overall financial condition and represents the most creditworthy profile.
2. Satisfactory (A): Borrower reflects a well-balanced financial condition, demonstrates a high level of creditworthiness and typically will have a strong banking relationship with the Bank.
3. Satisfactory (B): Borrower exhibits a balanced financial condition and does not expose the Bank to more than a normal or average overall amount of risk. Loans are considered fully collectable.
4. Watch List: Borrower reflects a fair financial condition, but there exists an overall greater than average risk. Risk is deemed acceptable by virtue of increased monitoring and control over borrowings. Probability of timely repayment is present.
5. Other Assets Especially Mentioned (OAEM): Financial condition is such that assets in this category have a potential weakness or pose unwarranted financial risk to the Bank even though the asset value is not currently impaired. The asset does not currently warrant adverse classification but if not corrected could weaken and could create future

increased risk exposure. Includes loans which require an increased degree of monitoring or servicing as a result of internal or external changes.

Substandard: This classification represents more severe cases of #5 (OAEM) characteristics that require increased monitoring. Assets are characterized by the distinct possibility that the Bank will sustain some loss if the

6. deficiencies are not corrected. Assets are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral. Asset has a well-defined weakness or weaknesses that impairs the ability to repay debt and jeopardizes the timely liquidation or realization of the collateral at the asset's net book value.

7. Doubtful: Assets which have all the weaknesses inherent in those assets classified #6 (Substandard) but the risks are more severe relative to financial deterioration in capital and/or asset value; accounting/evaluation techniques may be questionable and the overall possibility for collection in full is highly improbable. Borrowers in this category require constant monitoring, are considered work-out loans and present the potential for future loss to the Bank.

An analysis of the credit risk profile by internally assigned grades as of September 30, 2016 and December 31, 2015 is as follows:

| At September 30, 2016           | Pass                   | OAEM     | Substandard | Doubtful | Total      |
|---------------------------------|------------------------|----------|-------------|----------|------------|
|                                 | (amounts in thousands) |          |             |          |            |
| Commercial and Industrial       | \$23,629               | \$374    | \$221       | \$       | —\$24,224  |
| Real Estate Construction:       |                        |          |             |          |            |
| Residential                     | 8,929                  | —        | —           | —        | 8,929      |
| Commercial                      | 34,213                 | 21,179   | 3,891       | —        | 59,283     |
| Real Estate Mortgage:           |                        |          |             |          |            |
| Commercial – Owner Occupied     | 123,370                | 3,359    | 874         | —        | 127,603    |
| Commercial – Non-owner Occupied | 259,218                | 80       | 6,813       | —        | 266,111    |
| Residential – 1 to 4 Family     | 274,480                | 1,549    | 2,552       | —        | 278,581    |
| Residential – Multifamily       | 35,974                 | —        | 308         | —        | 36,282     |
| Consumer                        | 16,353                 | —        | 37          | —        | 16,390     |
| Total                           | \$776,166              | \$26,541 | \$14,696    | \$       | —\$817,403 |

  

| At December 31, 2015            | Pass                   | OAEM     | Substandard | Doubtful | Total      |
|---------------------------------|------------------------|----------|-------------|----------|------------|
|                                 | (amounts in thousands) |          |             |          |            |
| Commercial and Industrial       | \$25,658               | \$688    | \$794       | \$       | —\$27,140  |
| Real Estate Construction:       |                        |          |             |          |            |
| Residential                     | 7,750                  | —        | —           | —        | 7,750      |
| Commercial                      | 24,210                 | 15,831   | 5,204       | —        | 45,245     |
| Real Estate Mortgage:           |                        |          |             |          |            |
| Commercial – Owner Occupied     | 163,765                | 7,225    | 1,050       | —        | 172,040    |
| Commercial – Non-owner Occupied | 242,607                | 7,044    | 6,820       | —        | 256,471    |
| Residential – 1 to 4 Family     | 207,911                | 515      | 4,840       | —        | 213,266    |
| Residential – Multifamily       | 17,757                 | —        | 356         | —        | 18,113     |
| Consumer                        | 18,475                 | —        | 1           | —        | 18,476     |
| Total                           | \$708,133              | \$31,303 | \$19,065    | \$       | —\$758,501 |

#### NOTE 5. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of, and trends related to, nonaccrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a grade of 6 or higher, the loan is analyzed to determine whether the loan is impaired and, if impaired, whether there is a need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, any collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Bank's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, high-moderate, moderate, low-moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

An analysis of the allowance for loan losses for the three and nine month periods ended September 30, 2016 and 2015 is as follows:

| Allowance for Loan Losses:      | For the three months ended September 30, 2016 |             |            |                      |                |
|---------------------------------|-----------------------------------------------|-------------|------------|----------------------|----------------|
|                                 | Beginning Balance                             | Charge-offs | Recoveries | Provisions (Credits) | Ending Balance |
|                                 | (amounts in thousands)                        |             |            |                      |                |
| Commercial and Industrial       | \$870                                         | \$ —        | \$ 7       | \$ 24                | \$901          |
| Real Estate Construction:       |                                               |             |            |                      |                |
| Residential                     | 252                                           | —           | —          | 27                   | 279            |
| Commercial                      | 2,512                                         | —           | —          | 53                   | 2,565          |
| Real Estate Mortgage:           |                                               |             |            |                      |                |
| Commercial – Owner Occupied     | 1,686                                         | —           | —          | 319                  | 2,005          |
| Commercial – Non-owner Occupied | 3,923                                         | —           | —          | (78)                 | 3,845          |
| Residential – 1 to 4 Family     | 4,222                                         | —           | 2          | 355                  | 4,579          |
| Residential – Multifamily       | 452                                           | —           | —          | 10                   | 462            |
| Consumer                        | 248                                           | —           | —          | (10)                 | 238            |
| Total                           | \$14,165                                      | \$ —        | \$ 9       | \$ 700               | \$14,874       |



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| Allowance for Loan Losses:      | For the three months ended September 30, 2015 |             |            |                      |                |
|---------------------------------|-----------------------------------------------|-------------|------------|----------------------|----------------|
|                                 | Beginning Balance                             | Charge-offs | Recoveries | Provisions (Credits) | Ending Balance |
|                                 | (amounts in thousands)                        |             |            |                      |                |
| Commercial and Industrial       | \$2,357                                       | \$ (1,254 ) | \$ —       | \$ 108               | \$1,211        |
| Real Estate Construction:       |                                               |             |            |                      |                |
| Residential                     | 197                                           | —           | —          | 24                   | 221            |
| Commercial                      | 1,665                                         | (365 )      | —          | 703                  | 2,003          |
| Real Estate Mortgage:           |                                               |             |            |                      |                |
| Commercial – Owner Occupied     | 2,999                                         | —           | —          | 275                  | 3,274          |
| Commercial – Non-owner Occupied | 5,471                                         | (257 )      | —          | (528 )               | 4,686          |
| Residential – 1 to 4 Family     | 3,861                                         | (284 )      | 1          | 732                  | 4,310          |
| Residential – Multifamily       | 271                                           | —           | —          | 11                   | 282            |
| Consumer                        | 158                                           | —           | —          | 125                  | 283            |
| Total                           | \$16,979                                      | \$ (2,160 ) | \$ 1       | \$ 1,450             | \$16,270       |

| Allowance for Loan Losses:      | For the nine months ended September 30, 2016 |             |            |                        |                |
|---------------------------------|----------------------------------------------|-------------|------------|------------------------|----------------|
|                                 | Beginning Balance                            | Charge-offs | Recoveries | Provisions (Credits) * | Ending Balance |
|                                 | (amounts in thousands)                       |             |            |                        |                |
| Commercial and Industrial       | \$952                                        | \$ (76 )    | \$ 8       | \$ 17                  | \$901          |
| Real Estate Construction:       |                                              |             |            |                        |                |
| Residential                     | 247                                          | —           | —          | 32                     | 279            |
| Commercial                      | 2,501                                        | (1,081 )    | —          | 1,145                  | 2,565          |
| Real Estate Mortgage:           |                                              |             |            |                        |                |
| Commercial – Owner Occupied     | 3,267                                        | —           | —          | (1,262 )               | 2,005          |
| Commercial – Non-owner Occupied | 3,838                                        | (154 )      | —          | 161                    | 3,845          |
| Residential – 1 to 4 Family     | 4,802                                        | (698 )      | 22         | 453                    | 4,579          |
| Residential – Multifamily       | 254                                          | (45 )       | —          | 253                    | 462            |
| Consumer                        | 275                                          | —           | —          | (37 )                  | 238            |
| Total                           | \$16,136                                     | \$ (2,054 ) | \$ 30      | \$ 762                 | \$14,874       |

