LAKELAND BANCORP INC
Form 10-K
March 16, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

(MARK ONE)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005.

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM ______ TO ______.

Commission file number:

33-27312

LAKELAND BANCORP, INC.

(Exact name of registrant as specified in its charter)

New Jersey	**22-2953275**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
250 Oak Ridge Road, Oak Ridge, New Jersey	**07438**
(Address of principal executive offices)	**(Zip code)**

Registrant s telephone number, including area code: (973)697-2000

Securities registered pursuant to Section 12(b) of the Act: None

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Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class

Common Stock, no par value

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act:

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

As of June 30, 2005, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was approximately $291,000,000, based on the closing sale price as reported on the National Association of Securities Dealers Automated Quotation System National Market System.

The number of shares outstanding of the registrant s Common Stock, as of February 1, 2006, was 21,068,895.

DOCUMENTS INCORPORATED BY REFERENCE:

Lakeland Bancorp, Inc s. Proxy Statement for its 2006 Annual Meeting of Shareholders (Part III).

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[Page numbers to be filled in once Items 6, 7 and 8 are added.]

LAKELAND BANCORP, INC.

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PART I

ITEM 1 - Business

GENERAL

Lakeland Bancorp, Inc. (the Company), a New Jersey corporation, is a bank holding company registered with and supervised by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). The Company was organized in March of 1989 and commenced operations on May 19, 1989, upon consummation of the acquisition of all of the outstanding stock of Lakeland Bank, formerly named Lakeland State Bank (Lakeland). On February 20, 1998, the Company acquired Metropolitan State Bank, which became a subsidiary of the Company. On July 15, 1999, the Company completed its acquisition of The National Bank of Sussex County (NBSC). On January 28, 2000, the Company merged Metropolitan State Bank into Lakeland, with Lakeland as the survivor. On June 29, 2001, the Company merged NBSC into Lakeland, with Lakeland as the survivor. On August 25, 2003, the Company acquired CSB Financial Corp. and its subsidiary, Community State Bank, by merging CSB Financial Corp. into the Company and Community State Bank into Lakeland, with Lakeland as the survivor. On July 1, 2004, the Company acquired Newton Financial Corp. (NFC), which merged into the Company, and its subsidiary, Newton Trust Company (Newton). Newton operated as an independent bank until it merged into Lakeland, with Lakeland as the survivor, on November 4, 2005.

The Company s primary business currently consists of managing and supervising Lakeland. The principal source of the Company s income is dividends paid by Lakeland. At December 31, 2005, the Company had consolidated total assets, deposits, and stockholders equity of approximately $2.2 billion, $1.8 billion, and $191.8 million, respectively.

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (Forward-Looking Statements). Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected in such Forward-Looking Statements. Certain factors which could materially affect such results and the future performance of the Company are described in Item 1A - Risk Factors to this Annual Report on Form 10-K.

Lakeland is a state banking association, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC). Lakeland is not a member of the Federal Reserve System. Lakeland is a full-service commercial bank, offering a complete range of consumer and commercial services. Lakeland s 47 branch offices are located in the following six New Jersey counties: Morris, Passaic, Sussex, Warren, Essex, and Bergen.

Commercial Bank Services

Through Lakeland, the Company offers a broad range of lending, depository, and related financial services to individuals and small to medium sized businesses in its northern New Jersey market area. In the lending area, these services include short and medium term loans, lines of credit, letters of credit, inventory and accounts receivable financing, real estate construction loans and mortgage loans. Depository products include demand deposits, savings accounts, and time accounts. In addition, the Company offers collection, wire transfer, and night depository services. In the second quarter of 2000, Lakeland acquired NIA National Leasing Inc. Since its acquisition, this company has operated as a division of Lakeland under the name Lakeland Bank Equipment Leasing Division. This division provides a solution to small and medium sized companies who prefer to lease equipment over other financial alternatives. In the third quarter of 2004, Lakeland acquired a $25 million asset-based lending portfolio, which provides commercial borrowers with another lending alternative.

Consumer Banking

The Company also offers a broad range of consumer banking services, including checking accounts, savings accounts, NOW accounts, money market accounts, certificates of deposit, secured and unsecured loans, consumer installment loans, mortgage loans, and safe deposit services.

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Other Services

Investment and advisory services for individuals are also available.

Competition

The Company operates in a highly competitive market environment within northern New Jersey. Major multi-bank holding companies, several large independent regional banks, and several large multi-state thrift holding companies all operate within the Company s market area. These larger institutions have substantially larger lending capacities and typically offer services which the Company does not offer.

In recent years, the financial services industry has expanded rapidly as barriers to competition within the industry have become less significant. Within this industry, banks must compete not only with other banks and traditional financial institutions, but also with other business corporations that have begun to deliver financial services.

Concentration

The Company is not dependent for deposits or exposed by loan concentrations to a single customer or a small group of customers the loss of any one or more of which would have a material adverse effect upon the financial condition of the Company.

Employees

At December 31, 2005, there were 548 persons employed by the Company.

SUPERVISION AND REGULATION

General

The Company is a registered bank holding company under the federal Bank Holding Company Act of 1956, as amended (the Holding Company Act), and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the Holding Company Act. The Company is subject to examination by the Federal Reserve Board.

Lakeland is a state chartered banking association subject to supervision and examination by the Department of Banking and Insurance of the State of New Jersey and the FDIC. The regulations of the State of New Jersey and FDIC govern most aspects of Lakeland s business, including reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends, and location of branch offices. Lakeland is subject to certain restrictions imposed by law on, among other things, (i) the maximum amount of obligations of any one person or entity which may be outstanding at any one time, (ii) investments in stock or other securities of the Company or any subsidiary of the Company, and (iii) the taking of such stock or securities as collateral for loans to any borrower.

The Holding Company Act

The Holding Company Act limits the activities which may be engaged in by the Company and its subsidiaries to those of banking, the ownership and acquisition of assets and securities of banking organizations, and the management of banking organizations, and to certain non-banking activities which the Federal Reserve Board finds, by order or regulation, to be so closely related to banking or managing or controlling a bank as to be a proper incident thereto. The Federal Reserve Board is empowered to differentiate between activities by a bank holding company or a subsidiary thereof and activities commenced by acquisition of a going concern.

With respect to non-banking activities, the Federal Reserve Board has by regulation determined that several non-banking activities are closely related to banking within the meaning of the Holding Company Act and thus may be performed by bank holding companies. Although the Company s management periodically reviews other avenues of business opportunities that are included in that regulation, the Company has no present plans to engage in any of these activities other than providing brokerage services through a third party.

With respect to the acquisition of banking organizations, the Company is required to obtain the prior approval of the Federal Reserve Board before it may, by merger, purchase or otherwise, directly or indirectly acquire all

or substantially all of the assets of any bank or bank holding company, if, after such acquisition, it will own or control more than 5% of the voting shares of such bank or bank holding company.

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Regulation of Bank Subsidiaries

There are various legal limitations, including Sections 23A and 23B of the Federal Reserve Act, which govern the extent to which a bank subsidiary may finance or otherwise supply funds to its holding company or its holding company s non-bank subsidiaries. Under federal law, no bank subsidiary may, subject to certain limited exceptions, make loans or extensions of credit to, or investments in the securities of, its parent or the non-bank subsidiaries of its parent (other than direct subsidiaries of such bank which are not financial subsidiaries) or take their securities as collateral for loans to any borrower. Each bank subsidiary is also subject to collateral security requirements for any loans or extensions of credit permitted by such exceptions.

Commitments to Affiliated Institutions

The policy of the Federal Reserve Board provides that a bank holding company is expected to act as a source of financial strength to its subsidiary banks and to commit resources to support such subsidiary banks in circumstances in which it might not do so absent such policy.

Interstate Banking

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 permits bank holding companies to acquire banks in states other than their home state, regardless of applicable state law. This act also authorizes banks to merge across state lines, thereby creating interstate branches. Under the act, each state had the opportunity either to opt out of this provision, thereby prohibiting interstate branching in such state, or to opt in . A state may opt in with respect to de novo branching, thereby permitting a bank to open new branches in a state in which the bank does not already have a branch. Without de novo branching, an out-of-state bank can enter the state only by acquiring an existing bank. New Jersey enacted legislation to authorize interstate banking and branching and the entry into New Jersey of foreign country banks. New Jersey did not authorize de novo branching into the state. However, under federal law, federal savings banks, which meet certain conditions, may branch de novo into a state, regardless of state law.

Gramm-Leach Bliley Act of 1999

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

- allows bank holding companies meeting management, capital, and Community Reinvestment Act standards to engage in a substantially broader range of nonbanking activities than previously was permissible, including insurance underwriting and making merchant banking investments in commercial and financial companies; if a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals;

- allows insurers and other financial services companies to acquire banks;

- removes various restrictions that previously applied to bank holding company ownership of securities firms and mutual fund advisory companies; and

- establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

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

The USA PATRIOT Act

In response to the events of September 11, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), was signed into law on October 26, 2001. The USA PATRIOT Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA PATRIOT Act encourages information sharing among bank

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regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative

obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

Among other requirements, Title III of the USA PATRIOT Act imposes the following requirements with respect to financial institutions:

- All financial institutions must establish anti-money laundering programs that include, at a minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.

- The Secretary of the Department of Treasury, in conjunction with other bank regulators, was authorized to issue regulations that provide for minimum standards with respect to customer identification at the time new accounts are opened.

- Financial institutions that establish, maintain, administer, or manage private banking accounts or correspondence accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) are required to establish appropriate, specific and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.

- Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.

- Bank regulators are directed to consider a holding company s effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

The United States Treasury Department has issued a number of implementing regulations which apply to various requirements of the USA PATRIOT Act to financial institutions such as Lakeland. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers.

Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, or the SOA. The stated goals of the SOA are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The SOA generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission (the SEC) under the Securities Exchange Act of 1934 (the Exchange Act).

The SOA includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC and the Comptroller General. The SOA represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

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The SOA addresses, among other matters:

- audit committees for all reporting companies;
- certification of financial statements by the chief executive officer and the chief financial officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer s securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement;
- a prohibition on insider trading during pension plan black out periods;
- disclosure of off-balance sheet transactions;
- a prohibition on personal loans to directors and officers (other than loans made by an insured depository institution (as defined in the Federal Deposit Insurance Act), if the loan is subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act);
- expedited filing requirements for Forms 4 s;
- disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code;
- real time filing of periodic reports;
- the formation of a public accounting oversight board;
- auditor independence; and
- various increased criminal penalties for violations of securities laws.

The SEC has enacted various rules to implement various provisions of the SOA with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act.

Regulation W

Transactions between a bank and its affiliates are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Deposit Insurance Act applies Sections 23A and 23B to insured nonmember banks in the same manner and to the same extent as if they were members of the Federal Reserve System. The Federal Reserve Board has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretative guidance with respect to affiliate transactions. Regulation W incorporates the exemption from the affiliate transaction rules but expands the exemption to cover the purchase of any type of loan or extension of credit from an affiliate. Affiliates of a bank include, among other entities, the bank s holding company and companies that are under common control with the bank. The Company is considered to be an affiliate of Lakeland. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in

their ability to engage in covered transactions with affiliates:

- to an amount equal to 10% of the bank s capital and surplus, in the case of covered transactions with any one affiliate; and

- to an amount equal to 20% of the bank s capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A covered transaction includes:

- a loan or extension of credit to an affiliate;

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- a purchase of, or an investment in, securities issued by an affiliate;
- a purchase of assets from an affiliate, with some exceptions;
- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; and
- the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

In addition, under Regulation W:

- a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;
- covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and
- with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by certain types of collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve Board decides to treat these subsidiaries as affiliates.

