

PEAPACK GLADSTONE FINANCIAL CORP  
Form 10-Q  
November 01, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**(MARK ONE)**

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

**For the Quarter Ended September 30, 2013**

**OR**

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

**For the transition period from to**

**Commission File No. 001-16197**

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**(Exact name of registrant as specified in its charter)**

**New Jersey**                      **22-3537895**  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

**500 Hills Drive, Suite 300**

**Bedminster, New Jersey 07921-1538**

(Address of principal executive offices, including zip code)

**(908) 234-0700**

(Registrant's telephone number, including area code)

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

Yes       No .

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

Yes       No .

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

Large accelerated filer

Accelerated filer

Smaller reporting company

Non-accelerated filer (do not check if a smaller reporting company)

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

Number of shares of Common Stock outstanding as of October 25, 2013:

9,079,436

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**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

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Item 1. Financial Statements (Unaudited)

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

|   | (unaudited)<br>September 30,<br>2013 | (audited)<br>December 31,<br>2012 |
|---|--------------------------------------|-----------------------------------|
| <b>ASSETS</b>                                       |                                      |                                   |
| Cash and due from banks                             | \$ 5,886                             | \$ 6,733                          |
| Federal funds sold                                  | 101                                  | 100                               |
| Interest-earning deposits                           | 33,528                               | 112,395                           |
| Total cash and cash equivalents                     | 39,515                               | 119,228                           |
| Securities available for sale                       | 273,952                              | 304,479                           |
| FHLB and FRB stock, at cost                         | 7,707                                | 4,639                             |
| Loans held for sale, at fair value                  | 724                                  | 6,461                             |
| Loans held for sale, at lower of cost or fair value | —                                    | 13,749                            |
| Loans   | 1,396,949                            | 1,132,584                         |
| Less: Allowance for loan losses                     | 14,056                               | 12,735                            |
| Net loans   | 1,382,893                            | 1,119,849                         |
| Premises and equipment                              | 29,022                               | 30,030                            |
| Other real estate owned                             | 2,759                                | 3,496                             |
| Accrued interest receivable                         | 4,017                                | 3,864                             |
| Bank owned life insurance                           | 31,691                               | 31,088                            |
| Deferred tax assets, net                            | 7,951                                | 9,478                             |
| Other assets  | 17,473                               | 21,475                            |
| <b>TOTAL ASSETS</b>                                 | <b>\$ 1,797,704</b>                  | <b>\$ 1,667,836</b>               |
| <b>LIABILITIES</b>                                  |                                      |                                   |
| Deposits:   |                                      |                                   |
| Noninterest-bearing demand deposits                 | \$ 345,736                           | \$ 298,095                        |
| Interest-bearing deposits:                          |                                      |                                   |
| Checking  | 338,626                              | 346,877                           |
| Savings   | 115,571                              | 109,686                           |
| Money market accounts                               | 611,498                              | 583,197                           |
| Certificates of deposit \$100,000 and over          | 62,136                               | 68,741                            |
| Certificates of deposit less than \$100,000         | 98,996                               | 109,831                           |
| Total deposits                                      | 1,572,563                            | 1,516,427                         |
| Overnight borrowings                                | 30,361                               | —                                 |
| Federal home loan bank advances                     | 47,692                               | 12,218                            |
| Capital lease obligation                            | 8,809                                | 8,971                             |
| Accrued expenses and other liabilities              | 11,861                               | 8,163                             |

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|  |              |              |
|--|--------------|--------------|
| TOTAL LIABILITIES  | 1,671,286    | 1,545,779    |
| SHAREHOLDERS' EQUITY   |              |              |
| Common stock (no par value; stated value, \$0.83 per share; authorized 21,000,000 shares; issued shares, 9,486,414 at September 30, 2013 and 9,325,977 at December 31, 2012; outstanding shares, 9,078,236 at September 30, 2013 and 8,917,799 at December 31, 2012) | 7,889        | 7,755        |
| Surplus  | 99,963       | 97,675       |
| Treasury stock at cost, 408,178 shares at September 30, 2013 and December 31, 2012   | (8,988       | ) (8,988 )   |
| Retained earnings  | 26,834       | 21,316       |
| Accumulated other comprehensive income, net of income tax  | 720          | 4,299        |
| TOTAL SHAREHOLDERS' EQUITY   | 126,418      | 122,057      |
| TOTAL LIABILITIES & SHAREHOLDERS' EQUITY   | \$ 1,797,704 | \$ 1,667,836 |