\* Includes \$2,450 in provision for loan losses and \$1,688 credit related to the sale of the SBA loan portfolio.

| Allowance for Loan Losses:      | For the nine months ended September 30, 2015 |             |            |                      |                |
|---------------------------------|----------------------------------------------|-------------|------------|----------------------|----------------|
|                                 | Beginning Balance                            | Charge-offs | Recoveries | Provisions (Credits) | Ending Balance |
|                                 | (amounts in thousands)                       |             |            |                      |                |
| Commercial and Industrial       | \$1,679                                      | \$ (1,254 ) | \$ 32      | \$ 754               | \$1,211        |
| Real Estate Construction:       |                                              |             |            |                      |                |
| Residential                     | 316                                          | (238 )      | —          | 143                  | 221            |
| Commercial                      | 3,015                                        | (2,745 )    | —          | 1,733                | 2,003          |
| Real Estate Mortgage:           |                                              |             |            |                      |                |
| Commercial – Owner Occupied     | 3,296                                        | —           | 10         | (32 )                | 3,274          |
| Commercial – Non-owner Occupied | 4,962                                        | (638 )      | 398        | (36 )                | 4,686          |
| Residential – 1 to 4 Family     | 4,156                                        | (412 )      | 34         | 532                  | 4,310          |
| Residential – Multifamily       | 357                                          | —           | —          | (75 )                | 282            |
| Consumer                        | 262                                          | —           | —          | 21                   | 283            |
| Total                           | \$18,043                                     | \$ (5,287 ) | \$ 474     | \$ 3,040             | \$16,270       |



| Allowance for Loan Losses, at<br>September 30, 2016 | Individually<br>evaluated<br>for<br>impairment<br>(amounts in thousands) | Collectively<br>evaluated<br>for<br>impairment<br>(amounts in thousands) | Total    |
|-----------------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------|----------|
| Commercial and Industrial                           | \$—                                                                      | \$ 901                                                                   | \$901    |
| Real Estate Construction:                           |                                                                          |                                                                          |          |
| Residential                                         | —                                                                        | 279                                                                      | 279      |
| Commercial                                          | 163                                                                      | 2,402                                                                    | 2,565    |
| Real Estate Mortgage:                               |                                                                          |                                                                          |          |
| Commercial – Owner Occupied                         | 319                                                                      | 1,686                                                                    | 2,005    |
| Commercial – Non-owner Occupied                     | 228                                                                      | 3,617                                                                    | 3,845    |
| Residential – 1 to 4 Family                         | 39                                                                       | 4,540                                                                    | 4,579    |
| Residential – Multifamily                           | —                                                                        | 462                                                                      | 462      |
| Consumer                                            | 6                                                                        | 232                                                                      | 238      |
| Total                                               | \$755                                                                    | \$ 14,119                                                                | \$14,874 |

| Allowance for Loan Losses, at<br>December 31, 2015 | Individually<br>evaluated<br>for<br>impairment<br>(amounts in thousands) | Collectively<br>evaluated<br>for<br>impairment<br>(amounts in thousands) | Total    |
|----------------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------|----------|
| Commercial and Industrial                          | \$67                                                                     | \$ 885                                                                   | \$952    |
| Real Estate Construction:                          |                                                                          |                                                                          |          |
| Residential                                        | —                                                                        | 247                                                                      | 247      |
| Commercial                                         | 1,149                                                                    | 1,352                                                                    | 2,501    |
| Real Estate Mortgage:                              |                                                                          |                                                                          |          |
| Commercial – Owner Occupied                        | 73                                                                       | 3,194                                                                    | 3,267    |
| Commercial – Non-owner Occupied                    | 486                                                                      | 3,352                                                                    | 3,838    |
| Residential – 1 to 4 Family                        | 709                                                                      | 4,093                                                                    | 4,802    |
| Residential – Multifamily                          | 5                                                                        | 249                                                                      | 254      |
| Consumer                                           | —                                                                        | 275                                                                      | 275      |
| Total                                              | \$2,489                                                                  | \$ 13,647                                                                | \$16,136 |

| Loans, at September 30, 2016:   | Individually<br>evaluated<br>for<br>impairment<br>(amounts in thousands) | Collectively<br>evaluated<br>for<br>impairment<br>(amounts in thousands) | Total    |
|---------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------|----------|
| Commercial and Industrial       | \$243                                                                    | \$ 23,981                                                                | \$24,224 |
| Real Estate Construction:       |                                                                          |                                                                          |          |
| Residential                     | —                                                                        | 8,929                                                                    | 8,929    |
| Commercial                      | 9,091                                                                    | 50,192                                                                   | 59,283   |
| Real Estate Mortgage:           |                                                                          |                                                                          |          |
| Commercial – Owner Occupied     | 4,886                                                                    | 122,717                                                                  | 127,603  |
| Commercial – Non-owner Occupied | 19,062                                                                   | 247,049                                                                  | 266,111  |
| Residential – 1 to 4 Family     | 3,580                                                                    | 275,001                                                                  | 278,581  |
| Residential – Multifamily       | 308                                                                      | 35,974                                                                   | 36,282   |
| Consumer                        | 36                                                                       | 16,354                                                                   | 16,390   |

|       |          |            |           |
|-------|----------|------------|-----------|
| Total | \$37,206 | \$ 780,197 | \$817,403 |
|-------|----------|------------|-----------|

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| Loans, at December 31, 2015:    | Individually<br>evaluated                   |                                                                           | Total      |
|---------------------------------|---------------------------------------------|---------------------------------------------------------------------------|------------|
|                                 | for<br>impairment<br>(amounts in thousands) | collectively<br>devaluated<br>for<br>impairment<br>(amounts in thousands) |            |
| Commercial and Industrial       | \$ 1,183                                    | \$ 25,957                                                                 | \$ 27,140  |
| Real Estate Construction:       |                                             |                                                                           |            |
| Residential                     | —                                           | 7,750                                                                     | 7,750      |
| Commercial                      | 7,116                                       | 38,129                                                                    | 45,245     |
| Real Estate Mortgage:           |                                             |                                                                           |            |
| Commercial – Owner Occupied     | 4,699                                       | 167,341                                                                   | 172,040    |
| Commercial – Non-owner Occupied | 24,584                                      | 231,887                                                                   | 256,471    |
| Residential – 1 to 4 Family     | 4,284                                       | 208,982                                                                   | 213,266    |
| Residential – Multifamily       | 356                                         | 17,757                                                                    | 18,113     |
| Consumer                        | —                                           | 18,476                                                                    | 18,476     |
| Total                           | \$ 42,222                                   | \$ 716,279                                                                | \$ 758,501 |

## NOTE 6. REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements of federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined).