Community Reinvestment Act

Under the Community Reinvestment Act (CRA), as implemented by FDIC regulations, a state bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the FDIC, in connection with its examination of a state non-member bank, to assess the bank s record of meeting the credit needs of its community and to take that record into account in its evaluation of certain applications by the bank. Under the FDIC s CRA evaluation system, the FDIC focuses on three tests: (i) a lending test, to evaluate the institution s record of making loans in its service areas; (ii) an investment test, to evaluate the institution s record of investing in community development projects, affordable housing and programs benefiting low or moderate income individuals and businesses; and (iii) a service test, to evaluate the institution s delivery of services through its branches, ATMs and other offices.

Securities and Exchange Commission

The Common Stock of the Company is registered with the SEC under the Exchange Act. As a result, the Company and its officers, directors, and major stockholders are obligated to file certain reports with the SEC. The Company is subject to proxy and tender offer rules promulgated pursuant to the Exchange Act. You may read and copy any document the Company files with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room. The SEC maintains a website at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, such as the Company.

The Company maintains a website at http://www.lakelandbank.com. The Company makes available on its website the proxy statements and reports on Forms 8-K, 10-K and 10-Q that it files with the SEC as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Additionally, the Company has adopted and posted on its website a Code of Ethics that applies to its principal executive officer, principal financial officer and principal accounting officer. The Company intends to disclose any amendments to or waivers of the Code of Ethics on its website.

Effect of Government Monetary Policies

The earnings of the Company are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies.

The monetary policies of the Federal Reserve Board have had, and will likely continue to have, an important impact on the operating results of commercial banks through the Board s power to implement national monetary policy in order to, among other things, curb inflation or combat a recession. The Federal Reserve Board has a major effect upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of, among other things, the discount rate of borrowings of banks and the reserve requirements against bank deposits. It is not possible to predict the nature and impact of future changes in monetary fiscal policies.

Dividend Restrictions

The Company is a legal entity separate and distinct from Lakeland. Virtually all of the revenue of the Company available for payment of dividends on its capital stock will result from amounts paid to the Company by Lakeland. All such dividends are subject to various limitations imposed by federal and state laws and by regulations and policies adopted by federal and state regulatory agencies. Under State law, a bank may not pay dividends unless, following the dividend payment, the capital stock of the bank would be unimpaired and either (a) the bank will have a surplus of not less than 50% of its capital stock, or, if not, (b) the payment of the dividend will not reduce the surplus of the bank.

If, in the opinion of the FDIC, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which could include the payment of dividends), the FDIC may require, after notice and hearing, that such bank cease and desist from such practice or, as a result of an unrelated practice, require the bank to limit dividends in the future. The Federal Reserve Board has similar authority with respect to bank holding companies. In addition, the Federal Reserve Board and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally only pay dividends out of current operating earnings. Regulatory pressures to reclassify and charge off loans and to establish additional loan loss reserves can have the effect of reducing current operating earnings and thus impacting an institution s ability to pay dividends. Further, as described herein, the regulatory authorities have established guidelines with respect to the maintenance of appropriate levels of capital by a bank or bank holding company under their jurisdiction. Compliance with the standards set forth in these policy statements and guidelines could limit the amount of dividends which the Company and Lakeland may pay. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), banking institutions which are deemed to be undercapitalized will, in most instances, be prohibited from paying dividends. See FDICIA . See also Note 18 - Regulatory Matters of the Notes to Consolidated Financial Statements for further information regarding dividends.

Capital Adequacy Guidelines

The Federal Reserve Board has adopted Risk-Based Capital Guidelines. These guidelines establish minimum levels of capital and require capital adequacy to be measured in part upon the degree of risk associated with certain assets. Under these guidelines all banks and bank holding companies must have a core or tier 1 capital to risk-weighted assets ratio of at least 4% and a total capital to risk-weighted assets ratio of at least 8%. At December 31, 2005, the Company s Tier 1 capital to risk-weighted assets ratio and total capital to risk-weighted assets ratio were 11.51% and 12.47%, respectively.

In addition, the Federal Reserve Board and the FDIC have approved leverage ratio guidelines (Tier I capital to average quarterly assets, less goodwill) for bank holding companies such as the Company. These guidelines provide for a minimum leverage ratio of 3% for bank holding companies that meet certain specified criteria, including that they have the highest regulatory rating. All other holding companies are required to maintain a leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points. The Company s leverage ratio was 7.49% at December 31, 2005.

Under FDICIA, federal banking agencies have established certain additional minimum levels of capital which accord with guidelines established under that act. See FDICIA .

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FDICIA

Enacted in December 1991, FDICIA substantially revised the bank regulatory provisions of the Federal Deposit Insurance Act and several other federal banking statutes. Among other things, FDICIA requires federal banking agencies to broaden the scope of regulatory corrective action taken with respect to banks that do not meet minimum capital requirements and to take such actions promptly in order to minimize losses to the FDIC. Under FDICIA, federal banking agencies were required to establish minimum levels of capital (including both a leverage limit and a risk-based capital requirement) and specify for each capital measure the levels at which depository institutions will be considered well capitalized , adequately capitalized , undercapitalized , significantly undercapitalized or critically undercapitalized .

Under regulations adopted under these provisions, for an institution to be well capitalized it must have a total risk-based capital ratio of at least 10%, a Tier I risk-based capital ratio of at least 6% and a Tier I leverage ratio of at least 5% and not be subject to any specific capital order or directive. For an institution to be adequately capitalized it must have a total risk-based capital ratio of at least 8%, a Tier I risk-based capital ratio of at least 4% and a Tier I leverage ratio of at least 4% (or in some cases 3%). Under the regulations, an institution will be deemed to be undercapitalized if it has a total risk-based capital ratio that is less than 8%, a Tier I risk-based capital ratio that is less than 4%, or a Tier I leverage ratio of less than 4% (or in some cases 3%). An institution will be deemed to be significantly undercapitalized if it has a total risk-based capital ratio that is less than 6%, a Tier I risk-based capital ratio that is less than 3%, or a leverage ratio that is less than 3% and will be deemed to be critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2%. An institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives an unsatisfactory examination rating or is deemed to be in an unsafe or unsound condition or to be engaging in unsafe or unsound practices. As of December 31, 2005, the Company and Lakeland met all regulatory requirements for classification as well capitalized under the regulatory framework for prompt corrective action.

In addition, FDICIA requires banking regulators to promulgate standards in a number of other important areas to assure bank safety and soundness, including internal controls, information systems and internal audit systems, credit underwriting, asset growth, compensation, loan documentation and interest rate exposure.

Deposit Insurance and Premiums

Lakeland s deposits are insured by the Bank Insurance Fund (BIF) that is administered by the FDIC up to a maximum of $100,000 per depositor. The amount of the premium is determined by the FDIC s risk-based insurance assessment system in which each insured bank is placed in one of nine assessment risk classifications based on the FDIC s evaluation. There is a 27 basis point range between the highest and lowest assessment rate. Banks classified as strongest by the FDIC were subject in 2005 to a 0.00% assessment. Lakeland was placed in this category and, therefore, had a 0.00% assessment rate in 2005.

In addition to this assessment, Lakeland and all other members of the BIF are required to help fund interest payment obligations that the Financing Corporation (FICO) has assumed to recapitalize the Savings Association Insurance Fund (SAIF). During 2005, a FICO premium of approximately two basis points was charged on BIF deposits. Based on this premium, the Company paid a FICO premium of $235,000 in 2005.

Proposed Legislation

From time to time proposals are made in the United States Congress, the New Jersey Legislature, and before various bank regulatory authorities, which would alter the powers of, and place restrictions on, different types of banking organizations. It is impossible to predict the impact, if any, of potential legislative trends on the business of the Company and its subsidiaries.

In accordance with federal law providing for deregulation of interest on all deposits, banks and thrift organizations are now unrestricted by law or regulation from paying interest at any rate on most time deposits. It is not clear whether deregulation and other pending changes in certain aspects of the banking industry will result in further increases in the cost of funds in relation to prevailing lending rates.

ITEM 1A - Risk Factors.

Our business, financial condition, operating results and cash flows can be affected by a number of factors, including, but not limited to, those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results.

We are subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

We are unable to predict actual fluctuations of market interest rates. Rate fluctuations are influenced by many factors, including:

- inflation or recession;
- a rise or fall in unemployment;
- tightening or expansion of the money supply;
- domestic and international disorder; and
- instability in domestic and foreign financial markets.

Both increases and decreases in the interest rate environment may reduce our profits. We expect that we will continue to realize income from the difference or spread between the interest we earn on loans, securities and other interest-earning assets, and the interest we pay on deposits, borrowings and other interest-bearing liabilities. Our net interest spreads are affected by the differences between the maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities. Our interest-earning assets may not reprice as slowly or rapidly as our interest-bearing liabilities. Changes in market interest rates could materially and adversely affect our net interest spread, asset quality, levels of prepayments, cash flows, the market value of our securities portfolio, loan and deposit growth, costs and yields on loans and deposits and our overall profitability.

Lakeland s ability to pay dividends is subject to regulatory limitations which, to the extent that our holding company requires such dividends in the future, may affect our holding company s ability to pay its obligations and pay dividends to shareholders.

As a bank holding company, the Company is a separate legal entity from Lakeland and its subsidiaries, and we do not have significant operations of our own. We currently depend on Lakeland s cash and liquidity to pay our operating expenses and dividends to shareholders. The availability of dividends from Lakeland is limited by various statutes and regulations. The inability of the Company to receive dividends from Lakeland could adversely affect our financial condition, results of operations, cash flows and prospects.

Lakeland s allowance for loan and lease losses may not be adequate to cover actual losses.

Like all commercial banks, we maintain an allowance for loan and lease losses to provide for loan and lease defaults and non-performance. If Lakeland s allowance for loan and lease losses is not adequate to cover actual loan and lease losses, we may be required to significantly increase future provisions for loan and lease losses, which could materially and adversely affect our operating results. Our allowance for loan and lease losses is determined by analyzing historical loan and lease losses, current trends in delinquencies and charge-offs, plans for problem loan and lease resolution, the opinions of Lakeland s regulators, changes in the size and composition of the loan and lease portfolio and industry information. We also consider the possible effects of economic events, which are difficult to predict. The amount of future losses is affected by changes in economic, operating and other conditions, including changes in interest rates, many of which are beyond our control. These losses may exceed our current estimates. Federal regulatory agencies, as an integral part of their examination process, review Lakeland s loans and the allowance for loan and lease losses. While we

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believe that our allowance for loan and lease losses in relation to our current loan portfolio is adequate to cover current losses, we cannot assure you that we will not need to increase our allowance for loan and lease losses or that regulators will not require us to increase this allowance. An increase in our allowance for loan and lease losses could materially and adversely affect our earnings and profitability.

Lakeland is subject to various lending and other economic risks that could adversely affect our results of operations and financial condition.

Economic, political and market conditions, trends in industry and finance, legislative and regulatory changes, changes in governmental monetary and fiscal policies and inflation affect our business. These factors are beyond our control. A deterioration in economic conditions, particularly in New Jersey, could have the following consequences, any of which could materially adversely affect our business:

- loan and lease delinquencies may increase;
- problem assets and foreclosures may increase;
- demand for our products and services may decrease; and
- collateral for loans made by Lakeland may decline in value, in turn reducing the borrowing ability of Lakeland s customers.

A downturn in the real estate market, particularly in New Jersey, could hurt our business. If there is a significant decline in real estate values in New Jersey, Lakeland s ability to recover on defaulted loans by selling the underlying real estate would be reduced, and Lakeland would be more likely to suffer losses on defaulted loans.