*See accompanying notes to consolidated financial statements.*

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

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|------------------------------------|----------|
|   | 2013                                | 2012     | 2013                               | 2012     |
| <b>INTEREST INCOME</b>  |                                     |          |                                    |          |
| Interest and fees on loans                                      | \$13,041                            | \$11,939 | \$36,819                           | \$35,928 |
| Interest on investment securities held to maturity:             |                                     |          |                                    |          |
| Taxable   | —                                   | 564      | —                                  | 1,375    |
| Tax-exempt  | —                                   | 39       | —                                  | 151      |
| Interest on securities available for sale:                      |                                     |          |                                    |          |
| Taxable   | 1,141                               | 1,223    | 3,503                              | 4,234    |
| Tax-exempt  | 199                                 | 156      | 591                                | 477      |
| Interest on loans held for sale                                 | 21                                  | 34       | 267                                | 75       |
| Interest-earning deposits                                       | 21                                  | 27       | 135                                | 58       |
| Total interest income   | 14,423                              | 13,982   | 41,315                             | 42,298   |
| <b>INTEREST EXPENSE</b>   |                                     |          |                                    |          |
| Interest on savings and interest-bearing deposit<br>accounts    | 363                                 | 362      | 998                                | 1,168    |
| Interest on certificates of deposit over \$100,000              | 191                                 | 229      | 618                                | 678      |
| Interest on other time deposits                                 | 253                                 | 321      | 812                                | 1,031    |
| Interest on borrowed funds                                      | 138                                 | 113      | 322                                | 453      |
| Interest on capital lease obligation                            | 105                                 | 107      | 317                                | 324      |
| Total interest expense  | 1,050                               | 1,132    | 3,067                              | 3,654    |
| <b>NET INTEREST INCOME BEFORE<br/>PROVISION FOR LOAN LOSSES</b> |                                     |          |                                    |          |
| Provision for loan losses                                       | 13,373                              | 12,850   | 38,248                             | 38,644   |
|   | 750                                 | 750      | 2,100                              | 3,750    |
| <b>NET INTEREST INCOME AFTER<br/>PROVISION FOR LOAN LOSSES</b>  |                                     |          |                                    |          |
|   | 12,623                              | 12,100   | 36,148                             | 34,894   |
| <b>OTHER INCOME</b>   |                                     |          |                                    |          |
| Trust department income   | 3,295                               | 2,918    | 10,291                             | 9,353    |
| Service charges and fees  | 724                                 | 694      | 2,088                              | 2,073    |
| Bank owned life insurance                                       | 278                                 | 266      | 826                                | 794      |
| Securities gains, net   | 188                                 | 235      | 715                                | 732      |
| Gain on loans held for sale at fair value                       | 277                                 | 358      | 1,138                              | 825      |
| Gain on loans held for sale at lower of cost or fair value      | —                                   | —        | 522                                | —        |
| Other income  | 20                                  | 88       | 42                                 | 176      |
| Total other income  | 4,782                               | 4,559    | 15,622                             | 13,953   |
| <b>OPERATING EXPENSES</b>                                       |                                     |          |                                    |          |
| Salaries and employee benefits                                  | 8,927                               | 7,029    | 23,941                             | 19,550   |
| Premises and equipment  | 2,325                               | 2,290    | 6,967                              | 7,034    |

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Other operating expenses                                | 2,913     | 2,674     | 9,629     | 8,193     |
| Total operating expenses                                | 14,165    | 11,993    | 40,537    | 34,777    |
| INCOME BEFORE INCOME TAX EXPENSE                        | 3,240     | 4,666     | 11,233    | 14,070    |
| Income tax expense                                      | 1,276     | 1,834     | 4,367     | 5,432     |
| NET INCOME  | 1,964     | 2,832     | 6,866     | 8,638     |
| Dividends on preferred stock and accretion              | —         | —         | —         | 474       |
| NET INCOME AVAILABLE TO COMMON<br>SHAREHOLDERS          | \$1,964   | \$2,832   | \$6,866   | \$8,164   |
| EARNINGS PER COMMON SHARE                               |           |           |           |           |
| Basic   | \$0.22    | \$0.32    | \$0.77    | \$0.93    |
| Diluted   | \$0.22    | \$0.32    | \$0.76    | \$0.93    |
| WEIGHTED AVERAGE NUMBER OF COMMON<br>SHARES OUTSTANDING |           |           |           |           |
| Basic   | 8,950,931 | 8,778,649 | 8,910,514 | 8,775,022 |
| Diluted   | 9,022,415 | 8,819,431 | 8,982,158 | 8,805,859 |

*See accompanying notes to consolidated financial statements.*



Table of Contents**PEAPACK-GLADSTONE FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Dollars in thousands)**

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|------------------------------------|----------|
|   | 2013                                | 2012     | 2013                               | 2012     |
| Net income  | \$ 1,964                            | \$ 2,832 | \$ 6,866                           | \$ 8,638 |
| Other comprehensive (loss)/income:  |                                     |          |                                    |          |
| Unrealized (losses)/gains on available for sale securities:   |                                     |          |                                    |          |
| Unrealized holding (losses)/gains arising<br>during the period  | (204 )                              | 1,177    | (5,336 )                           | 2,296    |
| Less: Reclassification adjustment for gains<br>included in net income   | 188                                 | 235      | 715                                | 732      |
|   | (392 )                              | 942      | (6,051 )                           | 1,564    |
| Tax effect  | 160                                 | (385 )   | 2,472                              | (639 )   |
| Net of tax  | (232 )                              | 557      | (3,579 )                           | 925      |
| Unrealized losses on the noncredit, other-than-<br>temporarily impaired held to maturity securities<br>and on securities transferred from available for<br>sale to held to maturity | —                                   | 60       | —                                  | 173      |
| Tax effect  | —                                   | (25 )    | —                                  | (71 )    |
| Net of tax  | —                                   | 35       | —                                  | 102      |
| Total other comprehensive (loss)/income   | (232 )                              | 592      | (3,579 )                           | 1,027    |
| Total comprehensive income  | \$ 1,732                            | \$ 3,424 | \$ 3,287                           | \$ 9,665 |

*See accompanying notes to consolidated financial statements.*

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| (In thousands, except<br>per share data)                                    | Common<br>Stock | Surplus  | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total     |
|---|-----------------|----------|-------------------|----------------------|---|-----------|
| Balance at January 1, 2013<br>8,917,799 common shares<br>outstanding        | \$ 7,755        | \$97,675 | \$(8,988 )        | \$21,316             | \$ 4,299  | \$122,057 |
| Net income  |                 |          |                   | 6,866                |   | 6,866     |
| Net change in accumulated<br>other comprehensive income/(loss)              |                 |          |                   |                      | (3,579 )  | (3,579 )  |
| Issuance of restricted stock<br>39,474 shares                               | 33              | (33 )    |                   |                      |   | —         |
| Amortization of restricted stock  |                 | 304      |                   |                      |   | 304       |
| Cash dividends declared on<br>common stock<br>(\$0.15 per share)            |                 |          |                   | (1,348 )             |   | (1,348 )  |
| Common stock option expense   |                 | 234      |                   |                      |   | 234       |
| Common stock options<br>exercised and related tax<br>benefits, 1,782 shares | 2               | 15       |                   |                      |   | 17        |
| Sales of shares (Dividend<br>Reinvestment Program),<br>112,156 shares       | 93              | 1,644    |                   |                      |   | 1,737     |
| Issuance of shares for<br>Profit Sharing Plan<br>7,025 shares               | 6               | 124      |                   |                      |   | 130       |
| Balance at September 30, 2013<br>9,078,236 common shares<br>outstanding     | \$ 7,889        | \$99,963 | \$(8,988 )        | \$26,834             | \$ 720  | \$126,418 |