| Parke Bancorp, Inc.                                              | Actual     |         | For Capital Adequacy Purposes |       | To be Well-Capitalized Under Prompt Corrective Action Provisions |       |
|------------------------------------------------------------------|------------|---------|-------------------------------|-------|------------------------------------------------------------------|-------|
|                                                                  |            |         |                               |       |                                                                  |       |
| As of September 30, 2016<br>(amounts in thousands except ratios) | Amount     | Ratio   | Amount                        | Ratio | Amount                                                           | Ratio |
| Total Risk Based Capital<br>(to Risk Weighted Assets)            | \$ 151,208 | 18.43 % | \$ 65,652                     | 8.0 % | N/A                                                              | N/A   |
| Tier 1 Capital<br>(to Risk Weighted Assets)                      | \$ 140,893 | 17.17 % | \$ 49,239                     | 6.0 % | N/A                                                              | N/A   |
| Tier 1 Capital Common Equity<br>(to Risk Weighted Assets)        | \$ 107,893 | 13.15 % | \$ 36,929                     | 4.5 % | N/A                                                              | N/A   |

|                                       |            |         |           |       |     |     |
|---------------------------------------|------------|---------|-----------|-------|-----|-----|
| Tier 1 Capital<br>(to Average Assets) | \$ 140,893 | 15.38 % | \$ 36,654 | 4.0 % | N/A | N/A |
|---------------------------------------|------------|---------|-----------|-------|-----|-----|

| Parke Bancorp, Inc.                                              | Actual     |         | For Capital Adequacy Purposes |       | To be Well-Capitalized Under Prompt Corrective Action Provisions |        |
|------------------------------------------------------------------|------------|---------|-------------------------------|-------|------------------------------------------------------------------|--------|
|                                                                  |            |         |                               |       |                                                                  |        |
| As of December 31, 2015<br>(amounts in thousands except ratios)  | Amount     | Ratio   | Amount                        | Ratio | Amount                                                           | Ratio  |
| Total Risk Based Capital<br>(to Risk Weighted Assets)            | \$ 135,258 | 17.24 % | \$ 62,777                     | 8.0 % | N/A                                                              | N/A    |
| Tier 1 Capital<br>(to Risk Weighted Assets)                      | \$ 125,371 | 15.98 % | \$ 47,083                     | 6.0 % | N/A                                                              | N/A    |
| Tier 1 Capital Common Equity<br>(to Risk Weighted Assets)        | \$ 92,371  | 11.77 % | \$ 35,312                     | 4.5 % | N/A                                                              | N/A    |
| Tier 1 Capital<br>(to Average Assets)                            | \$ 125,371 | 14.69 % | \$ 34,133                     | 4.0 % | N/A                                                              | N/A    |
| Parke Bank                                                       | Actual     |         | For Capital Adequacy Purposes |       | To be Well-Capitalized Under Prompt Corrective Action Provisions |        |
|                                                                  |            |         |                               |       |                                                                  |        |
| As of September 30, 2016<br>(amounts in thousands except ratios) | Amount     | Ratio   | Amount                        | Ratio | Amount                                                           | Ratio  |
| Total Risk Based Capital<br>(to Risk Weighted Assets)            | \$ 147,779 | 18.01 % | \$ 65,652                     | 8.0 % | \$ 82,065                                                        | 10.0 % |
| Tier 1 Capital<br>(to Risk Weighted Assets)                      | \$ 137,464 | 16.75 % | \$ 49,239                     | 6.0 % | \$ 65,652                                                        | 8.0 %  |
| Tier 1 Capital Common Equity<br>(to Risk Weighted Assets)        | \$ 137,464 | 16.75 % | \$ 36,929                     | 4.5 % | \$ 53,342                                                        | 6.5 %  |
| Tier 1 Capital<br>(to Average Assets)                            | \$ 137,464 | 15.00 % | \$ 36,654                     | 4.0 % | \$ 45,818                                                        | 5.0 %  |
| Parke Bank                                                       | Actual     |         | For Capital Adequacy Purposes |       | To be Well-Capitalized Under Prompt Corrective Action Provisions |        |
|                                                                  |            |         |                               |       |                                                                  |        |
| As of December 31, 2015                                          | Amount     | Ratio   | Amount                        | Ratio | Amount                                                           | Ratio  |

(amounts in thousands except ratios)

|                                                           |           |        |          |      |          |       |
|-----------------------------------------------------------|-----------|--------|----------|------|----------|-------|
| Total Risk Based Capital<br>(to Risk Weighted Assets)     | \$134,415 | 17.13% | \$62,777 | 8.0% | \$78,471 | 10.0% |
| Tier 1 Capital<br>(to Risk Weighted Assets)               | \$124,528 | 15.87% | \$47,082 | 6.0% | \$62,777 | 8.0%  |
| Tier 1 Capital Common Equity<br>(to Risk Weighted Assets) | \$124,528 | 15.87% | \$35,312 | 4.5% | \$51,006 | 6.5%  |
| Tier 1 Capital<br>(to Average Assets)                     | \$124,528 | 14.59% | \$34,133 | 4.0% | \$42,666 | 5.0%  |

#### NOTE 7. OTHER COMPREHENSIVE INCOME (LOSS)

The Company's accumulated other comprehensive income (loss) consisted of the following at September 30, 2016 and December 31, 2015:

|                                                      | September 30,<br>2016     | December 31,<br>2015 |
|------------------------------------------------------|---------------------------|----------------------|
|                                                      | (amounts in<br>thousands) |                      |
| Securities:                                          |                           |                      |
| Non-credit unrealized losses on securities with OTTI | \$(320)                   | \$(344)              |
| Unrealized gains on securities without OTTI          | 851                       | 71                   |
| Tax impact                                           | (213)                     | 108                  |
| Other comprehensive income (loss)                    | \$318                     | \$(165)              |

## NOTE 8. FAIR VALUE

### Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures Topic 820 of FASB ASC, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions. In accordance with this guidance, the Company groups its assets and liabilities carried at fair value in three levels as follows:

#### Level 1 Input:

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

#### Level 2 Inputs:

- 1) Quoted prices for similar assets or liabilities in active markets.
- 2) Quoted prices for identical or similar assets or liabilities in markets that are not active.
- 3) Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (e.g., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."

#### Level 3 Inputs:

- 1) Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.  
These assets and liabilities include financial instruments whose value is determined using pricing models,
- 2) discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

#### Fair Value on a Recurring Basis:

The following is a description of the Company's valuation methodologies for assets carried at fair value. These methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes that its valuation methods are appropriate and consistent with

other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting measurement date.

Investment Securities Available for Sale:

Where quoted prices are available in an active market, securities are classified in Level 1 of the valuation hierarchy. If quoted market prices are not available for the specific security, then fair values are provided by independent third-party valuation services. These valuation services estimate fair values using pricing models and other accepted valuation methodologies, such as quotes for similar securities and observable yield curves and spreads. As part of the Company's overall valuation process, management evaluates these third-party methodologies to ensure that they are representative of exit prices in the Company's principal markets. Securities in Level 2 include mortgage-backed securities, corporate debt obligations, collateralized mortgage-backed securities, and Collateralized Debt Obligations, ("TruPS").

Securities in Level 3 include thinly-traded collateralized debt obligations. With the assistance of competent third-party valuation specialists, the Company utilized the following methodology to determine the fair value:

Cash flows were developed based on the estimated speeds at which the TruPS are expected to prepay (a range of 1% to 2%), the estimated rates at which the TruPS are expected to defer payments, the estimated rates at which the TruPS are expected to default (a range of 0.57% to 0.66%), and the severity of the losses on securities which default of 95%. TruPS generally allow for prepayment by the issuer without a prepayment penalty any time after five years. Due to the lack of new TruPS and the relatively poor conditions of the financial institution industry, a relatively modest rate of prepayment was assumed going forward. Estimates for the Constant Default Rate ("CDR") are based on the payment characteristics of the TruPS themselves (e.g. current, deferred, or defaulted) as well as the financial condition of the TruPS issuers in the pool. Estimates for the near-term rates of deferral and CDR are based on key financial ratios relating to the financial institutions' capitalization, asset quality, profitability and liquidity. Finally, we consider whether or not the financial institution has received Troubled Asset Relief Program, ("TARP") funding, and if it has, the amount. Longer-term rates of deferral and defaults are based on historical averages. The fair value of each bond was assessed by discounting its projected cash flows by a discount rate. The discount rates were based on the yields of publicly traded TruPS and preferred stock issued by comparably rated banks (3 month LIBOR plus a spread of 4.0% to 9.59%).