Lakeland may suffer losses in its loan portfolio despite its underwriting practices.

Lakeland seeks to mitigate the risks inherent in its loan portfolio by adhering to specific underwriting practices. Although we believe that Lakeland s underwriting criteria are appropriate for the various kinds of loans that it makes, Lakeland may incur losses on loans that meet its underwriting criteria, and these losses may exceed the amounts set aside as reserves in its allowance for loan and lease losses.

Lakeland faces strong competition from other financial institutions, financial service companies and other organizations offering services similar to the services that Lakeland provides.

Many competitors offer the types of loans and banking services that Lakeland offers. These competitors include other state and national banks, savings associations, regional banks and other community banks. Lakeland also faces competition from many other types of financial institutions, including finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. Many of Lakeland s competitors have greater financial resources than we do, which may enable them to offer a broader range of services and products, and to advertise more extensively, than we do. Our inability to compete effectively would adversely affect our business.

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

If we make acquisitions in the future, we will need to integrate the acquired entities into our existing business and systems. We may experience difficulties in accomplishing this integration or in effectively managing the combined company after any future acquisition. Any actual cost savings or revenue enhancements that we may anticipate from a future acquisition will depend on future expense levels and operating results, the timing of certain events and general industry, regulatory and business conditions. Many of these events will be beyond our control, and we cannot provide assurances that if we make any acquisitions in the future, we will be successful in integrating those businesses into our own.

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ITEM 1B - Unresolved Staff Comments

Not Applicable.

ITEM 2 - Properties

The Company s principal office is located at 250 Oak Ridge Road, Oak Ridge, New Jersey 07438. It also maintains an operations center in Branchville, New Jersey.

The Company operates 47 banking locations in Passaic, Morris, Sussex, Bergen, Essex and Warren Counties, New Jersey. The following chart provides information about the Company s leased offices:

Location	Lease Expiration Date
Wantage	April 30, 2006
Rockaway	August 15, 2008
Newton*	August 31, 2006
Wharton	July 24, 2010
Ringwood	February 28, 2008
Fairfield	February 28, 2007
Vernon	September 30, 2006
Bristol Glen	December 31, 2006
Hampton	September 30, 2018
Little Falls	November 30, 2010
Pompton Plains	March 31, 2008
Cedar Crest	August 19, 2011
Sussex/Wantage	July 31 2012
Park Ridge	December 31, 2009
Hackensack	September 1, 2008
Morristown	August 31, 2009
Caldwell	April 30, 2024
Andover*	December 31, 2006
Sparta*	March 31, 2007

* While these branches were consolidated with other branches in November 2005, the Company remains liable under the applicable leases. For information regarding all of the Company s rental obligations, see Notes to Consolidated Financial Statements.

All other offices of the Company and Lakeland are owned and are unencumbered.

ITEM 3 - Legal Proceedings

As the Company has disclosed in its periodic reports filed with the SEC, the Company was involved in legal proceedings concerning four separate portfolios of predominantly commercial leases which Lakeland purchased from Commercial Money Center, Inc. (CMC). CMC obtained surety bonds from three surety companies to guarantee each lessee s performance. Relying on these bonds, the Company and other investors purchased the leases and CMC s right to payment under the various surety bonds. CMC (and a related entity, Commercial Servicing Corp. (CSC)) eventually stopped forwarding to the Company the required amounts.

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On July 20, 2005, Lakeland entered into a settlement agreement with RLI Insurance Company and one remaining party in Lakeland s claims related to the CMC matter. Pursuant to the settlement agreements Lakeland was paid an aggregate of $3,315,000 and the parties executed mutual releases. As a result of the settlements, Lakeland s nonperforming assets were reduced by $6.4 million and no additional loan loss provision was required. A charge-off of $3.0 million was recorded.

A complaint captioned Ronnie Clayton dba Clayton Trucking, et al v. Ronald Fisher, et al was filed in the Los Angeles County Superior Court against Lakeland and others. Plaintiffs are certain of the lessees who had entered into leases with CMC. Plaintiffs allege, among other things, that these leases are not true leases but are instead loans which charge usurious interest rates. They further allege that because of various California Financial Code violations by CMC, the lease instruments are either void or must be reformed and all amounts paid by the lessees must be returned to them. The action against Lakeland has been stayed while an appeal by plaintiffs is pending concerning the dismissal of certain of plaintiffs claims against defendants.

From time to time, the Company and its subsidiaries are defendants in legal proceedings relating to their respective businesses. While the ultimate outcome of any pending matter cannot be determined at this time, management does not believe that the outcome of any pending legal proceeding will materially affect the consolidated financial position of the Company, but could possibly be material to the consolidated results of operations of any one period.

ITEM 4 - Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders of the Company during the fourth quarter of 2005.

ITEM 4A - Executive Officers of the Registrant

The following table sets forth the name and age of each executive officer of the Company. Each officer is appointed by the Company s Board of Directors. Unless otherwise indicated, the persons named below have held the position indicated for more than the past five years.

Name and Age	Officer of The Company Since	Position with the Company, its Subsidiary Banks, and Business Experience
Roger Bosma Age 63	1999	President and Chief Executive Officer of the Company (June, 1999 Present); President and Chief Executive Officer of Lakeland Bank (January 2002 to Present)
Robert A. Vandenbergh Age 54	1999	Executive Vice President and Chief Lending Officer of the Company (October, 1999 Present); President, NBSC (November, 1998 June, 2001)

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Name and Age	Officer of The Company Since	Position with the Company, its Subsidiary Banks, and Business Experience
Joseph F. Hurley Age 55	1999	Executive Vice President and Chief Financial Officer of the Company (November, 1999 Present)
Jeffrey J. Buonforte Age 54	1999	Executive Vice President and Chief Retail Officer of the Company (November, 1999 Present)
Louis E. Luddecke Age 59	1999	Executive Vice President and Chief Operations Officer of the Company (October, 1999 Present)
Steven Schachtel Age 48	2000	President, Lakeland Bank Equipment Leasing Division (April, 2000 Present)
James R. Noonan Age 54	2003	Executive Vice President and Chief Credit Officer of the Company (December, 2003 Present); Senior Vice President and Chief Credit Officer of the Company (March, 2003 December, 2003); Senior Credit Officer, Fleet National Bank (prior years March, 2003)

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PART II

ITEM 5 - MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Shares of the Common Stock of Lakeland Bancorp, Inc. have been traded under the symbol LBAI on the Nasdaq National Market since February 22, 2000 and in the over the counter market prior to this date. As of December 31, 2005, there were 3,899 shareholders of record of Common Stock. The following table sets forth the range of the high and low daily closing prices of the Common Stock as provided by Nasdaq and dividends declared for the periods presented. Prices and dividends have been adjusted to reflect the Company s 5% stock dividend paid on August 15, 2005.

Year ended December 31, 2005	High	Low	Dividends Declared
First Quarter	$ 17.03	$ 14.56	$ 0.095
Second Quarter	15.76	13.44	0.095
Third Quarter	16.31	14.75	0.100
Fourth Quarter	16.34	14.29	0.100
Year ended December 31, 2004	**High**	**Low**	**Dividends Declared**
First Quarter	$ 16.52	$ 14.90	$ 0.095
Second Quarter	16.14	14.68	0.095
Third Quarter	16.30	14.82	0.095
Fourth Quarter	17.57	15.24	0.095

Dividends on the Company s Common Stock are within the discretion of the Board of Directors of the Company and are dependent upon various factors, including the future earnings and financial condition of the Company and Lakeland and bank regulatory policies.

The Bank Holding Company Act of 1956 restricts the amount of dividends the Company can pay. Accordingly, dividends should generally only be paid out of current earnings, as defined.

The New Jersey Banking Act of 1948 restricts the amount of dividends paid on the capital stock of New Jersey chartered banks. Accordingly, no dividends shall be paid by such banks on their capital stock unless, following the payment of such dividends, the capital stock of the bank will be unimpaired and the bank will have a surplus of not less than 50% of its capital stock, or, if not, the payment of such dividend will not reduce the surplus of the bank. Under this limitation, approximately $134.2 million was available for the payment of dividends from Lakeland to the Company as of December 31, 2005.

Capital guidelines and other regulatory requirements may further limit the Company s and Lakeland s ability to pay dividends. See Item 1 Business Supervision and Regulation Dividend Restrictions.

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Equity Compensation Plan Information

The following table gives information about the Company s Common Stock that may be issued upon the exercise of options under the Company s Stock Option Plan, as of December 31, 2005. This plan was Lakeland s only equity compensation plan in existence as of December 31, 2005. No warrants or rights may be granted, or are outstanding, under the Stock Option Plan.

Plan Category	(a) Number Of Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price Of Outstanding Options, Warrants and Rights	(c) Number Of Securities Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected In Column (a))
Equity Compensation Plans Approved by Shareholders	1,160,237	$ 13.46	708,585
Equity Compensation Plans Not Approved by Shareholders			
TOTAL	1,160,237	$ 13.46	708,585

The following table provides information about purchases made by the Company of its Common Stock during the quarter ended December 31, 2005.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum No. of Shares that May Yet Be Purchased Under the Plans or Programs
October 2005	7,000	$ 15.00	7,000	460,648
November 2005	49,500	$ 15.78	49,500	411,148
December 2005	24,750	$ 15.04	24,750	386,398

On June 10, 2005, the Company announced a stock repurchase program for the purchase of up to 787,500 shares of the Company s Common Stock over the next year. Under the 2005 plan, the Company purchased 401,102 shares of its outstanding Common Stock at an average price of $15.18 per share for an aggregate cost of $6.1 million.

In January 2004, the Company announced a stock repurchase program for the purchase of up to 262,500 shares of the Company s Common Stock over the next year. On July 15, 2004, the amount of shares purchasable in the stock buyback plan was increased to 525,000 shares to be purchased over the following year. During 2004, the Company purchased 265,650 shares of its outstanding Common Stock at an average price of $16.61 per share for an aggregate cost of $4.4 million. During 2005, the Company completed purchasing the shares purchasable in the 2004 plan by purchasing 270,888 shares of its outstanding Common Stock at an average price of $14.80 per share for an aggregate price of $4.0 million.

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Any purchases under the Company s stock repurchase program may be made from time-to-time in the open market, through block trades or otherwise. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time-to-time without prior notice.