*See accompanying notes to consolidated financial statements.*

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

|   | Nine Months Ended September<br>30, |               |
|---|------------------------------------|---------------|
|   | 2013                               | 2012          |
| <b>OPERATING ACTIVITIES:</b>  |                                    |               |
| Net income:   | \$ 6,866                           | \$ 8,638      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |               |
| Depreciation  | 2,196                              | 2,214         |
| Amortization of premium and accretion of discount on securities, net              | 1,499                              | 1,708         |
| Amortization of restricted stock  | 304                                | 332           |
| Provision for loan losses   | 2,100                              | 3,750         |
| Provision for OREO losses   | 930                                | —             |
| Provision for deferred taxes  | 3,999                              | —             |
| Tax benefit on exercise of stock options  | —                                  | 2             |
| Stock-based compensation  | 234                                | 253           |
| Gains on security sales, available for sale                                       | (715 )                             | (648 )        |
| Gains on securities, held to maturity   | —                                  | (84 )         |
| Loans originated for sale at fair value   | (66,293 )                          | (67,503 )     |
| Proceeds from sales of loans at fair value  | 73,169                             | 62,726        |
| Gains on loans held for sale at fair value  | (1,138 )                           | (825 )        |
| Gains on loans held for sale at lower of cost or fair value                       | (522 )                             | —             |
| (Gains)/Losses on sale of other real estate owned                                 | (2 )                               | 62            |
| Losses/(Gains) on disposal of fixed assets  | 49                                 | (7 )          |
| Increase in cash surrender value of life insurance, net                           | (603 )                             | (595 )        |
| (Increase)/Decrease in accrued interest receivable                                | (153 )                             | 38            |
| Decrease/(Increase) in other assets   | 4,002                              | (572 )        |
| Increase in accrued expenses and other liabilities                                | 3,536                              | 1,801         |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                  | <b>29,458</b>                      | <b>11,290</b> |
| <b>INVESTING ACTIVITIES:</b>  |                                    |               |
| Maturities of investment securities held to maturity                              | —                                  | 36,714        |
| Maturities of securities available for sale                                       | 68,794                             | 61,794        |
| Calls of securities held to maturity  | —                                  | 136           |
| Calls of securities available for sale  | 18,115                             | 23,598        |
| Sales of securities available for sale  | 42,839                             | 29,358        |
| Purchase of investment securities held to maturity                                | —                                  | (9,546 )      |
| Purchase of securities available for sale, including FHLB and FRB stock           | (109,124 )                         | (47,913 )     |
| Proceeds from sales of loans held for sale at lower of cost or fair value         | 14,271                             | —             |
| Net increase in loans   | (268,263 )                         | (60,046 )     |
| Sales of other real estate owned  | 2,928                              | 2,512         |
| Purchases of premises and equipment   | (1,237 )                           | (738 )        |
| Purchase of life insurance  | —                                  | (2,996 )      |

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|   |            |           |
|---|------------|-----------|
| NET CASH (USED IN)/PROVIDED BY INVESTING ACTIVITIES | (231,677 ) | 32,873    |
| FINANCING ACTIVITIES:                               |            |           |
| Net increase/(decrease) in deposits                 | 56,136     | (11,206 ) |
| Net increase in overnight borrowings                | 30,361     | —         |
| Net increase in other borrowings                    | 35,692     |           |
| Repayments of Federal Home Loan Bank advances       | (218 )     | (5,345 )  |
| Redemption of preferred stock                       | —          | (14,341 ) |
| Repurchase of warrants                              | —          | (111 )    |
| Cash dividends paid on preferred stock              | —          | (112 )    |
| Cash dividends paid on common stock                 | (1,348 )   | (1,330 )  |
| Exercise of Stock Options                           | 17         | 21        |
| Sales of shares (DRIP Program)                      | 1,737      | 128       |
| Purchase of shares for Profit Sharing Plan          | 130        | —         |
| NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES | 122,507    | (32,296 ) |
| Net decrease in cash and cash equivalents           | (79,713 )  | 11,867    |
| Cash and cash equivalents at beginning of period    | 119,228    | 43,053    |
| Cash and cash equivalents at end of period          | \$ 39,515  | \$ 54,920 |

*See accompanying notes to consolidated financial statements.*

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**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Certain information and footnote disclosures normally included in the audited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the period ended December 31, 2012 for Peapack-Gladstone Financial Corporation (the "Corporation"). In the opinion of the Management of the Corporation, the accompanying unaudited Consolidated Interim Financial Statements contain all adjustments necessary to present fairly the financial position as of September 30, 2013 and the results of operations for the three and nine months ended September 30, 2013 and 2012 and cash flows for the nine months ended September 30, 2013 and 2012.

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

The consolidated financial statements of Peapack-Gladstone Financial Corporation (the "Corporation") are prepared on the accrual basis and include the accounts of the Corporation and its wholly-owned subsidiary, Peapack-Gladstone Bank (the "Bank"). The consolidated statements also include the Bank's wholly-owned subsidiary, PGB Trust & Investments of Delaware. All significant intercompany balances and transactions have been eliminated from the accompanying consolidated financial statements.