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis.

| Financial Assets                          | Level<br>1             | Level 2  | Level<br>3 | Total    |
|-------------------------------------------|------------------------|----------|------------|----------|
|                                           | (amounts in thousands) |          |            |          |
| Securities Available for Sale             |                        |          |            |          |
| As of September 30, 2016                  |                        |          |            |          |
| Corporate debt obligations                | \$—                    | \$1,021  | \$—        | \$1,021  |
| Residential mortgage-backed securities    | —                      | 36,233   | —          | 36,233   |
| Collateralized mortgage-backed securities | —                      | 185      | —          | 185      |
| Collateralized debt obligations           | —                      | —        | 441        | 441      |
| Total                                     | \$—                    | \$37,439 | \$441      | \$37,880 |
| As of December 31, 2015                   |                        |          |            |          |
| Corporate debt obligations                | \$—                    | \$1,031  | \$—        | \$1,031  |
| Residential mortgage-backed securities    | —                      | 40,821   | —          | 40,821   |
| Collateralized mortgage-backed securities | —                      | 253      | —          | 253      |
| Collateralized debt obligations           | —                      | —        | 462        | 462      |
| Total                                     | \$—                    | \$42,105 | \$462      | \$42,567 |

For the nine months ended September 30, 2016, there were no transfers between the levels within the fair value hierarchy.

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows for the nine months ended September 30,:

Securities  
Available for  
Sale  
September  
30, 2016  
September  
30, 2015

|                                       |                           |        |
|---------------------------------------|---------------------------|--------|
|                                       | (amounts in<br>thousands) |        |
| Beginning balance at January 1,       | \$462                     | \$ 349 |
| Total net gains (losses) included in: |                           |        |
| Other comprehensive income / (loss)   | (21                       | ) 26   |
| Ending balance                        | \$441                     | \$ 375 |

# Fair Value on a Non-recurring Basis:

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

| Financial Assets                    | Level 1 |     | Level 3   | Total    |
|-------------------------------------|---------|-----|-----------|----------|
|                                     | 1       | 2   |           |          |
| (amounts in thousands)              |         |     |           |          |
| As of September 30, 2016            |         |     |           |          |
| Collateral dependent impaired loans | \$—     | \$— | —\$16,093 | \$16,093 |
| OREO                                | —       | —   | 10,635    | 10,635   |
| As of December 31, 2015             |         |     |           |          |
| Collateral dependent impaired loans | \$—     | \$— | —\$20,066 | \$20,066 |
| OREO                                | —       | —   | 16,629    | 16,629   |

Collateral dependent impaired loans, which are measured in accordance with FASB ASC Topic 310 “Receivables”, for impairment, had a carrying amount of \$16.1 million and \$20.1 million at September 30, 2016 and December 31, 2015 respectively, with a valuation allowance of \$423,000 and \$2.1 million at September 30, 2016 and December 31, 2015, respectively. The valuation allowance for collateral dependent impaired loans is included in the allowance for loan losses on the balance sheet. All collateral dependent impaired loans have an independent third-party full appraisal to determine the NRV based on the fair value of the underlying collateral, less cost to sell (a range of 5% to 10%) and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an “as-is” valuation and will follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are updated every 12 months or sooner if we have identified possible further deterioration in value.

OREO consists of commercial real estate properties which are recorded at fair value based upon current appraised value, or agreements of sale less estimated disposition costs on level 3 inputs. Properties are reappraised annually.

# Fair Value of Financial Instruments

The Company discloses estimated fair values for its significant financial instruments in accordance with FASB ASC Topic 825, “Disclosures about Fair Value of Financial Instruments”. The methodologies for estimating the fair value of financial assets and liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The methodologies for estimating the fair value of other financial assets and liabilities are discussed below.

For certain financial assets and liabilities, carrying value approximates fair value due to the nature of the financial instrument. These instruments include cash and cash equivalents, restricted stock, accrued interest receivable, demand and other non-maturity deposits and accrued interest payable.

The Company used the following methods and assumptions in estimating the fair value of the following financial instruments:

Investment Securities: Fair value of securities available for sale is described above. Fair value of held to maturity securities is based upon quoted market prices.

Loans (other than impaired): Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, residential mortgage and other consumer. Each loan category is

further segmented into groups by fixed and adjustable rate interest terms and by performing and nonperforming categories. The fair value of performing loans is calculated by discounting scheduled cash flows through their estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in each group of loans. The estimate of maturity is based on contractual maturities for loans within each group, or on the Company's historical experience with repayments for each loan classification, modified as required by an estimate of the effect of current economic conditions.

Deposits: The fair value of time deposits is based on the discounted value of contractual cash flows, where the discount rate is estimated using the market rates currently offered for deposits of similar remaining maturities.

Borrowings: The fair values of FHLB borrowings, other borrowed funds and subordinated debt are based on the discounted value of estimated cash flows. The discounted rate is estimated using market rates currently offered for similar advances or borrowings.

Bank premises and equipment, customer relationships, deposit base and other information required to compute the Company's aggregate fair value are not included in the above information. Accordingly, the above fair values are not intended to represent the aggregate fair value of the Company.

The following table summarizes the carrying amounts and fair values for financial instruments at September 30, 2016 and December 31, 2015:

|                             | Level in<br>Fair Value<br>Hierarchy | September 30, 2016 |               | December 31, 2015 |               |
|-----------------------------|-------------------------------------|--------------------|---------------|-------------------|---------------|
|                             |                                     | Carrying<br>Value  | Fair<br>Value | Carrying<br>Value | Fair<br>Value |
| (amounts in thousands)      |                                     |                    |               |                   |               |
| Financial Assets:           |                                     |                    |               |                   |               |
| Cash and cash equivalents   | Level 1                             | \$52,147           | \$52,147      | \$27,429          | \$27,429      |
| Investment securities AFS   | (1)                                 | 37,880             | 37,880        | 42,567            | 42,467        |
| Investment securities HTM   | Level 2                             | 2,213              | 2,515         | 2,181             | 2,471         |
| Restricted stock            | Level 2                             | 4,208              | 4,208         | 4,789             | 4,789         |
| Loans held for sale         | Level 2                             | —                  | —             | 2,640             | 2,640         |
| Loans, net                  | (2)                                 | 802,529            | 817,819       | 742,365           | 743,604       |
| Accrued interest receivable | Level 2                             | 2,904              | 2,904         | 3,012             | 3,012         |
| Financial Liabilities:      |                                     |                    |               |                   |               |
| Demand and savings deposits | Level 2                             | \$416,615          | \$416,615     | \$384,726         | \$384,726     |
| Time deposits               | Level 2                             | 323,261            | 324,646       | 280,484           | 282,080       |
| Borrowings                  | Level 2                             | 83,053             | 82,428        | 98,053            | 95,492        |
| Accrued interest payable    | Level 2                             | 581                | 581           | 494               | 494           |

(1) See the recurring fair value table above.

(2) For non-impaired loans, Level 2; for impaired loans, Level 3.