ITEMS 6 - Selected Financial Data

SELECTED CONSOLIDATED FINANCIAL DATA

(Not covered by Report of Independent Registered Public Accounting Firm)

Years Ended December 31	2005	2004 (2)	2003 (3)	2002	2001
	(in thousands except per share data)				
Interest income	**$ 103,839**	$ 83,319	$ 66,922	$ 65,520	$ 63,323
Interest expense	**33,632**	21,817	16,224	17,346	22,831
Net interest income	**70,207**	61,502	50,698	48,174	40,492
Provision for loan and lease losses	**1,555**	3,602	3,000	10,500	1,600
Noninterest income	**15,128**	12,761	10,926	9,001	8,347
Gains (losses) on sales of investment securities	**(583)**	638	1,857	876	(57)
Noninterest expenses	**53,392**	47,185	38,287	33,587	31,206
Income before income taxes	**29,805**	24,114	22,194	13,964	15,976
Income tax provision	**9,584**	7,619	7,087	3,887	4,953
Net income	**$ 20,221**	$ 16,495	$ 15,107	$ 10,077	$ 11,023
Per-Share Data[1]					
Weighted average shares outstanding:					
Basic	**21,439**	19,329	16,045	15,788	15,895
Diluted	**21,601**	19,567	16,268	16,082	16,089
Earnings per share:					
Basic	**$ 0.94**	$ 0.85	$ 0.94	$ 0.64	$ 0.70
Diluted	**$ 0.94**	$ 0.84	$ 0.93	$ 0.63	$ 0.69
Cash dividend per common share	**$ 0.39**	$ 0.38	$ 0.36	$ 0.32	$ 0.28
Book value per common share	**$ 9.08**	$ 8.96	$ 6.63	$ 5.79	$ 5.41
At December 31					
Investment securities available for sale	**$ 515,903**	$ 582,106	$ 557,402	$ 361,760	$ 273,082
Investment securities held to maturity	**154,569**	162,922	43,009	46,083	70,259
Loans, net of deferred fees	**1,312,767**	1,176,005	851,536	719,658	601,959
Goodwill and other identifiable intangible assets	**93,395**	94,119	27,609	3,020	3,149
Total assets	**2,206,033**	2,141,021	1,585,290	1,207,105	1,044,338
Total deposits	**1,798,160**	1,726,804	1,325,682	1,059,092	912,110
Total core deposits	**1,350,567**	1,360,980	1,038,195	807,747	677,346
Long-term borrowings	**101,764**	98,991	89,500	31,000	21,004
Total stockholders equity	**191,781**	194,548	110,951	90,767	85,567
Performance ratios					
Return on Average Assets	**0.94%**	0.90%	1.10%	0.89%	1.14%
Return on Average Equity	**10.55%**	10.79%	15.45%	11.29%	13.37%
Efficiency ratio	**59.76%**	60.70%	60.32%	57.23%	61.72%
Net Interest Margin (tax equivalent basis)	**3.73%**	3.82%	4.12%	4.75%	4.69%
Capital ratios					
Tier 1 leverage ratio	**7.49%**	7.71%	7.84%	7.01%	7.86%

Total risk-based capital ratio	**12.47%**	13.27%	15.96%	12.20%	13.61%

(1) Restated for 5% stock dividends in 2005, 2003, 2002, and 2001.

(2) The results of operations include Newton Trust Company from July 1, 2004 forward.

(3) The results of operations include Community State Bank for the period August 25, 2003 forward.

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ITEMS 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations

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

This section presents a review of Lakeland Bancorp, Inc. s consolidated results of operations and financial condition. You should read this section in conjunction with the selected consolidated financial data that is presented on the preceding page as well as the accompanying financial statements and notes to financial statements. As used in the following discussion, the term Company refers to Lakeland Bancorp, Inc. and Lakeland refers to the Company s wholly owned banking subsidiary Lakeland Bank. The Newton Trust Company (Newton) was merged into Lakeland on November 4, 2005. Newton Financial Corporation (NFC), the parent company of Newton, was merged into the Company on July 1, 2004, Community State Bank (CSB) was merged into Lakeland on August 25, 2003, and The National Bank of Sussex County (NBSC) was merged into Lakeland on June 29, 2001.

Statements Regarding Forward-Looking Information

The information disclosed in this document includes various forward-looking statements that are made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 with respect to credit quality (including delinquency trends and the allowance for loan and lease losses), corporate objectives, and other financial and business matters. The words anticipates , projects , intends , estimates , expects , believes, plans, may, will, should, could, and other similar expressions are intended to identify such forward-looking statemer Company cautions that these forward-looking statements are necessarily speculative and speak only as of the date made, and are subject to numerous assumptions, risks and uncertainties, all of which may change over time. Actual results could differ materially from such forward-looking statements.

In addition to the factors disclosed by the Company elsewhere in this document, the following factors, among others, could cause the Company s actual results to differ materially and adversely from such forward-looking statements: pricing pressures on loan and deposit products; competition; changes in economic conditions nationally, regionally and in the Company s markets; the extent and timing of actions of the Federal Reserve Board; changes in levels of market interest rates; clients acceptance of the Company s products and services; credit risks of lending activities and competitive factors; changes in the conditions of the capital markets in general and in the capital markets for financial institutions in particular and the impact of the war in Iraq on such markets; and the extent and timing of legislative and regulatory actions and reforms.

The above-listed risk factors are not necessarily exhaustive, particularly as to possible future events, and new risk factors may emerge from time to time. Certain events may occur that could cause the Company s actual results to be materially different than those described in the Company s periodic filings with the Securities and Exchange Commission. Any statements made by the Company that are not historical facts should be considered to be forward-looking statements. The Company is not obligated to update and does not undertake to update any of its forward-looking statements made herein.

Significant Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company and Lakeland conform with accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company, Lakeland, Lakeland Investment Corp, and Lakeland NJ Investment Corp. All intercompany balances and transactions have been eliminated.

The preparation of financial statements 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. These estimates and assumptions also affect reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Significant estimates implicit in these financial statements are as follows.

The principal estimates that are particularly susceptible to significant change in the near term relate to the allowance for loan and lease losses, the Company s deferred tax asset and the analysis of goodwill impairment. The evaluation of the adequacy of the allowance for loan and lease losses includes, among other factors, an analysis of historical loss rates, by category, applied to current loan totals. However, actual losses may be higher or lower than historical trends, which vary. Actual losses on specified problem loans, which also are provided for in the evaluation, may vary from estimated loss percentages, which are established based upon a limited number of potential loss classifications.

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The allowance for loan and lease losses is established through a provision for loan and lease losses charged to expense. Loan principal considered to be uncollectible by management is charged against the allowance for loan and lease losses. The allowance is an amount that management believes will be adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. The evaluation takes into consideration such factors as changes in the nature and size of the loan portfolio, overall portfolio quality, specific problem loans, and current economic conditions which may affect the borrowers ability to pay. The evaluation also details historical losses by loan category, the resulting loss rates for which are projected at current loan total amounts. Loss estimates for specified problem loans are also detailed. All of the factors considered in the analysis of the adequacy of the allowance for loan and lease losses may be subject to change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods.

The Company accounts for impaired loans in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan, as amended by SFAS No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures. Impairment is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan s observable market price, or the fair value of the collateral if the loan is collateral-dependent. Regardless of the measurement method, a creditor must measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable.

The Company accounts for income taxes under the liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Deferred tax expense is the result of changes in deferred tax assets and liabilities. The principal types of differences between assets and liabilities for financial statement and tax return purposes are allowance for loan and lease losses, core deposit intangible, deferred loan fees, deferred compensation and securities available for sale.

The Company accounts for goodwill and other identifiable intangible assets in accordance with SFAS No. 142, Goodwill and Intangible Assets. SFAS No. 142 includes requirements to test goodwill and indefinite lived intangible assets for impairment rather than amortize them. The Company tests goodwill for impairment annually at the reporting unit level using various market valuation methodologies. The Company has tested the goodwill as of December 31, 2005 and has determined that it is not impaired.

Financial Overview

The year ended December 31, 2005 represented a year of continued growth and consolidation for the Company. In November 2005, the Company merged Newton into Lakeland and closed three branches two of Newton and one of Lakeland. In 2005 the Company opened two new branches in towns where Lakeland did not previously have a presence. As discussed in this management s discussion and analysis:

- Net income increased $3.7 million or 23% from 2004 to 2005.
- Total loans increased by $139.6 million or 12%.
- Non-performing assets decreased $9.8 million from December 31, 2004 to December 31, 2005 which reflected the settlement between Lakeland and the remaining surety company which issued surety bonds to guarantee the income stream of several commercial lease pools. For more information see Note 15 Commitments and Contingencies Litigation.
- Lakeland expensed $225,000 related to the merger of Newton into Lakeland.
- Lakeland terminated its post retirement benefit plan and thereby reduced its benefit expense by $750,000.

Lakeland sold $80.4 million in securities in 2005 for a loss of $583,000 to position its portfolio to take advantage of higher yielding bonds.

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Net income for 2005 was $20.2 million or $0.94 per diluted share compared to net income of $16.5 million and $0.84 per diluted share in 2004. For 2005, Return on Average Assets was 0.94% and Return on Average Equity was 10.55%. For 2004, Return on Average Assets was 0.90% and Return on Average Equity was 10.79%.

In 2003, net income was $15.1 million or $0.93 per diluted share with a Return on Average Assets of 1.10% and a Return on Average Equity of 15.45%. The decline in earnings per share from 2003 to 2004 resulted from the increased average shares outstanding from the NFC acquisition.

Net interest income

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. The Company s net interest income is determined by: *(i)* the volume of interest-earning assets that it holds and the yields that it earns on those assets, and *(ii)* the volume of interest-bearing liabilities that it has assumed and the rates that it pays on those liabilities. Net interest income increases when the Company can use noninterest bearing deposits to fund or support interest-earning assets.

Net interest income for 2005 on a tax equivalent basis was $72.2 million, representing an increase of $8.9 million or 14% from the $63.2 million earned in 2004. Net interest income for 2003 on a tax equivalent basis was $52.3 million. The increase in net interest income from 2004 to 2005 resulted from an increase in average interest-earning assets of $279.3 million partially offset by a $257.7 million increase in interest-bearing liabilities and a 47 basis point increase in the cost of funds. The increase in net interest income in 2004 from 2003 resulted from an increase in earning assets of $389.5 million partially offset by a 30 basis point decline in the net interest margin. Factors contributing to the decline in the net interest margin will be discussed in further detail below.

Interest income and expense volume/rate analysis. The following table shows the impact that changes in average balances of the Company s assets and liabilities and changes in average interest rates have had on the Company s net interest income over the past three years. This information is presented on a tax equivalent basis assuming a 35% tax rate. If a change in interest income or expense is attributable to a change in volume and a change in rate, the amount of the change is allocated proportionately.

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INTEREST INCOME AND EXPENSE VOLUME/RATE ANALYSIS

(tax equivalent basis, in thousands)

	2005 vs. 2004 Increase (Decrease) Due to Change in:		Total Increase	2004 vs. 2003 Increase (Decrease) Due to Change in:		Total Increase
	Volume	Rate	(Decrease)	Volume	Rate	(Decrease)
Interest Income						
Loans	**$ 13,722**	**$ 3,714**	**$ 17,436**	$ 14,096	$ (3,281)	$ 10,815
Taxable investment securities	**1,700**	**491**	**2,191**	5,382	(157)	5,225
Tax-exempt investment securities	**801**	**(162)**	**639**	664	(195)	469
Federal funds sold	**(14)**	**492**	**478**	(3)	55	52
Total interest income	**16,209**	**4,535**	**20,744**	20,139	(3,578)	16,561
Interest Expense						
Savings deposits	**85**	**236**	**321**	290	(337)	(47)
Interest-bearing transaction accounts	**1,183**	**3,649**	**4,832**	2,067	77	2,144
Time deposits	**2,241**	**1,911**	**4,152**	611	(447)	164
Borrowings	**2,645**	**(135)**	**2,510**	2,961	371	3,332
Total interest expense	**6,154**	**5,661**	**11,815**	5,929	(336)	5,593
NET INTEREST INCOME (TAX EQUIVALENT BASIS)	**$ 10,055**	**$ (1,126)**	**$ 8,929**	$ 14,210	$ (3,242)	$ 10,968

The following table reflects the components of the Company s net interest income, setting forth for the years presented, (1) average assets, liabilities and stockholders equity, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, (4) the Company s net interest spread (i.e., the average yield on interest-earning assets less the average cost of interest-bearing liabilities) and (5) the Company s net interest margin. Rates are computed on a tax equivalent basis assuming a 35% tax rate.