**Securities:** Debt securities are classified as held to maturity and carried at amortized cost when Management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. As of September 30, 2013 and December 31, 2012, the Corporation no longer had any debt securities classified as held to maturity.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where

prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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

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**Loans:** Loans that Management has the intent and ability to hold for the foreseeable future or until maturity are stated at the principal amount outstanding. Interest on loans is recognized based upon the principal amount outstanding. Loans are stated at face value, less purchased premium and discounts and net deferred fees. Loan origination fees and certain direct loan origination costs are deferred and recognized over the life of the loan as an adjustment, on a level-yield method, to the loan's yield. The definition of recorded investment in loans includes accrued interest receivable, however, for the Corporation's loan disclosures, accrued interest was excluded as the impact was not material.

Loans are considered past due when they are not paid in accordance with contractual terms. The accrual of income on loans, including impaired loans, is discontinued if, in the opinion of Management, principal or interest is not likely to be paid in accordance with the terms of the loan agreement, or when principal or interest is past due 90 days or more and collateral, if any, is insufficient to cover principal and interest. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Payments received on nonaccrual loans are recorded as principal payments. A nonaccrual loan is returned to accrual status only when interest and principal payments are brought current and future payments are reasonably assured, generally when the Bank receives contractual payments for a minimum of six months. Commercial loans are generally charged off after an analysis is completed which indicates that collectability of the full principal balance is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments are credited to income only if collection of principal is not in doubt. If principal and interest payments are brought contractually current and future collectability is reasonably assured, loans are returned to accrual status. Nonaccrual mortgage loans are generally charged off when the value of the underlying collateral does not cover the outstanding principal balance.

The majority of the Corporation's loans are secured by real estate in the New Jersey and New York area.

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

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

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



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

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

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

Primary Residential Mortgages. The Bank originates one to four family residential mortgage loans within or near its primary geographic market area. Loans are secured by first liens on the primary residence or investment property. Primary risk characteristics associated with residential mortgage loans typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. In addition, residential mortgage loans that have adjustable rates could expose the borrower to higher debt service requirements in a rising interest rate environment. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

Home Equity Lines of Credit. The Bank provides revolving lines of credit against one to four family residences within or near its primary geographic market. Primary risk characteristics associated with home equity lines of credit typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. In addition, home equity lines of credit typically are made with variable or floating interest rates, such as the Prime Rate, which could expose the borrower to higher debt service requirements in a rising interest rate environment. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

Junior Lien Loan on Residence. The Bank provides junior lien loans ("JLL") against one to four family properties within or near its primary geographic market area. Junior lien loans can be either in the form of an amortizing home equity

loan or a revolving home equity line of credit. These loans are subordinate to a first mortgage which may be from another lending institution. Primary risk characteristics associated with junior lien loans typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

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Multifamily and Commercial Real Estate Loans. The Bank provides mortgage loans for multifamily properties (i.e. buildings which have five or more residential units) and other commercial real estate that is either owner occupied or managed as an investment property in New Jersey and New York. Commercial real estate properties primarily include office and medical buildings, retail space, and warehouse or flex space. Some properties are considered “mixed use” as they are a combination of building types, such as an apartment building that may also have retail space. Multifamily loans are expected to be repaid from the cash flow of the underlying property so the collective amount of rents must be sufficient to cover all operating expenses, property management and maintenance, taxes and debt service. Increases in vacancy rates, interest rates or other changes in general economic conditions can all have an impact on the borrower and their ability to repay the loan. Commercial real estate loans are generally considered to have a higher degree of credit risk than multifamily loans as they may be dependent on the ongoing success and operating viability of a fewer number of tenants who are occupying the property and who may have a greater degree of exposure to economic conditions.

Commercial and Industrial Loans. The Bank provides lines of credit and term loans to operating companies for business purposes. The loans are generally secured by business assets such as accounts receivable, inventory and equipment. Commercial and industrial loans are typically repaid first by the cash flow generated by the borrower’s business operation. The primary risk characteristics are specific to the underlying business and its ability to generate sustainable profitability and resulting positive cash flow. Factors that may influence a business’s profitability include, but are not limited to, demand for its products or services, quality and depth of management, degree of competition, regulatory changes, and general economic conditions. Commercial and industrial loans are generally secured by business assets; however, the ability of the Bank to foreclose and realize sufficient value from the assets is often highly uncertain.

Commercial Construction. The Bank has substantially wound down its commercial construction lending activity given the current economic environment. New construction loans would be considered only to experienced and reputable local builders and developers that have the capital and liquidity to carry a project to completion and stabilization. Construction loans are considered riskier than commercial financing on improved and established commercial real estate. The risk of potential loss increases if the original cost estimates or time to complete are significantly underestimated.

Consumer and Other. These are loans to individuals for household, family and other personal expenditures as well as obligations of states and political subdivisions in the U.S. This also represents all other loans that cannot be categorized in any of the previous mentioned loan segments.

**Stock-Based Compensation:** The Corporation’s 2006 Long-Term Stock Incentive Plan and 2012 Long-Term Stock Incentive Plan as amended allow the granting of shares of the Corporation’s common stock as incentive stock options, nonqualified stock options, restricted stock awards and stock appreciation rights to directors, officers, employees and independent contractors of the Corporation and its Subsidiaries. The options granted under these plans are exercisable at a price equal to the fair value of common stock on the date of grant and expire not more than ten years after the date of grant. Stock options may vest during a period of up to five years after the date of grant.

For the three months ended September 30, 2013 and 2012, the Corporation recorded total compensation cost for stock options of \$65 thousand and \$83 thousand respectively, with a recognized tax benefit of \$11 thousand for the quarter ended September 30, 2013 and \$15 thousand for the September 30, 2012 quarter. The Corporation recorded total compensation cost for stock options for the nine months ended September 30, 2013 and 2012, of \$234 thousand and \$253 thousand, respectively, with a recognized tax benefit of \$41 thousand for the nine months ended September 30, 2013 and \$45 thousand for the nine months ended September 30, 2012. There was approximately \$568 thousand of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Corporation's stock incentive plans at September 30, 2013. That cost is expected to be recognized over a weighted average period of 1.2 years.