## NOTE 9. EARNINGS PER SHARE (“EPS”)

The following tables set forth the calculation of basic and diluted EPS for the three and nine month periods ended September 30, 2016 and 2015.

|                                                 | For the three<br>months ended<br>September 30,<br>2016 2015<br>(amounts in thousands except share<br>data) |           | For the nine<br>months ended<br>September 30,<br>2016 2015 |           |
|-------------------------------------------------|------------------------------------------------------------------------------------------------------------|-----------|------------------------------------------------------------|-----------|
| Basic earnings per common share                 |                                                                                                            |           |                                                            |           |
| Net income available to common shareholders     | \$3,576                                                                                                    | \$ 2,130  | \$ 14,233                                                  | \$ 6,550  |
| Average common shares outstanding               | 6,843,050                                                                                                  | 6,740,665 | 6,843,064                                                  | 6,664,009 |
| Basic earnings per common share                 | \$0.52                                                                                                     | \$ 0.32   | \$2.08                                                     | \$ 0.98   |
| Diluted earnings per common share               |                                                                                                            |           |                                                            |           |
| Net income available to common shareholders     | \$3,576                                                                                                    | \$ 2,130  | \$ 14,233                                                  | \$ 6,550  |
| Dividend on Preferred Series B                  | 300                                                                                                        | 300       | 900                                                        | 900       |
| Average common shares outstanding               | 6,843,050                                                                                                  | 6,740,665 | 6,843,064                                                  | 6,664,009 |
| Dilutive potential common shares                | 2,124,913                                                                                                  | 1,910,916 | 2,116,971                                                  | 1,908,849 |
| Total diluted average common shares outstanding | 8,967,972                                                                                                  | 8,651,581 | 8,960,048                                                  | 8,572,858 |
| Diluted earnings per common share               | \$0.43                                                                                                     | \$ 0.28   | \$ 1.69                                                    | \$ 0.87   |

On September 20, 2016 the Company declared a quarterly cash dividend of \$0.08 per share to common shareholders of record as of October 14, 2016 and payable on October 31, 2016.

## NOTE 10. SUBSEQUENT EVENTS

Accounting guidance establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Accordingly, Management has evaluated subsequent events after September 30, 2016 through the date the financial statements were issued and determined that no subsequent events warranted recognition in or disclosure in the interim financial statements.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Forward-Looking Statements

The Company may from time to time make written or oral "forward-looking statements" including statements contained in this Report and in other communications by the Company which are made in good faith pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements, such as statements of the Company's plans, objectives, expectations, estimates and intentions, involve risks and uncertainties and are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company also cautions readers not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date on which they are given. The Company is not obligated to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after any such date.

### General

The Company's results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on its interest-earning assets, such as loans and securities, and the interest expense paid on its interest-bearing liabilities, such as deposits and borrowings. The Company also generates non-interest income such as service charges, gains from the sale of loans, earnings from BOLI, loan exit fees and other fees. The Company's non-interest expenses primarily consist of employee compensation and benefits, occupancy expenses, marketing expenses, data processing costs and other operating expenses. The Company is also subject to losses in its loan portfolio if borrowers fail to meet their obligations. The Company's results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory agencies.

### Comparison of Financial Condition at September 30, 2016 and December 31, 2015

At September 30, 2016, the Company's total assets increased to \$954.6 million from \$885.1 million at December 31, 2015, an increase of \$69.5 million or 7.9%.

Cash and cash equivalents increased \$24.7 million to \$52.1 million at September 30, 2016 from \$27.4 million at December 31, 2015, an increase of 90.1%. The increase was due to the sale of the Bank's SBA assets and an increase in non-interest bearing deposits.

Total investment securities decreased to \$40.1 million at September 30, 2016, from \$44.7 million at December 31, 2015, a decrease of \$4.7 million or 10.4%. The decrease was due to the normal pay downs of mortgage backed

securities.

Management evaluates the investment portfolio for OTTI on a quarterly basis. Factors considered in the analysis include, but are not limited to, whether an adverse change in cash flows has occurred, the length of time and the extent to which the fair value has been less than cost, whether the Company intends to sell, or will more likely than not be required to sell, the investment before recovery of its amortized cost basis, which may be maturity, credit rating downgrades, the percentage of performing collateral that would need to default or defer to cause a break in yield or a temporary interest shortfall, and management's assessment of the financial condition of the underlying issuers. For the nine months ended September 30, 2016, the Company did not recognize any credit-related OTTI charges.

Total gross loans increased to \$817.4 million at September 30, 2016 from \$758.5 million at December 31, 2015, an increase of \$58.9 million or 7.8%. The increase during the quarter is attributable to an increase in Commercial Real Estate loans.

Delinquent loans totaled \$12.7 million or 1.6% of total loans at September 30, 2016, a decrease of \$2.1 million from December 31, 2015. Delinquent loan balances by number of days delinquent at September 30, 2016 were: 30 to 89 days --- \$1.4 million; 90 days and greater not accruing interest --- \$11.3 million.

At September 30, 2016 the Bank had \$11.3 million in non-accrual loans or 1.4% of total loans, a decrease from \$13.6 million or 1.8% of total loans at December 31, 2015. The three largest nonperforming loan relationships are a \$2.7 million land development loan, a \$1.9 million commercial real estate loan and a \$1.3 million land development loan.

The composition of nonaccrual loans as of September 30, 2016 and December 31, 2015 was as follows:

|                                    | September 30,<br>2016                   | December 31,<br>2015 |
|------------------------------------|-----------------------------------------|----------------------|
|                                    | (amounts in thousands<br>except ratios) |                      |
| Commercial and Industrial          | \$243                                   | \$ 740               |
| Real Estate Construction:          |                                         |                      |
| Residential                        | —                                       | —                    |
| Commercial                         | 3,891                                   | 5,204                |
| Real Estate Mortgage:              |                                         |                      |
| Commercial – Owner Occupied        | 874                                     | 358                  |
| Commercial – Non-owner Occupied    | 3,891                                   | 4,002                |
| Residential – 1 to 4 Family        | 2,026                                   | 3,255                |
| Residential – Multifamily          | 308                                     | —                    |
| Consumer                           | 36                                      | —                    |
| Total                              | \$11,269                                | \$ 13,559            |
| Nonperforming loans to total loans | 1.4                                     | % 1.8                |

At September 30, 2016, the allowance for loan losses was \$14.9 million, as compared to \$16.1 million at December 31, 2015. The ratio of allowance for loan losses to total loans was 1.8% at September 30, 2016 and 2.1% at December 31, 2015. Continued improvements in the credit quality of the loan portfolio has lowered this ratio since the last quarter. The ratio of allowance for loan losses to non-performing loans increased to 132.0% at September 30, 2016, compared to 119.0% at December 31, 2015. During the nine month period ended September 30, 2016, the Company charged off \$2.1 million in loans, and recovered \$30,000, compared to \$5.3 million charged off in the nine months ended September 30, 2015, and \$474,000 in recoveries. Specific allowances for loan losses have been established in the amount of \$755,000 on impaired loans totaling \$37.2 million at September 30, 2016, as compared to \$2.5 million on impaired loans totaling \$42.2 million at December 31, 2015. We have provided for all losses that are both probable and reasonably estimable at September 30, 2016 and December 31, 2015. There can be no assurance, however, that further additions to the allowance will not be required in future periods.

OREO at September 30, 2016 was \$10.6 million, compared to \$16.6 million at December 31, 2015 with the largest property being a condominium development valued at \$3.6 million.

An analysis of OREO activity is as follows:

|                                             | For the nine months<br>ended<br>September 30,<br>2016      2015<br>(amounts in<br>thousands) |          |
|---------------------------------------------|----------------------------------------------------------------------------------------------|----------|
| Balance at beginning of period              | \$16,629                                                                                     | \$20,931 |
| Real estate acquired in settlement of loans | 789                                                                                          | 3,518    |
| Sales of real estate                        | (4,945 )                                                                                     | (3,936 ) |
| Gain (loss) on sale of real estate          | 266                                                                                          | (353 )   |
| Write-down of real estate carrying values   | (2,026 )                                                                                     | (943 )   |
| Reimbursement of funds                      | —                                                                                            | 4        |
| Donated property                            | (31 )                                                                                        | —        |
| Capitalized improvements to real estate     | (47 )                                                                                        | 175      |
| Balance at end of period                    | \$10,635                                                                                     | \$19,396 |

At September 30, 2016, the Bank's total deposits increased to \$739.9 million from \$665.2 million at December 31, 2015, an increase of \$74.7 million or 11.2%. During the first nine months of the year the Company closed on a Brokered CD transaction totaling \$43.0 million. In addition the Company ran a 13 month CD special.