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CONSOLIDATED STATISTICS ON A TAX EQUIVALENT BASIS

	2005			2004			2003		
	Average Balance	Interest Income/ Expense	Average rates earned/ paid	Average Balance	Interest Income/ Expense	Average rates earned/ paid	Average Balance	Interest Income/ Expense	Average rates earned/ paid
				(dollars in thousands)					
Assets									
Interest-earning assets:									
Loans (A)	**$ 1,222,084**	**$ 76,388**	**6.25%**	$ 999,865	$ 58,952	5.90%	$ 763,607	$ 48,137	6.30%
Taxable investment securities	**593,789**	**23,027**	**3.88%**	549,728	20,836	3.79%	407,684	15,611	3.83%
Tax-exempt securities	**99,110**	**5,631**	**5.68%**	84,889	4,992	5.88%	73,361	4,523	6.17%
Federal funds sold (B)	**21,798**	**764**	**3.50%**	23,034	286	1.24%	23,321	234	1.00%
Total interest-earning assets	**1,936,781**	**105,810**	**5.46%**	1,657,516	85,066	5.13%	1,267,973	68,505	5.40%
Noninterest earning assets:									
Allowance for loan and lease losses	**(15,513)**			(18,150)			(18,284)		
Other assets	**232,455**			191,100			122,459		
TOTAL ASSETS	**$ 2,153,723**			$ 1,830,466			$ 1,372,148		
Liabilities and Stockholders Equity									
Interest-bearing liabilities:									
Savings accounts	**$ 343,219**	**$ 2,084**	**0.61%**	$ 327,965	$ 1,763	0.54%	$ 279,084	$ 1,810	0.65%
Interest-bearing transaction accounts	**695,415**	**11,707**	**1.68%**	602,575	6,875	1.14%	421,307	4,731	1.12%
Time deposits	**411,704**	**11,041**	**2.68%**	319,808	6,889	2.15%	266,512	6,725	2.52%
Borrowings	**191,807**	**8,800**	**4.59%**	134,082	6,290	4.69%	70,228	2,958	4.21%
Total interest-bearing liabilities	**1,642,145**	**33,632**	**2.05%**	1,384,430	21,817	1.58%	1,037,131	16,224	1.56%
Noninterest-bearing liabilities:									
Demand deposits	**308,025**			284,638			231,116		
Other liabilities	**11,945**			8,503			6,140		
Stockholders equity	**191,608**			152,895			97,761		
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**$ 2,153,723**			$ 1,830,466			$ 1,372,148		
Net interest income/spread		**72,178**	**3.42%**		63,249	3.56%		52,281	3.84%
Tax equivalent basis adjustment		**1,971**			1,747			1,583	
NET INTEREST INCOME		**$ 70,207**			$ 61,502			$ 50,698	
Net interest margin (C)			**3.73%**			3.82%			4.12%

(A) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, and deferred loan fees.

(B) Includes interest-bearing cash accounts.
(C) Net interest income divided by interest-earning assets.

Total interest income on a tax equivalent basis increased from $85.1 million in 2004 to $105.8 million in 2005, an increase of $20.7 million. The increase in interest income in 2005 was primarily due to a $279.3 million increase in interest-earning assets due to growth in the loan and investment portfolios resulting from a full year s impact of the Newton merger as well as from growth generated internally. The increase in interest income was also due to a 33 basis point increase in the average yield on earning assets due to the increasing rate environment and to a shift in the Company s mix in earning assets from lower yielding investment securities and federal funds sold to higher yielding loans. Loans as a percent of average interest-earning assets increased from 60% in 2004 to 63% in 2005.

The increase in interest income from $68.5 million in 2003 to $85.1 million in 2004 resulted from a $389.5 million increase in average interest-earning assets offset by a 27 basis point decrease in the yield on average interest-earning assets reflecting loan and investment prepayments being reinvested at lower rates.

Total interest expense increased from $21.8 million in 2004 to $33.6 million in 2005 as a result of an increase in the volume of interest-bearing liabilities of $257.7 million. Interest expense also increased due to an increase in the Company s cost of funds from 1.58% in 2004 to 2.05% in 2005. A change in the mix of the deposits also had the effect of increasing the Company s cost of funds. Average savings and interest-bearing transaction accounts decreased from 67% of total interest-bearing liabilities in 2004 to 63% in 2005. Higher yielding time deposits increased from 23% of interest-bearing liabilities in 2004 to 25% of total deposits in 2005. Average borrowings which have an average rate paid of 4.59% in 2005 increased from 10% of interest-bearing liabilities in 2004 to 12% in 2005. Interest expense increased from $16.2 million in 2003 to $21.8 million in 2004 due to the increase in the

volume of interest-bearing liabilities of $347.3 million The cost of funds remained relatively stable at 1.58% resulting from an increase in average savings and interest bearing transaction accounts as a percent of total deposits and a decline in higher yielding time deposits as a percent of total deposits. The cost of funds in 2004 was impacted by the Company s trust preferred offerings of $30 million completed in June of 2003 and $25 million completed in December of 2003. The trust preferred securities have a weighted average rate of 6.78%. For more information see Note 7 Debt Subordinated Debentures.

Net Interest Margin

Net interest margin is calculated by dividing net interest income on a fully taxable equivalent basis by average interest-earning assets. The Company s net interest margin was 3.73%, 3.82% and 4.12% for 2005, 2004 and 2003, respectively. The decrease in the net interest margin from 2004 to 2005 resulted from deposits repricing faster than interest earning assets and from a shift in interest-bearing liabilities from core deposits to time deposits and borrowings. The 33 basis point increase in the average yield on interest-earning assets and the 47 basis point increase in the average rate paid on interest-bearing liabilities resulted in a lower net interest spread and a lower net interest margin. The decrease in the net interest margin from 2003 to 2004 resulted from a decline in the average yield earned on interest-earning assets due to investment and loan prepayments being reinvested in lower yielding assets.

Provision for Loan and Lease Losses

In determining the provision for loan and lease losses, management considers national and local economic conditions; trends in the portfolio including orientation to specific loan types or industries; experience, ability and depth of lending management in relation to the complexity of the portfolio; adequacy and adherence to policies, procedures and practices; levels and trends in delinquencies, impaired loans and net charge-offs and the results of independent third party loan review. The provision for loan and lease losses at $1.6 million in 2005 decreased from $3.6 million in 2004 due to management s evaluation of the loan portfolio. For more information, see Financial Condition Risk Elements below. Net charge-offs decreased from $6.2 million in 2004 to $5.0 million in 2005. Charge-offs in 2005 and 2004 included charge-offs of $3.0 million and $3.4 million, respectively, in two of the commercial lease pools due to the settlement with two of the surety companies which issued surety bonds to guarantee the income stream of several commercial lease pools. Net charge-offs as a percent of average loans outstanding decreased from 0.62% in 2004 to 0.41% in 2005. Without the impact of the commercial lease pool charge-offs, net charge-offs as a percentage of average loans outstanding would have been 0.16% and 0.41% for 2005 and 2004, respectively.

The 2004 provision for loan and lease losses at $3.6 million increased from $3.0 million in 2003 due to management s evaluation of the loan portfolio including its evaluation of the risk in the commercial lease pools discussed above. Net charge-offs were $4.9 million in 2003 including a $2.1 million charge-off in one of the commercial lease pools due to a settlement with one of the surety companies which issued surety bonds to guarantee the income stream of several commercial lease pools. The ratio of net charge-offs to average loans outstanding was 0.64%. Without the impact of the commercial lease pool charge-off in 2003, the ratio of net-charge-offs to average loans outstanding would have been 0.37%.

Noninterest Income

Noninterest income increased $1.1 million or 9% to $14.5 million in 2005 from $13.4 million in 2004 and represented 17.2% of total revenue for 2005. (Total revenue is defined as net interest income plus noninterest income.) A primary source of this increase in revenue was an increase in service charges on demand deposit accounts from $7.8 million in 2004 to $9.6 million in 2005, a $1.8 million or 23% increase. This increase resulted from fee income generated by Lakeland s overdraft protection program implemented in second quarter of 2005 and a full year of income from the Newton branches. Gains (losses) on sales of securities decreased from a gain of $638,000 in 2004 to a loss of $583,000 in 2005 as a result of a decline in the market value of securities due to the interest rate environment and from a sale of securities so that Lakeland could position its portfolio to take advantage of higher yielding bonds. Income from bank owned life insurance (BOLI) increased as a result of a full year of income earned on $5.5 million in BOLI policies acquired in the Newton acquisition. Other income increased from $803,000 in 2004 to $1.2 million in 2005 as a result of leasing income.

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Noninterest income increased $616,000 or 5% from $12.8 million in 2003 to $13.4 million in 2004 and represented 17.9% of total revenue for 2004. Noninterest income increased from 2003 to 2004 primarily as a result of increases in service charges on demand deposit accounts generated by the Newton branches purchased on July 1, 2004, and increased ATM income. Gains on sales of securities decreased from $1.9 million in 2003 to $638,000 in 2004 because Lakeland sold less securities in 2004 than 2003. Commissions and fees increased from $2.5 million in 2003 to $3.0 million in 2004, an increase of $466,000 or 18% due to increased loan volumes, increased prepayment fees on commercial loans and increased investment services brokerage income. Income from bank owned life insurance (BOLI) increased as a result of income earned on $7.0 million in BOLI policies purchased in the second quarter of 2003 and income earned from BOLI policies acquired in the Newton and CSB acquisitions. Other income increased from $389,000 in 2003 to $803,000 in 2004 as a result of gains on sales of leases and income received on the Company s investment in the common stock of the trusts that are described in further detail in Note 1 under Variable Interest Entities.

Noninterest Expense

Noninterest expense increased from $47.2 million in 2004 to $53.4 million in 2005, a $6.2 million or 13% increase. Salaries and benefits, the largest component of noninterest expense, increased by $3.4 million or 13%. A full year of the salaries paid to Newton s 119 employees contributed to this increase as well as normal salary and benefit increases. Occupancy expense increased from $4.4 million in 2004 to $5.4 million in 2005 as a result of expenses related to the ten branches and one administration center acquired in the Newton acquisition. Occupancy expense also included $161,000 in expenses relating to the closing of three branch offices. Furniture and equipment expenses increased $373,000 or 9% due to costs related to upgrading the Company s computer system as well as additional costs incurred from the acquisition of the Newton branches. Stationery, supplies and postage increased $254,000 or 16% from 2004 to 2005 as a result of expenses related to the Newton merger as well as expenses related to internal growth. Marketing expense increased from $1.5 million in 2004 to $1.6 million in 2005 primarily as a result of expenses related to the merger of Newton into Lakeland and related to the opening of two new branches. Core deposit intangible expense increased from $810,000 in 2004 to $1.2 million in 2005 resulting from a full year s amortization of core deposit intangible acquired in the Newton acquisition. Other expenses increased from $8.1 million in 2004 to $9.6 million in 2005, a $1.4 million or 18% increase. Other expenses included a $408,000 increase in director fees which included a full year of fees related to Newton, costs related to the merger of Newton to Lakeland, and costs related to the increased size of the Company s Board of Directors in connection with the merger of NFC. Other expenses also included a $200,000 increase in telecommunications expense, and a $139,000 increase in expenses related to personnel recruitment. The remainder of the increase in other expenses resulted from a full year of expenses related to Newton and expense related to our increased customer base.