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For the Corporation's stock option plans, changes in options outstanding during the nine months ended September 30, 2013 were as follows:

|                                   | Number of<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value<br>(In Thousands) |
|-----------------------------------|----------------------|--|---|---|
| Balance, January 1, 2013          | 613,507              | \$ 22.37                                 |   |   |
| Granted during 2013               | 84,050               | 14.81                                    |   |   |
| Exercised during 2013             | (2,790 )             | 11.76                                    |   |   |
| Expired during 2013               | (36,996 )            | 26.08                                    |   |   |
| Forfeited during 2013             | (2,938 )             | 13.41                                    |   |   |
| Balance, September 30, 2013       | 654,833              | \$ 21.27                                 | 4.06 years  | \$ 599  |
| Vested and expected to vest (1)   | 619,909              | \$ 21.71                                 | 4.06 years  | \$ 778  |
| Exercisable at September 30, 2013 | 471,024              | \$ 24.34                                 | 2.37 years  | \$ 75   |

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

The aggregate intrinsic value represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the third quarter of 2013 and the exercise price, multiplied by the number of in-the-money options). The Corporation's closing stock price on September 30, 2013 was \$18.55.

For the third quarter of 2013, the per share weighted-average fair value of stock options granted was \$6.89 compared to \$5.29 for the same quarter of 2012. The per share weighted-average fair value of stock options granted during the first nine months of 2013 and 2012 was \$5.28 and \$3.91, respectively on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                         | Three Months<br>Ended<br>September 30,<br>2013 |   | 2012    |   | Nine Months<br>Ended<br>September 30,<br>2013 |   | 2012    |   |
|-------------------------|--|---|---------|---|---|---|---------|---|
| Dividend Yield          | 1.09   | % | 1.24    | % | 1.31  | % | 1.47    | % |
| Expected volatility     | 41   | % | 39      | % | 39  | % | 39      | % |
| Expected life           | 7 years  |   | 7 years |   | 7 years                                       |   | 7 years |   |
| Risk-free interest rate | 1.88   | % | 1.08    | % | 1.13  | % | 1.43    | % |

The Corporation also awards restricted stock to certain executives at a fair value equal to the fair value of the Corporation's common stock on the date of the grant. The awards may vest fully during a period of up to five years

after the date of award.

For the three months ended September 30, 2013 and 2012, the Corporation recorded total compensation cost for restricted shares of \$264 thousand and \$111 thousand, respectively. For the nine months ended September 30, 2013 and 2012, the Corporation recorded total compensation cost for restricted stock awards of \$461 thousand and \$332 thousand, respectively. As of September 30, 2013, there was approximately \$795 thousand of unrecognized compensation cost related to non-vested restricted stock awards granted under the Corporation's stock incentive plans, which is expected to be recognized over a weighted average period of 1.5 years.

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Changes in non-vested, restricted common shares for 2013 were as follows:

|                             | Number<br>of<br>Shares | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|-----------------------------|------------------------|---|
| Balance, January 1, 2013    | 82,717                 | \$ 12.87  |
| Granted during 2013         | 39,474                 | 14.87   |
| Vested during 2013          | (19,035 )              | 13.48   |
| Balance, September 30, 2013 | 103,156                | \$ 13.52  |

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

| (In thousands, except per share data)              | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2013                                | 2012      | 2013                               | 2012      |
| Net income to common shareholders                  | \$1,964                             | \$2,832   | \$6,866                            | \$8,164   |
| Basic weighted-average common shares outstanding   | 8,950,931                           | 8,778,649 | 8,910,514                          | 8,775,022 |
| Plus: common stock equivalents                     | 71,484                              | 40,782    | 71,644                             | 30,837    |
| Diluted weighted-average common shares outstanding | 9,022,415                           | 8,819,431 | 8,982,158                          | 8,805,859 |
| Net income per common share                        |                                     |           |                                    |           |
| Basic  | \$0.22                              | \$0.32    | \$0.77                             | \$0.93    |
| Diluted  | 0.22                                | 0.32      | 0.76                               | 0.93      |

Stock options and restricted stock totaling 461,564 and 569,642 shares were not included in the computation of diluted earnings per share in the third quarters of 2013 and 2012, respectively, because they were considered antidilutive. Stock options and restricted stock totaling 479,827 and 590,867 shares were not included in the computation of diluted earnings per share in the nine months ended September 30, 2013 and 2012, respectively, because they were considered antidilutive.

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

The Corporation is no longer subject to examination by the U.S. Federal tax authorities for years prior to 2009 or by New Jersey tax authorities for years prior to 2008.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest and penalties at September 30, 2013.

**Reclassification:** Certain reclassifications may have been made in the prior periods' financial statements in order to conform to the 2013 presentation.



Table of Contents**2. INVESTMENT SECURITIES AVAILABLE FOR SALE**

A summary of amortized cost and approximate fair value of securities available for sale included in the consolidated statements of condition as of September 30, 2013 and December 31, 2012 follows:

|  | September 30, 2013 |             |                           |              |
|--|--------------------|-------------|---------------------------|--------------|
|  | Amortized Cost     | Gross Gains | Gross Unrecognized Losses | Fair Value   |
| (In thousands)                           |                    |             |                           |              |
| U.S. government-sponsored entities       | \$ 15,984          | \$ —        | \$ (770)                  | ) \$ 15,214  |
| Mortgage-backed securities – residential | 194,093            | 3,220       | (1,011)                   | ) 196,302    |
| State and political subdivisions         | 56,658             | 529         | (79)                      | ) 57,108     |
| Single-issuer trust preferred security   | 2,999              | —           | (599)                     | ) 2,400      |
| CRA investment                           | 3,000              | —           | (72)                      | ) 2,928      |
| Total                                    | \$ 272,734         | \$ 3,749    | \$ (2,531)                | ) \$ 273,952 |

|  | December 31, 2012 |             |                           |              |
|--|-------------------|-------------|---------------------------|--------------|
|  | Amortized Cost    | Gross Gains | Gross Unrecognized Losses | Fair Value   |
| (In thousands)                           |                   |             |                           |              |
| U.S. government-sponsored entities       | \$ 26,647         | \$ 200      | \$ (2)                    | ) \$ 26,845  |
| Mortgage-backed securities – residential | 215,092           | 6,366       | (18)                      | ) 221,440    |
| State and political subdivisions         | 49,262            | 1,372       | (2)                       | ) 50,632     |
| Single-issuer trust preferred security   | 2,999             | —           | (710)                     | ) 2,289      |
| CRA investment                           | 3,000             | 62          | —                         | ) 3,062      |
| Marketable equity securities             | 210               | 1           | —                         | ) 211        |
| Total                                    | \$ 297,210        | \$ 8,001    | \$ (732)                  | ) \$ 304,479 |