Total borrowings decreased to \$69.7 million at September 30, 2016 from \$84.7 million at December 31, 2015 a decrease of \$15.0 million or 17.7%. Funds from the sale of the Bank's SBA assets were used to pay down borrowings.

Total shareholders' equity increased to \$125.2 million at September 30, 2016 from \$112.0 million at December 31, 2015, an increase of \$13.2 million or 11.8%, due to the retention of earnings from the period.

#### Comparison of Operating Results for the Three Months Ended September 30, 2016 and 2015

General: Net income available to common shareholders for the three months ended September 30, 2016 was \$3.6 million and for the three months ended September 30, 2015 was \$2.1 million.

Interest Income: Interest income increased by \$453,000, or 4.57%, to \$10.4 million for the three months ended September 30, 2016, from \$9.9 million for the three months ended September 30, 2015. The increase was attributable to an increase in the average outstanding loan balances, offset by a lower average yield on loans. Average loans for the three month period ended September 30, 2016 were \$801.3 million compared to \$737.1 million for the same period last year. The average yield on loans was 4.97% for the three months ended September 30, 2016 compared to 5.13% for the same period in 2015.

Interest Expense: Interest expense increased \$196,000 to \$1.7 million for the three months ended September 30, 2016, from \$1.5 million for the three months ended September 30, 2015. The increase was primarily attributable to an increase in the average interest bearing deposits and an increase in rate on deposits and borrowings. The average rate paid on borrowings for the three month period ended September 30, 2016 was 1.57%, compared to 1.34% for the same period last year. Average interest bearing deposits for the three month period ended September 30, 2016 were \$660.7 million compared to \$619.9 million for the same period last year. The average rate paid on deposits for the three month period ended September 30, 2016 was 0.82% compared to 0.78% for the same period last year. The average rate paid on borrowings for the three month period ended September 30, 2016 was 1.57% compared to 1.34% for the same period last year.

Net Interest Income: Net interest income increased \$257,000 to \$8.7 million for the three months ended September 30, 2016, as compared to \$8.4 million for the same period last year. We experienced a larger increase in the average loans outstanding than we did in our average deposits outstandings. This situation allowed us to increase out net interest income. Our net interest rate spread was 3.73% for the three months ended September 30, 2016, as compared to 3.94% for the same period last year. Our net interest margin decreased 23 basis points to 3.83% for the three months ended September 30, 2016, from 4.06% for the same period last year.

Provision for Loan Losses: We recorded a provision for loan losses of \$700,000 for the three months ended September 30, 2016, compared to \$1,450,000 for the same period last year. The decrease was primarily due to higher loan quality and a \$1.7 million reduction due to sale our SBA loan portfolio.

**Non-interest Income:** Non-interest income was \$130,000 for the three months ended September 30, 2016, compared to \$2,052,000 for the same period last year. The decrease was primarily attributable to the \$1.5 million in gain on sale of SBA loans during the same period last year.

**Non-interest Expense:** Non-interest expense decreased \$184,000 to \$4.2 million for the three months ended September 30, 2016, from \$4.4 million for the three months ended September 30, 2015. The decrease was primarily due to a \$185,000 decrease in salary expense, due to the sale of our SBA business and a \$201,000 decrease in OREO expense due to the drop in overall OREO balances. The reduction in OREO balances resulted in decreased real estate taxes and general maintenance of the properties owned. The decreases were offset by a \$102,000 increase in data processing and a \$137,000 increase in other operating expenses.

**Income Taxes:** The Company recorded income tax expense of \$51,000 on income before taxes of \$3.9 million for the three months ended September 30, 2016, resulting in an effective tax rate of 1.3%, compared to income tax expense of \$1.7 million on income before taxes of \$4.7 million for the same period of 2015, resulting in an effective tax rate of 37.1%. The decrease in the effective rate is due to the Bank utilizing a \$1.5 million Historic Tax Credit which reduced the Bank's income tax expense.

|                                             | For the Three Months Ended September 30,<br>2016 |                                |                | 2015               |                                |                |
|---------------------------------------------|--------------------------------------------------|--------------------------------|----------------|--------------------|--------------------------------|----------------|
|                                             | Average<br>Balance                               | Interest<br>Income/<br>Expense | Yield/<br>Cost | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/<br>Cost |
| (amounts in thousands, except percentages)  |                                                  |                                |                |                    |                                |                |
| <b>Assets</b>                               |                                                  |                                |                |                    |                                |                |
| Loans                                       | \$801,328                                        | \$10,012                       | 4.97 %         | \$737,097          | \$ 9,532                       | 5.13 %         |
| Investment securities                       | 45,590                                           | 293                            | 2.56 %         | 51,347             | 365                            | 2.82 %         |
| Federal funds sold and cash equivalents     | 53,030                                           | 66                             | 0.50 %         | 33,810             | 21                             | 0.25 %         |
| Total interest-earning assets               | 899,948                                          | \$10,371                       | 4.63 %         | 822,254            | \$ 9,918                       | 4.79 %         |
| Other assets                                | 57,211                                           |                                |                | 58,530             |                                |                |
| Allowance for loan losses                   | (14,530 )                                        |                                |                | (17,316 )          |                                |                |
| Total assets                                | \$942,629                                        |                                |                | \$863,468          |                                |                |
| <b>Liabilities and Shareholders' Equity</b> |                                                  |                                |                |                    |                                |                |
| Interest bearing deposits:                  |                                                  |                                |                |                    |                                |                |
| NOWs                                        | \$32,355                                         | \$41                           | 0.50 %         | \$31,557           | \$ 40                          | 0.50 %         |
| Money markets                               | 122,521                                          | 157                            | 0.51 %         | 115,228            | 145                            | 0.50 %         |
| Savings                                     | 176,178                                          | 235                            | 0.53 %         | 185,617            | 250                            | 0.53 %         |
| Time deposits                               | 283,747                                          | 838                            | 1.17 %         | 254,066            | 730                            | 1.14 %         |
| Brokered certificates of deposit            | 45,850                                           | 99                             | 0.86 %         | 33,393             | 54                             | 0.64 %         |
| Total interest-bearing deposits             | 660,651                                          | 1,370                          | 0.82 %         | 619,861            | 1,219                          | 0.78 %         |
| Borrowings                                  | 83,053                                           | 327                            | 1.57 %         | 83,241             | 282                            | 1.34 %         |
| Total interest-bearing liabilities          | 743,704                                          | 1,697                          | 0.91 %         | 703,102            | 1,501                          | 0.85 %         |
| Non-interest bearing deposits               | 68,672                                           |                                |                | 45,759             |                                |                |
| Other liabilities                           | 6,114                                            |                                |                | 5,134              |                                |                |
| Total non-interest bearing liabilities      | 74,786                                           |                                |                | 50,893             |                                |                |
| Shareholders' equity                        | 124,139                                          |                                |                | 109,473            |                                |                |
| Total liabilities and shareholders' equity  | \$942,629                                        |                                |                | \$863,468          |                                |                |
| Net interest income                         |                                                  | \$8,674                        |                |                    | \$ 8,417                       |                |
| Interest rate spread                        |                                                  |                                | 3.73 %         |                    |                                | 3.94 %         |
| Net interest margin                         |                                                  |                                | 3.83 %         |                    |                                | 4.06 %         |

Comparison of Operating Results for the Nine Months Ended September 30, 2016 and 2015

General: Net income available to common shareholders for the nine months ended September 30, 2016 was \$14.2 million and for the nine months ended September 30, 2015 was \$6.6 million. On April 29, 2016, the Bank and its majority-owned subsidiary, 44 Business Capital, LLC ("44BC") completed the sale transaction of the assets of 44BC and certain related assets held by the Bank to Berkshire Bank ("Berkshire"). Under the transaction, Berkshire purchased the assets of 44BC. In addition, Berkshire purchased the Bank's SBA loan portfolio, totaling \$42.6 million, and related servicing rights held by the Bank. The pretax gain to the Bank was approximately \$9.3 million, which included the \$7.6 million gain on sale of SBA related assets and relief of \$1.7 million of related allowance for loan losses.