Noninterest expense in 2004 increased $8.9 million or 23% over 2003. This increase included a $4.5 million or 22% increase in salary expense due to the 119 employees added from the Newton acquisition, a full year of salary paid to the 34 employees added from the CSB acquisition and normal increases. Occupancy expense increased from $3.7 million in 2003 to $4.4 million in 2004 as a result of expenses related to four branches acquired in the CSB acquisition and the ten branches and one administration center acquired in the Newton acquisition. Furniture and equipment expenses increased $714,000 or 21% due to costs related to upgrading the Company s computer system as well as additional costs incurred from the acquisition of the Newton branches. Stationery, supplies and postage increased $185,000 or 14% from 2003 to 2004 as a result of expenses related to the Newton merger as well as expenses related to internal growth. Marketing expense increased from $1.1 million in 2003 to $1.5 million in 2004 primarily as a result of expenses incurred in Bergen County, the market area the Company entered as a result of the CSB acquisition. The Newton acquisition also contributed to the increased marketing expense. Core deposit intangible expense increased $588,000 from $222,000 in 2003 to $810,000 in 2004 resulting from the Newton and CSB mergers. Other expenses increased from $6.3 million in 2003 to $8.1 million in 2004, a $1.8 million or 29% increase. Other expenses included $885,000 resulting from the addition of the Newton offices beginning July 1, 2004, and a $311,000 increase in audit fees resulting from costs incurred to comply with the Sarbanes-Oxley Act. Also included in other expenses was a $200,000 writedown of other real estate owned property in fourth quarter 2004. The remainder of the increase in other expenses resulted from expense related to our increased customer base.

The efficiency ratio expresses the relationship between non-interest expense (excluding other real estate expense and core deposit amortization) to total tax-equivalent revenue (excluding gains (losses) on sales of securities). In 2005, the Company s efficiency ratio on a tax equivalent basis decreased to 59.8% from 60.7% in 2004. The efficiency ratio was 60.3% in 2003.

Income Taxes

The Company s effective income tax rate was 32.2%, 31.6% and 31.9%, in the years ended December 31, 2005, 2004 and 2003, respectively.

Financial Condition

Total assets increased from $2.141 billion on December 31, 2004 to $2.206 billion on December 31, 2005, an increase of $65.0 million, or 3%. Total assets at year-end 2004 increased $555.7 million or 35% from year-end 2003, including $316.4 million from the Newton acquisition.

Loans

Lakeland primarily serves Northern New Jersey and the surrounding areas. All of its borrowers are U.S. residents or entities.

Total loans increased from $1.18 billion on December 31, 2004 to $1.32 billion on December 31, 2005, an increase of $139.6 million or 12%. The increase in loans occurred in all major loan categories. Commercial loans increased from $602.1 million to $691.1 million, an increase of $89.0 million or 15%. Commercial loans included $23.7 million in growth in leases from the Company s leasing division. The home equity and consumer installment portfolio increased from $289.9 million in 2004 to $302.2 million in 2005, an increase of $12.3 million or 4%. The residential real estate mortgage portfolio also increased $32.7 million or 15%. Real estate construction loans, which include both residential and commercial construction loans, increased from $62.7 million in 2004 to $68.3 million in 2005, an increase of $5.6 million or 9%. In 2004, total loans increased from $852.4 million to $1.18 billion including $201.5 million from the Newton acquisition. The majority of the growth was in the commercial loan portfolio which increased $202.6 million or 51% including $138.4 million from the Newton acquisition.

The following table sets forth the classification of the Company s loans by major category as of December 31 for each of the last five years:

			December 31,		
	2005	**2004**	**2003**	**2002**	**2001**
			(in thousands)		
Commercial	**$ 691,054**	$ 602,062	$ 399,468	$ 303,381	$ 251,821
Real estate mortgage	**256,621**	223,936	178,404	161,469	156,251
Real estate construction	**68,325**	62,687	20,476	19,567	15,598
Home equity and consumer installment	**302,236**	289,920	254,039	234,259	176,404
	$ 1,318,236	$ 1,178,605	$ 852,387	$ 718,676	$ 600,074

The following table shows the percentage distributions of loans by category as of December 31 for each of the last five years.

			December 31,		
	2005	**2004**	**2003**	**2002**	**2001**
Commercial	**52.4%**	51.1%	46.9%	42.2%	42.0%
Real estate mortgage	**19.5%**	19.0%	20.9%	22.5%	26.0%
Real estate construction	**5.2%**	5.3%	2.4%	2.7%	2.6%
Home equity and consumer installment	**22.9%**	24.6%	29.8%	32.6%	29.4%
	100.0%	100.0%	100.0%	100.0%	100.0%

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At December 31, 2005, there were no concentrations of loans exceeding 10% of total loans outstanding other than loans that are secured by real estate. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by economic or other related conditions.

The following table sets forth certain categories of loans as of December 31, 2005, in terms of contractual maturity date:

	Within one year	After one but within five years (in thousands)	After five years	Total
Types of Loans:				
Commercial	$ 94,478	$ 181,144	$ 415,432	$ 691,054
Real Estate construction	35,097	11,302	21,926	68,325
Total	$ 129,575	$ 192,446	$ 437,358	$ 759,379
Amount of such loans with:				
Predetermined rates	$ 37,759	$ 152,368	$ 120,006	$ 310,133
Floating or adjustable rates	91,816	40,078	317,352	449,246
Total	$ 129,575	$ 192,446	$ 437,358	$ 759,379

Risk Elements

Commercial loans are placed on a non-accrual status with all accrued interest and unpaid interest reversed if (a) because of the deterioration in the financial position of the borrower they are maintained on a cash basis (which means payments are applied when and as received rather than on a regularly scheduled basis), (b) payment in full of interest or principal is not expected, or (c) principal and interest has been in default for a period of 90 days or more unless the obligation is both well secured and in process of collection. Residential mortgage loans are placed on non-accrual status at the time when foreclosure proceedings are commenced except where there exists sufficient collateral to cover the defaulted principal and interest payments, and management s knowledge of the specific circumstances warrant continued accrual. Consumer loans are generally charged off when principal and interest payments are four months in arrears unless the obligations are well secured and in the process of collection. Interest thereafter on such charged-off consumer loans is taken into income when received only after full recovery of principal.

The following schedule sets forth certain information regarding the Company s non-accrual, past due and renegotiated loans and other real estate owned as of December 31, for each of the last five years:

	2005	2004	December 31, 2003 (in thousands)	2002	2001
Non-performing assets:					
Non-accrual loans	**3,907**	13,017	16,653	19,985	1,985
Other real estate owned		650			513
TOTAL NON-PERFORMING ASSETS	**$ 3,907**	$ 13,667	$ 16,653	$ 19,985	$ 2,498
Non-performing assets as a percent of total assets	**0.18%**	0.64%	1.05%	1.66%	0.24%
Past due loans*	**$ 5,127**	$ 2,347	$ 1,248	$ 1,342	$ 1,370

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*

Represents loans as to which payments of interest or principal are contractually past due ninety days or more, but which are currently accruing income at the contractually stated rates. A determination is made to continue accruing income on such loans only if collection of the debt is proceeding in due course and collection efforts are reasonably expected to result in repayment of the debt or in its restoration to a current status.

Non-accrual loans decreased from $13.0 million at December 31, 2004 to $3.9 million on December 31, 2005 primarily as a result of a settlement with the one remaining surety company which had guaranteed the income stream of $6.4 million of the commercial lease pools. Lakeland received $3.3 million in the settlement. The remaining $3.0 million of the loan was charged-off. Excluding the impact of the settlement of the lease pools, non-accrual loans decreased $2.7 million from 2004 to 2005. In 2004, non-accruals decreased $3.7 million from the prior year resulting primarily from the settlement with one of the surety companies that guaranteed the income stream of $4.0 million of commercial lease pools. The settlement included a $1.9 million principal payment and a charge-off of the remaining $2.1 million. Included in 2004 non-accrual loans are $2.7 million in non-accrual loans from Newton. Other real estate owned increased to $650,000 in 2004, resulting from the Newton acquisition. All non-accrual loans are in various stages of litigation, foreclosure, or workout.

For 2005, the gross interest income that would have been recorded, had the loans classified at year-end as non-accrual been performing in conformance with their original loan terms, is approximately $661,000. The amount of interest income actually recorded on those loans for 2005 was $323,000. The resultant income loss of $338,000 for 2005 compares to losses of $1.3 million and $1.6 million for 2004 and 2003, respectively.

Loans specifically evaluated are deemed impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreements. Loans which are in process of collection will not be classified as impaired. A loan is not impaired during the process of collection of payment if the Company expects to collect all amounts due, including interest accrued at the contractual interest rate. All commercial loans identified as impaired in excess of $250,000 are evaluated by an independent loan review consultant. The Company aggregates consumer loans and residential mortgages for evaluation purposes.

The Company s policy concerning commercial non-accrual loans states that, except for loans which are considered to be fully collectible by virtue of collateral held and in the process of collection, loans are placed on a non-accrual status when payments are 90 days delinquent or more. It is possible for a loan to be on non-accrual status and not be classified as impaired if the balance of such loan is relatively small and, therefore, that loan has not been specifically reviewed for impairment.

Loans, or portions thereof, are charged off in the period that the loss is identified. Until such time, an allowance for loan loss is maintained for estimated losses. With regard to interest income recognition for payments received on impaired loans, as well as all non-accrual loans, the Company follows regulatory guidelines, which apply any payments to principal as long as there is doubt as to the collectibility of the loan balance.

As of December 31, 2005, based on the above criteria, the Company had impaired loans totaling $3.7 million (including $3.4 million in non-accrual loans). The impairment of these loans is based on the fair value of the underlying collateral for these loans. Based upon such evaluation, $953,000 has been allocated to the allowance for loan and lease losses for impairment. At December 31, 2005, the Company also had $11.4 million in loans that were rated substandard that were not classified as non-performing or impaired.

There were no loans at December 31, 2005, other than those designated non-performing, impaired, or substandard where the Company was aware of any credit conditions of any borrowers that would indicate a strong possibility of the borrowers not complying with the present terms and conditions of repayment and which may result in such loans being included as non-accrual, past due or renegotiated at a future date.

The following table sets forth for each of the five years ended December 31, 2005, the historical relationships among the amount of loans outstanding, the allowance for loan and lease losses, the provision for loan and lease losses, the amount of loans charged off and the amount of loan recoveries:

	December 31,				
	2005	**2004**	**2003**	**2002**	**2001**
			(in thousands)		
Balance of the allowance at the beginning of the year	**$ 16,638**	$ 16,899	$ 17,940	$ 8,220	$ 8,890
Loans charged off:					
Commercial	**4,350**	4,964	4,100	501	2,248
Home equity and consumer	**1,923**	1,718	1,817	926	398
Real estate mortgage					4
Total loans charged off	**6,273**	6,682	5,917	1,427	2,650
Recoveries:					
Commercial	**753**	145	653	446	245
Home equity and consumer	**499**	363	350	195	124
Real estate mortgage	**1**	10	1	6	11
Total Recoveries	**1,253**	518	1,004	647	380
Net charge-offs:	**5,020**	6,164	4,913	780	2,270
Addition related to acquisitions		2,301	872		
Provision for loan and lease losses charged to operations	**1,555**	3,602	3,000	10,500	1,600
Ending balance	**$ 13,173**	$ 16,638	$ 16,899	$ 17,940	$ 8,220
Ratio of net charge-offs to average loans outstanding	**0.41%**	0.62%	0.64%	0.12%	0.41%
Ratio of allowance at end of year as a percentage of year-end total loans	**1.00%**	1.41%	1.98%	2.49%	1.37%

The ratio of the allowance for loan and lease losses to loans outstanding reflects management s evaluation of the underlying credit risk inherent in the loan portfolio. The determination of the adequacy of the allowance for loan and lease losses and the periodic provisioning for estimated losses included in the consolidated financial statements is the responsibility of management. The evaluation process is undertaken on a quarterly basis.

Methodology employed for assessing the adequacy of the allowance consists of the following criteria:

- The establishment of reserve amounts for all specifically identified classified loans that have been designated as requiring attention by the Company s external loan review consultant.