The following tables present the Corporation's available for sale securities with continuous unrealized losses and the approximate fair value of these investments as of September 30, 2013 and December 31, 2012.

|                                    | September 30, 2013  |                     |                     |                     |            |                     |
|------------------------------------|---------------------|---------------------|---------------------|---------------------|------------|---------------------|
|                                    | Less than 12 Months |                     | 12 Months or Longer |                     | Total      |                     |
| (In thousands)                     | Fair Value          | Unrecognized Losses | Fair Value          | Unrecognized Losses | Fair Value | Unrecognized Losses |
| U.S. government sponsored entities | \$ 15,214           | \$ (770)            | ) \$ —              | \$ —                | \$ 15,214  | \$ (770)            |

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|  |          |           |   |          |         |   |          |           |   |
|--|----------|-----------|---|----------|---------|---|----------|-----------|---|
| Mortgage-backed securities - residential | 67,274   | (1,008    | ) | 84       | (3      | ) | 67,358   | (1,011    | ) |
| State and political subdivisions         | 5,938    | (79       | ) | —        | —       |   | 5,938    | (79       | ) |
| Single-issuer trust preferred security   | —        | —         |   | 2,400    | (599    | ) | 2,400    | (599      | ) |
| CRA investment                           | 2,928    | (72       | ) | —        | —       |   | 2,928    | (72       | ) |
| Total                                    | \$91,354 | \$ (1,929 | ) | \$ 2,484 | \$ (602 | ) | \$93,838 | \$ (2,531 | ) |

December 31, 2012

Duration of Unrealized Loss

| (In thousands)                         | Less than 12 Months |                     | 12 Months or Longer |                     | Total      |                     |          |         |   |
|--|---------------------|---------------------|---------------------|---------------------|------------|---------------------|----------|---------|---|
|  | Fair Value          | Unrecognized Losses | Fair Value          | Unrecognized Losses | Fair Value | Unrecognized Losses |          |         |   |
| U.S. government sponsored Entities     | \$4,998             | \$ (2               | )                   | \$ —                | \$ —       | \$4,998             | \$ (2    | )       |   |
| Mortgage-backed securities-residential | 8,433               | (17                 | )                   | 95                  | (1         | )                   | 8,528    | (18     | ) |
| State and political subdivisions       | 1,290               | (2                  | )                   | —                   | —          | 1,290               | (2       | )       |   |
| Single-issuer trust preferred Security | —                   | —                   |                     | 2,289               | (710       | )                   | 2,289    | (710    | ) |
| Total                                  | \$14,721            | \$ (21              | )                   | \$ 2,384            | \$ (711    | )                   | \$17,105 | \$ (732 | ) |

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Management believes that the unrealized losses on investment securities available for sale are temporary and due to interest rate fluctuations and/or volatile market conditions rather than the creditworthiness of the issuers. As of September 30, 2013, the Corporation does not intend to sell these securities nor is it likely that it will be required to sell the securities before their anticipated recovery; therefore, none of the securities in unrealized loss position were determined to be other-than-temporarily impaired.

At September 30, 2013, the unrealized loss on the single-issuer trust preferred security of \$599 thousand is related to a debt security issued by a large bank holding company that has experienced declines in all its securities due to the turmoil in the financial markets and a merger. The security was downgraded to below investment grade by Moody's and is currently rated Ba1. Management monitors the performance of the issuer on a quarterly basis to determine if there are any credit events that could result in deferral or default of the security. Management believes the depressed valuation is a result of the nature of the security, a trust preferred bond, and the bond's very low yield. As Management does not intend to sell this security nor is it likely that it will be required to sell the security before its anticipated recovery, the security is not considered other-than-temporarily impaired at September 30, 2013.

**3. LOANS**

Loans outstanding, by general ledger classification, as of September 30, 2013 and December 31, 2012, consisted of the following:

| (In thousands)  | September 30,<br>2013 | % of<br>Total<br>Loans | December 31,<br>2012 | % of<br>Total<br>Loans |
|---|-----------------------|------------------------|----------------------|------------------------|
| Residential mortgage                                      | \$ 527,927            | 37.79 %                | \$ 515,014           | 45.47 %                |
| Commercial mortgage                                       | 680,762               | 48.73                  | 420,086              | 37.09                  |
| Commercial loans  | 110,843               | 7.93                   | 115,372              | 10.19                  |
| Construction loans  | 8,390                 | 0.60                   | 9,328                | 0.83                   |
| Home equity lines of credit                               | 47,020                | 3.37                   | 49,635               | 4.38                   |
| Consumer loans, including fixed<br>rate home equity loans | 19,932                | 1.43                   | 21,188               | 1.87                   |
| Other loans   | 2,075                 | 0.15                   | 1,961                | 0.17                   |
| Total loans   | \$ 1,396,949          | 100.00 %               | \$ 1,132,584         | 100.00 %               |

In determining an appropriate amount for the allowance, the Bank segments and evaluates the loan portfolio based on federal call report codes. The following portfolio classes have been identified as of September 30, 2013 and December 31, 2012:

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| (In thousands)                           | September 30,<br>2013 | % of<br>Total<br>Loans | December 31,<br>2012 | % of<br>Total<br>Loans |
|--|-----------------------|------------------------|----------------------|------------------------|
| Primary residential mortgage             | \$ 538,758            | 38.67 %                | \$ 527,803           | 46.74 %                |
| Home equity lines of credit              | 47,020                | 3.37                   | 49,635               | 4.40                   |
| Junior lien loan on residence            | 13,169                | 0.95                   | 11,893               | 1.05                   |
| Multifamily property                     | 393,889               | 28.27                  | 161,705              | 14.32                  |
| Owner-occupied commercial real estate    | 82,437                | 5.92                   | 84,720               | 7.50                   |
| Investment commercial real estate        | 264,516               | 18.99                  | 242,586              | 21.48                  |
| Commercial and industrial                | 32,095                | 2.30                   | 25,820               | 2.29                   |
| Secured by farmland                      | 201                   | 0.01                   | 207                  | 0.02                   |
| Agricultural production loans            | —                     | N/A                    | 14                   | N/A                    |
| Commercial construction loans            | 8,390                 | 0.60                   | 9,323                | 0.83                   |
| Consumer and other loans                 | 12,783                | 0.92                   | 15,480               | 1.37                   |
| Total loans                              | \$ 1,393,258          | 100.00 %               | \$ 1,129,186         | 100.00 %               |
| Net deferred fees                        | 3,691                 |                        | 3,398                |                        |
| Total loans including net deferred costs | \$ 1,396,949          |                        | \$ 1,132,584         |                        |

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Included in the totals above for September 30, 2013 are \$417 thousand of unamortized discount compared to \$543 thousand of unamortized discount for December 31, 2012.

The following tables present the loan balances by portfolio class, based on impairment method, and the corresponding balances in the allowance for loan losses as of September 30, 2013 and December 31, 2012:

## September 30, 2013

| (In thousands)                        | Total                                       | Ending   | Total                                       | Ending   |              |                   |
|---------------------------------------|---|--|---|--|--------------|-------------------|
|                                       | Loans Individually Evaluated for Impairment | ALLL Attributable to Loans Individually Evaluated for Impairment | Loans Collectively Evaluated for Impairment | ALLL Attributable to Loans Collectively Evaluated for Impairment | Total Loans  | Total Ending ALLL |
| Primary residential mortgage          | \$ 3,816                                    | \$ 120   | \$ 534,942                                  | \$ 2,782   | \$ 538,758   | \$ 2,902          |
| Home equity lines of credit           | 158   | —  | 46,862                                      | 238  | 47,020       | 238               |
| Junior lien loan on residence         | 225   | —  | 12,944                                      | 202  | 13,169       | 202               |
| Multifamily property                  | —   | —  | 393,889                                     | 2,910  | 393,889      | 2,910             |
| Owner-occupied commercial real estate | 3,390                                       | —  | 79,047                                      | 2,075  | 82,437       | 2,075             |
| Investment commercial real estate     | 4,949                                       | 769  | 259,567                                     | 3,799  | 264,516      | 4,568             |
| Commercial and industrial             | 486   | 291  | 31,609                                      | 692  | 32,095       | 983               |
| Secured by farmland                   | —   | —  | 201   | 2  | 201          | 2                 |
| Agricultural production               | —   | —  | —   | —  | —            | —                 |
| Commercial construction               | 3,770                                       | —  | 4,620                                       | 110  | 8,390        | 110               |
| Consumer and other                    | —   | —  | 12,783                                      | 66   | 12,783       | 66                |
| Total ALLL                            | \$ 16,794                                   | \$ 1,180   | \$ 1,376,464                                | \$ 12,876  | \$ 1,393,258 | \$ 14,056         |

## December 31, 2012

| Ending ALLL | Ending ALLL |
|-------------|-------------|
|-------------|-------------|

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| (In thousands)                        | Total<br>Loans<br>Individually<br>Evaluated<br>For<br>Impairment | Attributable<br>To Loans<br>Individually<br>Evaluated<br>For<br>Impairment | Total<br>Loans<br>Collectively<br>Evaluated<br>For<br>Impairment | Attributable<br>To Loans<br>Collectively<br>Evaluated<br>For<br>Impairment | Total<br>Loans | Total<br>Ending<br>ALLL<br>Before<br>Allocation | Allocation<br>Of<br>Previous<br>Unallocated<br>ALLL | Total<br>Ending<br>ALLL |
|---------------------------------------|--|--|--|--|----------------|---|---|-------------------------|
|                                       | Primary residential mortgage                                     | \$ 7,155   | \$ 148   | \$ 520,648   | \$ 2,789       | \$ 527,803                                      | \$ 2,937  | \$ 110                  |
| Home equity lines of credit           | 110  | —  | 49,525   | 257  | 49,635         | 257   | 10  | 267                     |
| Junior lien loan on residence         | 562  | 240  | 11,331   | 71   | 11,893         | 311   | 3   | 314                     |
| Multifamily property                  | —  | —  | 161,705  | 1,255  | 161,705        | 1,255   | 50  | 1,305                   |
| Owner-occupied commercial real estate | 4,724  | —  | 79,996   | 2,413  | 84,720         | 2,413   | 96  | 2,509                   |
| Investment commercial real estate     | 5,173  | 384  | 237,413  | 3,627  | 242,586        | 4,011   | 144   | 4,155                   |
| Commercial and industrial             | 423  | 41   | 25,397   | 733  | 25,820         | 774   | 29  | 803                     |
| Secured by farmland                   | —  | —  | 207  | 3  | 207            | 3   | —   | 3                       |
| Agricultural production               | —  | —  | 14   | —  | 14             | —   | —   | —                       |
| Commercial construction               | —  | —  | 9,323  | 231  | 9,323          | 231   | 9   | 240                     |
| Consumer and other                    | —  | —  | 15,480   | 89   | 15,480         | 89  | 3   | 92                      |
| Unallocated                           | —  | —  | —  | 454  | —              | 454   | (454 )  | —                       |
| Total ALLL                            | \$ 18,147  | \$ 813   | \$ 1,111,039   | \$ 11,922  | \$ 1,129,186   | \$ 12,735                                       | \$ —  | \$ 12,735               |