**Interest Income:** Interest income increased by \$1.9 million, or 6.61%, to \$31.2 million for the nine months ended September 30, 2016, from \$29.3 million for the nine months ended September 30, 2015. The increase was attributable to an increase in average outstanding loan balances, offset by lower yield on loans. Average loans for the nine month period ended September 30, 2016 were \$789.6 million compared to \$724.5 million for the same period last year. The average yield on loans was 5.09% for the nine months ended September 30, 2016 compared to 5.21% for the same period in 2015.

**Interest Expense:** Interest expense increased \$683,000 to \$5.0 million for the nine months ended September 30, 2016, from \$4.3 million for the nine months ended September 30, 2015. The increase was primarily attributable to an increase in average interest bearing deposits and to a lesser extent, an increase in average borrowings. Average interest bearing deposits for the nine month period ended September 30, 2016 were \$653.0 million compared to \$615.1 million for the same period last year. The average rate paid on deposits for the nine month period ended September 30, 2016 was 0.82% compared to 0.77% for the same period last year. Average borrowings for the nine month period ended September 30, 2016 were \$91.2 million, compared to \$77.5 million for the same period last year. The average rate paid on borrowings for the nine month period ended September 30, 2016 was 1.47%, compared to 1.33% for the same period last year.

**Net Interest Income:** Net interest income increased \$1.3 million to \$26.2 million for the nine months ended September 30, 2016, as compared to \$24.9 million for the same period last year. Our net interest rate spread was 3.85% for the nine months ended September 30, 2016, as compared to 4.02% for the same period last year. Our net interest margin decreased 15 basis points to 3.98% for the nine months ended September 30, 2016, from 4.13% for the same period last year.

**Provision for Loan Losses:** We recorded a provision for loan losses of \$762,000 for the nine months ended September 30, 2016, compared to \$3.0 million for the same period last year. The decrease was primarily due to higher loan quality and a \$1.7 million reduction due to the sale of our SBA loan portfolio.

**Non-interest Income:** Non-interest income was \$9.8 million for the nine months ended September 30, 2016, compared to \$4.2 million for the same period last year. The increase was primarily attributable to the \$7.6 million gain on sale of our SBA assets discussed above.

**Non-interest Expense:** Non-interest expense decreased by \$108,000 to \$12.9 million for the nine months ended September 30, 2016, from \$13.0 million for the nine months ended September 30, 2015. The decrease was primarily due to a \$513,000 decrease in OREO expenses, \$229,000 decrease in salary expense and a \$57,000 decrease in professional services. Offset by a \$574,000 increase in other operating expenses and \$115,000 increase in data processing.

**Income Taxes:** The Company recorded income tax expense of \$6.8 million on income before taxes of \$22.3 million for the nine months ended September 30, 2016, resulting in an effective tax rate of 30.2%, compared to income tax expense of \$4.6 million on income before taxes of \$13.1 million for the same period of 2015, resulting in an effective tax rate of 35.4%. The decrease in the effective rate is due to using an annualized tax rate versus using a monthly tax rate. The increase in our tax expense is due to the gain on sale of our SBA business of \$7.6 million. The decrease in the effective rate is due to the Bank utilizing a \$1.5 million Historic Tax Credit ("HTC") offset by a \$482,000 write down (included in non interest expense) of the HTC partnership investment. This resulted in a net benefit to the Company of \$1.0 million, which reduced the Bank's income tax expense.

|                                            | For the Nine Months Ended September 30, |                                |                |                    |                                |                |
|--------------------------------------------|-----------------------------------------|--------------------------------|----------------|--------------------|--------------------------------|----------------|
|                                            | 2016                                    |                                |                | 2015               |                                |                |
|                                            | Average<br>Balance                      | Interest<br>Income/<br>Expense | Yield/<br>Cost | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/<br>Cost |
| (amounts in thousands, except percentages) |                                         |                                |                |                    |                                |                |
| Assets                                     |                                         |                                |                |                    |                                |                |
| Loans                                      | \$789,646                               | \$30,074                       | 5.09 %         | \$724,474          | \$28,238                       | 5.21 %         |
| Investment securities                      | 47,550                                  | 966                            | 2.71 %         | 46,316             | 950                            | 2.74 %         |
| Federal funds sold and cash equivalents    | 40,762                                  | 144                            | 0.47 %         | 35,594             | 63                             | 0.24 %         |
| Total interest-earning assets              | 877,958                                 | \$31,184                       | 4.74 %         | 806,384            | \$29,251                       | 4.85 %         |
| Other assets                               | 63,007                                  |                                |                | 59,975             |                                |                |
| Allowance for loan losses                  | (15,638 )                               |                                |                | (17,401 )          |                                |                |
| Total assets                               | \$925,327                               |                                |                | \$848,958          |                                |                |
| Liabilities and Shareholders' Equity       |                                         |                                |                |                    |                                |                |
| Interest bearing deposits:                 |                                         |                                |                |                    |                                |                |
| NOWs                                       | \$31,771                                | \$117                          | 0.49 %         | \$31,050           | \$114                          | 0.49 %         |
| Money markets                              | 119,767                                 | 453                            | 0.51 %         | 110,800            | 414                            | 0.50 %         |
| Savings                                    | 174,454                                 | 694                            | 0.53 %         | 190,684            | 762                            | 0.53 %         |
| Time deposits                              | 280,979                                 | 2,455                          | 1.17 %         | 252,588            | 2,121                          | 1.12 %         |
| Brokered certificates of deposit           | 46,069                                  | 282                            | 0.82 %         | 30,009             | 137                            | 0.61 %         |
| Total interest-bearing deposits            | 653,040                                 | 4,001                          | 0.82 %         | 615,131            | 3,548                          | 0.77 %         |
| Borrowings                                 | 91,228                                  | 1,001                          | 1.47 %         | 77,464             | 771                            | 1.33 %         |
| Total interest-bearing liabilities         | 744,268                                 | 5,002                          | 0.90 %         | 692,595            | 4,319                          | 0.83 %         |
| Non-interest bearing deposits              | 55,866                                  |                                |                | 44,217             |                                |                |
| Other liabilities                          | 5,491                                   |                                |                | 5,274              |                                |                |
| Total non-interest bearing liabilities     | 61,357                                  |                                |                | 49,491             |                                |                |
| Shareholders' equity                       | 119,702                                 |                                |                | 106,872            |                                |                |
| Total liabilities and shareholders' equity | \$925,327                               |                                |                | \$848,958          |                                |                |
| Net interest income                        |                                         | \$26,182                       |                |                    | \$24,932                       |                |
| Interest rate spread                       |                                         |                                | 3.85 %         |                    |                                | 4.02 %         |
| Net interest margin                        |                                         |                                | 3.98 %         |                    |                                | 4.13 %         |

### Critical Accounting Policies

In the preparation of our consolidated financial statements, management has adopted various accounting policies that govern the application of accounting principles generally accepted in the United States. The significant accounting policies are described below.