- The establishment of reserves for pools of homogeneous types of loans not subject to specific review, including 1 4 family residential mortgages, and consumer loans.

- The establishment of reserve amounts for the non-classified loans in each portfolio based upon the historical average loss experience for these portfolios and management s evaluation of key factors.

Consideration is given to the results of ongoing credit quality monitoring processes, the adequacy and expertise of the Company s lending staff, underwriting policies, loss histories, delinquency trends, and the cyclical nature of economic and business conditions. Since many of the Company s loans depend on the sufficiency of collateral as a secondary source of repayment, any adverse trend in the real estate markets could affect underlying values available to protect the Company from loss.

Based upon the process employed and giving recognition to all accompanying factors related to the loan portfolio, management considers the allowance for loan and lease losses to be adequate at December 31, 2005. The preceding statement constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.

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The following table shows how the allowance for loan and lease losses is allocated among the various types of loans that the Company has outstanding. This allocation is based on management s specific review of the credit risk of the outstanding loans in each category as well as historical trends.

	At December 31,				
	2005	2004	2003	2002	2001
	(in thousands)				
Commercial	**$ 9,821**	$ 13,598	$ 14,036	$ 16,086	$ 6,308
Home equity and consumer	**2,592**	2,411	2,117	1,109	1,173
Real estate construction	**350**	146	54	54	54
Real estate mortgage	**410**	483	692	691	685
	$ 13,173	$ 16,638	$ 16,899	$ 17,940	$ 8,220

Investment Securities

The Company has classified its investment securities into the available for sale and held to maturity categories pursuant to SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities.

The following table sets forth the carrying value of the Company s investment securities, both available for sale and held to maturity, as of December 31 for each of the last three years. Investment securities available for sale are stated at fair value while securities held for maturity are stated at cost, adjusted for amortization of premiums and accretion of discounts.

	December 31,		
	2005	2004	2003
	(in thousands)		
U.S. Treasury and U.S. government agencies	**$ 195,914**	$ 194,378	$ 169,826
Obligations of states and political subdivisions	**109,862**	101,023	82,139
Mortgage-backed securities	**335,081**	403,150	332,904
Equity securities	**19,067**	18,352	10,874
Other debt securities	**10,548**	28,125	4,668
	$ 670,472	$ 745,028	$ 600,411

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The following table sets forth the maturity distribution and weighted average yields (calculated on the basis of the stated yields to maturity, considering applicable premium or discount), on a fully taxable equivalent basis, of investment securities available for sale as of December 31, 2005:

Available for sale	Within one year	Over one but within five years	Over five but within ten years	After ten years	Total
			(dollars in thousands)		
U.S. Treasury and U.S. government agencies					
Amount	$ 10,546	$ 117,044	$ 25,980	$ 3,812	$ 157,382
Yield	3.86%	3.85%	3.97%	4.72%	3.89%
Obligations of states and political subdivisions					
Amount	3,860	17,671	22,718	1,470	45,719
Yield	5.58%	5.75%	5.54%	5.67%	5.63%
Mortgage-backed securities					
Amount	102	18,022	45,514	222,166	285,804
Yield	4.48%	3.71%	3.88%	4.16%	4.09%
Other debt securities					
Amount		1,162		6,769	7,931
Yield	%	3.87%	%	6.68%	6.27%
Other equity securities					
Amount	19,067				19,067
Yield	%	%	%	%	%
Total securities					
Amount	$ 33,575	$ 153,899	$ 94,212	$ 234,217	$ 515,903
Yield	1.87%	4.05%	4.30%	4.25%	4.05%

The following table sets forth the maturity distribution and weighted average yields (calculated on the basis of the stated yields to maturity, considering applicable premium or discount), on a fully taxable equivalent basis, of investment securities held to maturity as of December 31, 2005:

Held to maturity	Within one year	Over one but within five years	Over five but within ten years	After ten years	Total
			(dollars in thousands)		
U.S. Treasury and U.S. government agencies					
Amount	$ 308	$ 28,445	$ 9,779	$	$ 38,532
Yield	1.85%	3.87%	4.68%	%	4.06%
Obligations of states and political subdivisions					
Amount	18,020	7,924	25,887	12,312	64,143
Yield	4.60%	5.28%	4.92%	5.47%	4.98%
Mortgage-backed securities					
Amount	183	4,888	4,547	39,659	49,277
Yield	4.53%	4.03%	3.79%	4.24%	4.18%
Other debt securities					
Amount	1,002		509	1,106	2,617
Yield	4.64%	%	5.00%	5.45%	5.05%
Total securities					
Amount	$ 19,513	$ 41,257	$ 40,722	$ 53,077	$ 154,569
Yield	4.56%	4.16%	4.74%	4.55%	4.50%

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Deposits

Total deposits increased from $1.727 billion on December 31, 2004 to $1.798 billion on December 31, 2005, an increase of $71.4 million, or 4%. The major factor driving deposit growth in 2005 was a growth in time deposits which increased from $365.8 million at December 31, 2004 to $447.6 million at December 31, 2005, an increase of $81.8 million or 22% as customers moved their funds from transaction and savings accounts to higher yielding time deposits. The growth in time deposits included $58.3 million in certificates of deposits over $100,000 which included municipal deposits. Total noninterest bearing demand accounts decreased from $319.4 million to $312.5 million, a $6.8 million or 2% decrease. Total core deposits, which are defined as noninterest bearing deposits and savings and interest-bearing transaction accounts, decreased from $1.361 billion on December 31, 2004 to $1.351 billion on December 31, 2005, a decrease of $10.4 million or 1%. Total deposits in 2004 increased $401.1 million or 30% from December 31, 2003, including $266.9 million from the Newton acquisition.

The average amount of deposits and the average rates paid on deposits for the years indicated are summarized in the following table:

	Year Ended December 31, 2005		Year Ended December 31, 2004		Year Ended December 31, 2003	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Noninterest-bearing demand deposits	$ 308,025	%	$ 284,638	%	$ 231,116	%
Interest-bearing transaction accounts	695,415	1.68%	602,575	1.14%	421,307	1.12%
Savings	343,219	0.61%	327,965	0.54%	279,084	0.65%
Time deposits	411,704	2.68%	319,808	2.15%	266,512	2.52%
Total	$ 1,758,363	1.41%	$ 1,534,986	1.01%	$ 1,198,019	1.11%

As of December 31, 2005, the aggregate amount of outstanding time deposits issued in amounts of $100,000 or more, broken down by time remaining to maturity, was as follows (in thousands):

Maturity	
Within 3 months	$ 69,530
Over 3 through 6 months	34,571
Over 6 through 12 months	24,616
Over 12 months	25,583
Total	$ 154,300

Liquidity

Liquidity measures whether an entity has sufficient cash flow to meet its financial obligations and commitments on a timely basis. The Company is liquid when its subsidiary bank has the cash available to meet the borrowing and cash withdrawal requirements of customers and the Company can pay for current and planned expenditures and satisfy its debt obligations.

Lakeland funds loan demand and operation expenses from four sources:

Net income.

Deposits. Lakeland can offer new products or change its rate structure in order to increase deposits. In 2005, the Company generated $71.4 million in deposit growth.

Sales of securities and overnight funds. At year-end 2005, the Company had $515.9 million in securities designated available for sale.

Overnight credit lines. Lakeland is a member of the Federal Home Loan Bank of New York (FHLB). One membership benefit is that members can borrow overnight funds. Lakeland has overnight credit lines of $100 million available for it to borrow from the FHLB. Lakeland also has overnight federal funds lines available for it to borrow up to $85 million.

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The Company s management believes that its current level of liquidity is sufficient to meet its current and anticipated operational needs including current loan commitments, deposit maturities and other obligations. This constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from anticipated results due to a variety of factors, including uncertainties relating to general economic conditions; unanticipated decreases in deposits; changes in or failure to comply with governmental regulations; and uncertainties relating to the analysis of the Company s assessment of rate sensitive assets and rate sensitive liabilities and relating to the extent to which market factors indicate that a financial institution such as Lakeland should match such assets and liabilities.

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of December 31, 2005:

(dollars in thousands)	Total	Within one year	After one but within three years	After three but within five years	After five years
Minimum annual rentals or noncancellable operating leases	$ 6,623	$ 1,084	$ 1,528	$ 1,057	$ 2,954
Benefit plan commitments	2,565	35	220	370	1,940
Remaining contractual maturities of time deposits	447,593	349,719	93,045	3,426	1,403
Subordinated debentures	56,703				56,703
Loan commitments	351,418	306,916	20,956	2,978	20,568
Long-term borrowed funds	45,061	3,355	11,706	10,000	20,000
Standby letters of credit	11,842	11,458	384		
Total	$ 921,805	$ 672,567	$ 127,839	$ 17,831	$ 103,568

Interest Rate Risk

Closely related to the concept of liquidity is the concept of interest rate sensitivity (i.e., the extent to which assets and liabilities are sensitive to changes in interest rates). Interest rate sensitivity is often measured by the extent to which mismatches or gaps occur in the repricing of assets and liabilities within a given time period. Gap analysis is utilized to quantify such mismatches. A positive gap results when the amount of earning assets repricing within a given time period exceeds the amount of interest-bearing liabilities repricing within that time period. A negative gap results when the amount of interest-bearing liabilities repricing within a given time period exceeds the amount of earning assets repricing within such time period.

In general, a financial institution with a positive gap in relevant time periods will benefit from an increase in market interest rates and will experience erosion in net interest income if such rates fall. Likewise, a financial institution with a negative gap in relevant time periods will normally benefit from a decrease in market interest rates and will be adversely affected by an increase in rates. By maintaining a balanced interest rate sensitivity position, where interest rate sensitive assets roughly equal interest sensitive liabilities in relevant time periods, interest rate risk can be limited.

As a financial institution, the Company s potential interest rate volatility is a primary component of its market risk. Fluctuations in interest rates will ultimately impact the level of income and expense recorded on a large portion of the Company s assets and liabilities, and the market value of all interest-earning assets, other than those

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which possess a short term to maturity. Based upon the Company s nature of operations, the Company is not subject to foreign currency exchange or commodity price risk. The Company does not own any trading assets and does not have any hedging transactions in place, such as interest rate swaps and caps.

The Company s Board of Directors has adopted an Asset/Liability Policy designed to stabilize net interest income and preserve capital over a broad range of interest rate movements. This policy outlines guidelines and ratios dealing with, among others, liquidity, volatile liability dependence, investment portfolio composition, loan portfolio composition, loan-to-deposit ratio and gap analysis ratio. The Company s performance as compared to the Asset/Liability Policy is monitored by its Board of Directors. In addition, to effectively administer the Asset/Liability Policy and to monitor exposure to fluctuations in interest rates, the Company maintains an Asset/Liability Committee, consisting of the Chief Executive Officer, Chief Financial Officer, Chief Lending Officer, Chief Retail Officer, Chief Credit Officer, certain other senior officers and certain directors. This committee meets quarterly to review the Company s financial results and to develop strategies to implement the Asset/Liability Policy and to respond to market conditions.

The Company monitors and controls interest rate risk through a variety of techniques, including use of traditional interest rate sensitivity analysis (also known as gap analysis) and an interest rate risk management model. With the interest rate risk management model, the Company projects future net interest income, and then estimates the effect of various changes in interest rates and balance sheet growth rates on that projected net interest income. The Company also uses the interest rate risk management model to calculate the change in net portfolio value over a range of interest rate change scenarios. Traditional gap analysis involves arranging the Company s interest-earning assets and interest-bearing liabilities by repricing periods and then computing the difference (or interest rate sensitivity gap) between the assets and liabilities that are estimated to reprice during each time period and cumulatively through the end of each time period.