Certain accounting policies involve significant judgments and assumptions by management that have a material impact on the carrying value of certain assets and liabilities. Management considers these accounting policies to be critical accounting policies. The judgments and assumptions used are based on historical experience and other factors, which management believes to be reasonable under the circumstances. Actual results could differ from these judgments and estimates under different conditions, resulting in a change that could have a material impact on the carrying values of assets and liabilities and results of operations.

**Allowance for Loan Losses:** The allowance for loan losses is considered a critical accounting policy. The allowance for loan losses is the amount estimated by management as necessary to cover losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses, which is charged to income.

Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment.

In evaluating the allowance for loan losses, management considers historical loss factors, the mix of the loan portfolio (types of loans and amounts), geographic and industry concentrations, current national and local economic conditions and other factors related to the collectability of the loan portfolio, including underlying collateral values and estimated future cash flows. All of these estimates are susceptible to significant change. Large groups of smaller balance homogeneous loans, such as residential real estate, home equity loans, and consumer loans, are evaluated in the aggregate under FASB ASC Topic 450, "Accounting for Contingencies", using historical loss factors adjusted for economic conditions and other qualitative factors which include trends

in delinquencies, classified and nonperforming loans, loan concentrations by loan category and by property type, seasonality of the portfolio, internal and external analysis of credit quality, peer group data, loan charge offs, local and national economic conditions and single and total credit exposure. Large balance and/or more complex loans, such as multi-family and commercial real estate loans, commercial business loans, and construction loans are evaluated individually for impairment in accordance with FASB ASC Topic 310 "Receivables". If a loan is 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 effective interest rate or at the fair value of collateral if repayment is expected solely from the collateral. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available or as projected events change.

Management reviews the level of the allowance monthly. Although management uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. In addition, the FDIC and the Department, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require us to recognize adjustments to the allowance based on judgments about information available to them at the time of their examination. A large loss could deplete the allowance and require increased provisions to replenish the allowance, which would adversely affect earnings.

**Other Than Temporary Impairment on Investment Securities:** Management periodically performs analyses to determine whether there has been an OTTI in the value of one or more securities. The available for sale securities portfolio is carried at estimated fair value, with any unrealized gains or losses, net of taxes, reported as accumulated other comprehensive income or loss in stockholder's equity. The held to maturity securities portfolio, consisting of debt securities for which there is a positive intent and ability to hold to maturity, is carried at amortized cost. Management conducts a quarterly review and evaluation of the securities portfolio to determine if the value of any security has declined below its cost or amortized cost, and whether such decline is other-than-temporary. If such decline is deemed other-than-temporary, the cost basis of the security is adjusted by writing down the security to estimated fair market value through a charge to current period earnings to the extent that such decline is credit related. All other changes in unrealized gains or losses for investment securities available for sale are recorded, net of tax effect, through other comprehensive income.

**Income Taxes:** Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss carry forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the difference between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Realization of deferred tax assets is dependent on generating sufficient taxable income in the future.

When tax returns are filed, it is highly likely that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the more likely than not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

**Liquidity:** Liquidity describes the ability of the Company to meet the financial obligations that arise out of the ordinary course of business. Liquidity addresses the Company's ability to meet deposit withdrawals on demand or at contractual maturity, to repay borrowings as they mature, and to fund current and planned expenditures. Liquidity is derived from increased repayment and income from interest-earning assets. The loan to deposit ratio was 110.5% and 114.0% at September 30, 2016 and December 31, 2015, respectively. Funds received from new and existing depositors provided a large source of liquidity for the three month period ended September 30, 2016. The Company seeks to rely primarily on core deposits from customers to provide stable and cost-effective sources of funding to support loan growth. The Company also seeks to augment such deposits with longer term and higher yielding certificates of deposit. To the extent that retail deposits are not adequate to fund customer loan demand, liquidity needs can be met in the short-term funds market. Longer term funding can be obtained through advances from the FHLB. As of September 30, 2016, the Company maintained lines of credit with the FHLB of \$145.0 million, of which \$69.7 million was outstanding at September 30, 2016.

As of September 30, 2016, the Company's investment securities portfolio included \$36.2 million of residential mortgage-backed securities that provide cash flow each month. The majority of the investment portfolio is classified as available for sale, is marketable, and is available to meet liquidity needs. The Company's residential real estate portfolio includes loans, which are underwritten to secondary market criteria, and accordingly could be sold in the secondary mortgage market if needed as an additional source of liquidity. The Company's management is not aware of any known trends, demands, commitments or uncertainties that are reasonably likely to result in material changes in liquidity.

Capital: On January 1, 2015, new capital rules, approved by the Federal Reserve Board and other federal banking agencies, became effective for the Company's subsidiary Parke Bank. Under the new capital rules, Parke Bank, as a non-advanced approaches banking organization, had the option to exclude the effects of certain AOCI items from the equity calculation. Parke Bank did exercise the one-time irrevocable option to exclude these certain components of AOCI from the equity calculation.

We actively review our capital strategies in light of current and anticipated business risks, future growth opportunities, industry standards, and compliance with regulatory requirements. The assessment of overall capital adequacy depends on a variety of factors, including asset quality, liquidity, earnings stability, competitive forces, economic conditions, and strength of management. At September 30, 2016, the capital ratios of Parke Bank exceed the "well capitalized" thresholds under the current capital requirements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable as the Company is a smaller reporting company.

### ITEM 4. CONTROLS AND PROCEDURES

#### Disclosure Controls and Procedures

Evaluation of disclosure controls and procedures. Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, (the "Exchange Act")), the Company's principal executive officer and principal financial officer have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q, such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the required time periods specified in the SEC's rules and forms.

#### Internal Controls

Changes in internal control over financial reporting. During the last quarter, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On June 19, 2015, Devon Drive Lionville, LP, North Charlotte Road Pottstown, LP, Main Street Peckville, LP, Rhoads Avenue Newtown Square, LP, VG West Chester Pike, LP, 1301 Phoenix, LP, John M. Shea and George Spaeder (collectively, the "Plaintiffs"), filed suit in the U.S. District Court for the Eastern District of Pennsylvania, against Parke Bancorp, Inc., Parke Bank and ParkeBanks President and Chief Executive Officer and Senior Vice

President (collectively the "Parke Parties") alleging civil violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), among other claims, seeking compensatory and punitive damages. The allegations stem from a series of loans made by Parke Bank to the various Plaintiffs which subsequently went into default. The Plaintiffs are alleging that funds of one or more of the Plaintiffs were used to repay loans of another. The Parke Parties believe the material allegations of wrongdoing are without merit and intend to vigorously defend against the claims asserted in this litigation. The Parke Parties have filed a motion to dismiss all of the claims asserted against the Parke Parties on the grounds that, among other things, the claims asserted were addressed in prior litigation between the parties, including foreclosure actions, resolved in favor of the Parke Parties.

#### ITEM 1A. RISK FACTORS

Not applicable as the Company is a smaller reporting company.



ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no securities purchased during the three months ending September 30, 2016.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1 Certification of CEO required by Rule 13a-14(a).

31.2 Certification of CFO required by Rule 13a-14(a).

32 Certification required by 18 U.S.C. §1350.

101.INS XBRL Instance Document \*

101.SCH XBRL Schema Document \*

101.CAL XBRL Calculation Linkbase Document \*

101.LAB XBRL Labels Linkbase Document \*

101.PRE XBRL Presentation Linkbase Document \*

101.DEF XBRL Definition Linkbase Document \*

\* Submitted as Exhibits 101 to this Form 10-Q are documents formatted in XBRL (Extensible Business Reporting Language).

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.

PARKE BANCORP, INC.

Date: November 14, 2016 /s/ Vito S. Pantilione  
Vito S. Pantilione  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: November 14, 2016 /s/ John F. Hawkins  
John F. Hawkins  
Senior Vice President and  
Chief Financial Officer  
(Principal Accounting Officer)