Both interest rate sensitivity modeling and gap analysis are done at a specific point in time and involve a variety of significant estimates and assumptions. Interest rate sensitivity modeling requires, among other things, estimates of how much and when yields and costs on individual categories of interest-earning assets and interest-bearing liabilities will respond to general changes in market rates, future cash flows and discount rates.

Gap analysis requires estimates as to when individual categories of interest-sensitive assets and liabilities will reprice, and assumes that assets and liabilities assigned to the same repricing period will reprice at the same time and in the same amount. Gap analysis does not account for the fact that repricing of assets and liabilities is discretionary and subject to competitive and other pressures.

The following table sets forth the estimated maturity/repricing structure of the Company s interest-earning assets and interest-bearing liabilities at December 31, 2005. Except as stated below, the amounts of assets or liabilities shown which reprice or mature during a particular period were determined in accordance with the contractual terms of each asset or liability. The majority of interest-bearing demand deposits and savings deposits are assumed to be core deposits, or deposits that will generally remain at the Company regardless of market interest rates. Therefore, 13% of the core interest-bearing deposits, 20% of core savings deposits and 35% of money market deposit accounts are shown as maturing or repricing within three months. The remainder is divided between the after 1 but within 5 years column and the after 5 years column. Interest-bearing transaction accounts held by states and municipalities are seen to be more sensitive than personal interest-bearing transaction accounts. Therefore, 50% of public interest-bearing transaction accounts are shown as repricing within three months. The table does not assume any prepayment of fixed-rate loans.

The table does not necessarily indicate the impact of general interest rate movements on the Company s net interest income because the repricing of certain categories of assets and liabilities, for example, prepayments of loans and withdrawal of deposits, is beyond the Company s control. As a result, certain assets and liabilities indicated as repricing within a stated period may in fact reprice at different times and at different rate levels.

December 31, 2005	Within three months	After 3 months but within 1 year	After 1 but within 5 years	After 5 Years	Total
	Maturing or Repricing (dollars in thousands)				
Interest-earning assets:					
Loans	$ 291,081	$ 111,015	$ 566,247	$ 344,424	$ 1,312,767
Investment securities	48,774	95,679	375,577	150,442	670,472
Interest-bearing cash accounts	10,176				10,176
Total interest-earning assets	350,031	206,694	941,824	494,866	1,993,415
Interest-bearing liabilities:					
Deposits:					
Interest-bearing demand	188,682		321,487	192,156	702,325
Savings accounts	65,563		120,067	150,083	335,713
Time deposits	136,898	213,022	96,270	1,403	447,593
Total interest-bearing deposits	391,143	213,022	537,824	343,642	1,485,631
Borrowings:					
Fed funds purchased and securities sold under agreements to repurchase	78,199	25,000			103,199
Long-term debt	2,906	451	41,704	0	45,061
Subordinated debentures			30,929	25,774	56,703
Total borrowings	81,105	25,451	72,633	25,774	204,963
Total interest-bearing liabilities	472,248	238,473	610,457	369,416	1,690,594
Interest rate sensitivity gap	$ (122,217)	$ (31,779)	$ 331,367	$ 125,450	$ 302,821
Cumulative rate sensitivity gap	$ (122,217)	$ (153,996)	$ 177,371	$ 302,821	

Changes in estimates and assumptions made for interest rate sensitivity modeling and gap analysis could have a significant impact on projected results and conclusions. Therefore, these techniques may not accurately reflect the impact of general interest rate movements on the Company s net interest income or net portfolio value.

Because of the limitations in the gap analysis discussed above, members of the Company s Asset/Liability Management Committee believe that the interest sensitivity modeling more accurately reflects the effects and exposure to changes in interest rates. Net interest income simulation considers the relative sensitivities of the balance sheet including the effects of interest rate caps on adjustable rate mortgages and the relatively stable aspects of core deposits. As such, net interest income simulation is designed to address the probability of interest rate changes and the behavioral response of the balance sheet to those changes. Market Value of Portfolio Equity represents the fair value of the net present value of assets, liabilities and off-balance-sheet items.

The starting point (or base case) for the following table is an estimate of the Company s net portfolio value at December 31, 2005 using current discount rates, and an estimate of net interest income for 2006 assuming that both interest rates and the Company s interest-sensitive assets and liabilities remain at December 31, 2005 levels. The information provided for the net portfolio value assumes fluctuations or rate shocks of plus 200 basis points and minus 200 basis points. Rate shocks assume that current interest rates change immediately. The information provided for net interest income for 2006 assumes that changes in interest rates of plus 200 basis points and minus 200 basis points change gradually in equal increments over the twelve month period. The information set forth in the following table is based on significant estimates and assumptions, and constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.

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Rate Scenario	Net Portfolio Value at December 31, 2005 Amount	Percent Change From Base Case	Net interest income for 2006 Amount	Percent Change From Base Case
	(dollars in thousands)			
+200 basis points	$ 292,451	(11.7)%	$ 67,380	(3.3)%
Base Case	331,370	%	69,680	%
-200 basis points	340,049	2.6%	72,035	3.4%

Capital Resources

Stockholders equity decreased $2.8 million to $191.8 million at December 31, 2005, from $194.5 million at December 31, 2004, reflecting net income during the year of $20.2 million, cash dividends to stockholders of $8.3 million, an unrealized securities loss, net of deferred income taxes, of $5.2 million, purchases of treasury stock of $10.1 million and a net change from the exercise of stock options of $608,000.

Book value per share (total stockholders equity divided by the number of shares outstanding) increased from $8.96 on December 31, 2004 to $9.08 on December 31, 2005 as a result of increased income and a decrease in shares outstanding resulting from the buyback of shares under the stock repurchase program. Book value per share was $6.63 on December 31, 2003.

The FDIC s risk-based capital policy statement imposes a minimum capital standard on insured banks. The minimum ratio of risk-based capital to risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit) is 8%. At least half of the total capital is to be comprised of common stock equity and qualifying perpetual preferred stock, less goodwill (Tier I capital). The remainder (Tier II capital) may consist of mandatory convertible debt securities, qualifying subordinated debt, other preferred stock and a portion of the allowance for loan and lease losses. The Federal Reserve Board has adopted a similar risk-based capital guideline for the Company which is computed on a consolidated basis.

In addition, the bank regulators have adopted minimum leverage ratio guidelines (Tier I capital to average quarterly assets, less goodwill) for financial institutions. These guidelines provide for a minimum leverage ratio of 3% for financial institutions that meet certain specified criteria, including that they have the highest regulatory rating. All other holding companies are required to maintain a leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points.

The following table reflects capital ratios of the Company and its subsidiaries as of December 31, 2005 and 2004:

	Tier 1 Capital to Total Average Assets Ratio December 31,		Tier 1 Capital to Risk-Weighted Assets Ratio December 31,		Total Capital to Risk-Weighted Assets Ratio December 31,	
Capital Ratios:	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**
The Company	**7.49%**	7.71%	**11.51%**	12.02%	**12.47%**	13.27%
Lakeland Bank	**6.86%**	6.11%	**10.57%**	9.78%	**11.53%**	11.03%
Newton Trust Company	**N/A**	10.36%	**N/A**	14.52%	**N/A**	15.38%
Well capitalized institution under FDIC Regulations	**5.00%**	5.00%	**6.00%**	6.00%	**10.00%**	10.00%

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Recent Accounting Pronouncements

In November 2005, FASB Staff Position 115-1 and 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (FSP 115-1) was issued. FSP 115-1 replaced the guidance in paragraphs 10 18 of EITF Issue 03-1 with references to existing other-than-temporary impairment guidance, such as SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, Staff Accounting Bulletin 59, Accounting for Noncurrent Marketable Equity Securities, and APB Opinion 18, The Equity Method of Accounting for Investments in Common Stock. FSP 115-1 codified the guidance set forth in EITF Topic D-44 and clarified that an investor should recognize an impairment loss no later than when the impairment is considered other-than-temporary, even if a decision to sell has not been made. FSP 115-1 also includes language from EITF Issue 03-1 regarding the accounting for debt securities subsequent to an other-than-temporary impairment.

The Company has evaluated its investments under EITF 03-1 and FSP 115-1. Because it has concluded that none of its securities have impairments that are other-than-temporary, the impact of these pronouncements have not had a material impact on the Company s financial statements.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), Share-Based Payment, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. Under SFAS No. 123(R), all forms of share-based payments to employees, including employee stock options, would be treated the same as other forms of compensation by recognizing the related cost in the income statement. The expense of the award would generally be measured at fair value at the grant date. Current accounting guidance requires that the expense relating to employee stock options only be disclosed in the footnotes to the financial statements. SFAS No. 123(R) eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) is effective for public companies as of the beginning of the first fiscal year that begins after June 15, 2005. All public companies that used the fair-value-based method for either recognition or disclosure under SFAS No. 123 will apply SFAS No. 123(R) using a modified method of prospective application. Under this transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered based on the grant-date fair value of those awards calculated under SFAS No. 123 for either recognition or pro forma disclosures. The impact of this new standard, if it had been in effect, on the net earnings and related per share amounts for the years ended December 31, 2005, 2004 and 2003 is disclosed in Note 1-Summary of Accounting Policies Stock-Based Compensation.

On March 29, 2005, the SEC released Staff Accounting Bulletin 107, Share Based Payments (SAB 107). The interpretations in SAB 107 express views of the SEC staff regarding the application of SFAS No. 123(R). Among other things, SAB 107 provides interpretive guidance related to the interaction between Statement 123(R) and certain SEC rules and regulations, as well as provides the staff s views regarding the valuation of share-based payment arrangements for public companies. Since all of the Company s stock options outstanding at December 31, 2005 are vested, management does not believe that the implementation of SAB 107 and SFAS No. 123(R) will have an immediate impact on its earnings. The Company will implement SAB 107 and SFAS No. 123(R) using a modified method of prospective application. The Company is evaluating the impact that the implementation of SAB 107 and SFAS No. 123 (R) will have on future option, restricted stock, or other potential grants.

Effects of Inflation

The impact of inflation, as it affects banks, differs substantially from the impact on non-financial institutions. Banks have assets which are primarily monetary in nature and which tend to move with inflation. This is especially true for banks with a high percentage of rate sensitive interest-earning assets and interest-bearing liabilities. A bank can further reduce the impact of inflation with proper management of its rate sensitivity gap. This gap represents the difference between interest rate sensitive assets and interest rate sensitive liabilities. Lakeland attempts to structure its assets and liabilities and manages its gap to protect against substantial changes in interest rate scenarios, in order to minimize the potential effects of inflation.

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ITEM 7A - Quantitative and Qualitative Disclosures About Market Risk

See Management s Discussion and Analysis of Financial Condition and Results of Operations

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ITEM 8 - Financial Statements and Supplementary Data

Lakeland Bancorp, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

	December 31, 2005	December 31, 2004
	(dollars in thousands)	
ASSETS		
Cash	**$ 42,639**	$ 47,981
Interest-bearing deposits due from banks	**10,176**	7,365
Total cash and cash equivalents	**52,815**	55,346
Investment securities available for sale	**515,903**	582,106
Investment securities held to maturity; fair value of $151,637 in 2005 and $162,926 in 2004	**154,569**	162,922
Loans, net of deferred fees	**1,312,767**	1,176,005
Less: allowance for loan and lease losses	**13,173**	16,638
Net loans	**1,299,594**	1,159,367
Premises and equipment - net	**32,428**	31,749
Accrued interest receivable	**8,851**	8,002
Goodwill and other identifiable intangible assets	**93,395**	94,119
Bank owned life insurance	**35,479**	34,240
Other assets	**12,999**	