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Impaired loans include nonaccrual loans of \$6.9 million at September 30, 2013 and \$11.7 million at December 31, 2012. Impaired loans also include performing residential, commercial mortgage and commercial troubled debt restructured loans of \$6.1 million at September 30, 2013 and \$6.4 million at December 31, 2012. The allowance allocated to troubled debt restructured loans which are nonaccrual was \$261 thousand at September 30, 2013 and the allowance allocated to troubled debt restructured loans which are nonaccrual was \$240 thousand at December 31, 2012. All accruing troubled debt restructured loans were paying in accordance with restructured terms as of September 30, 2013. The Corporation has not committed to lend additional amounts as of September 30, 2013 to customers with outstanding loans that are classified as loan restructurings.

The following tables present loans individually evaluated for impairment by class of loans as of September 30, 2013 and December 31, 2012:

## September 30, 2013

| (In thousands)                                    | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Specific<br>Reserves | Average<br>Impaired<br>Loans | Interest<br>Income<br>Recognized |
|---|--------------------------------|------------------------|----------------------|------------------------------|----------------------------------|
| With no related allowance recorded:               |                                |                        |                      |                              |                                  |
| Primary residential mortgage                      | 3,951                          | 3,195                  | —                    | 5,405                        | \$ 60                            |
| Multifamily property                              | —                              | —                      | —                    | —                            | —                                |
| Owner-occupied commercial real estate             | 3,645                          | 3,390                  | —                    | 4,290                        | 55                               |
| Investment commercial real estate                 | —                              | —                      | —                    | 144                          | 2                                |
| Commercial and industrial                         | 165                            | 165                    | —                    | 106                          | 3                                |
| Commercial Construction                           | 3,770                          | 3,770                  | —                    | —                            | —                                |
| Home equity lines of credit                       | 160                            | 158                    | —                    | 121                          | 4                                |
| Junior lien loan on residence                     | 302                            | 225                    | —                    | 344                          | 6                                |
| Consumer and other                                | —                              | —                      | —                    | —                            | —                                |
| Total loans with no related allowance             | 11,993                         | 10,903                 | —                    | 10,410                       | \$ 130                           |
| With related allowance recorded:                  |                                |                        |                      |                              |                                  |
| Primary residential mortgage                      | 621                            | 621                    | 120                  | 631                          | \$ 28                            |
| Owner-occupied commercial real estate             | —                              | —                      | —                    | —                            | —                                |
| Investment commercial real estate                 | 4,949                          | 4,949                  | 769                  | 4,949                        | 619                              |
| Commercial and industrial                         | 331                            | 321                    | 291                  | 252                          | 4                                |
| Junior lien loan on residence                     | —                              | —                      | —                    | —                            | —                                |
| Total loans with related allowance                | 5,901                          | 5,891                  | 1,180                | 5,832                        | \$ 651                           |
| Total loans individually evaluated for impairment | 17,894                         | 16,794                 | 1,180                | 16,242                       | \$ 781                           |

## December 31, 2012

| (In thousands)                        | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Specific<br>Reserves | Average<br>Impaired<br>Loans | Interest<br>Income<br>Recognized |
|---------------------------------------|--------------------------------|------------------------|----------------------|------------------------------|----------------------------------|
| With no related allowance recorded:   |                                |                        |                      |                              |                                  |
| Primary residential mortgage          | \$ 8,605                       | \$ 6,148               | \$ —                 | \$ 8,110                     | \$ 384                           |
| Multifamily property                  | —                              | —                      | —                    | 185                          | 16                               |
| Owner-occupied commercial real estate | 4,971                          | 4,724                  | —                    | 9,575                        | 570                              |

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|  |           |           |        |           |          |
|--|-----------|-----------|--------|-----------|----------|
| Investment commercial real estate                    | 336       | —         | —      | 796       | 51       |
| Commercial and industrial                            | 432       | 345       | —      | 640       | 47       |
| Home equity lines of credit                          | 110       | 110       | —      | 221       | 11       |
| Junior lien loan on residence                        | 429       | 235       | —      | 439       | 30       |
| Total loans with no related allowance                | \$ 14,883 | \$ 11,562 | \$ —   | \$ 19,966 | \$ 1,109 |
| With related allowance recorded:                     |           |           |        |           |          |
| Primary residential mortgage                         | \$ 1,056  | \$ 1,007  | \$ 148 | \$ 851    | \$ 38    |
| Multifamily property                                 | —         | —         | —      | —         | —        |
| Owner-occupied commercial real estate                | —         | —         | —      | —         | —        |
| Investment commercial real estate                    | 5,183     | 5,173     | 384    | 5,013     | 251      |
| Commercial and industrial                            | 78        | 78        | 41     | 92        | 74       |
| Junior lien loan on residence                        | 327       | 327       | 240    | —         | 8        |
| Commercial construction                              | —         | —         | —      | 194       | —        |
| Total loans with related allowance                   | \$ 6,644  | \$ 6,585  | \$ 813 | \$ 6,150  | \$ 371   |
| Total loans individually evaluated for<br>Impairment | \$ 21,527 | \$ 18,147 | \$ 813 | \$ 26,116 | \$ 1,480 |



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The Corporation did not recognize any income on nonaccruing impaired loans for the three and nine months ended September 30, 2013 and 2012.

The following tables present the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of September 30, 2013 and December 31, 2012:

|                                       | September 30,<br>2013   |          |
|---------------------------------------|---|----------|
|                                       | Loans<br>Past Due<br>Over 90<br>Days<br>And Still<br>Accruing |          |
| (In thousands)                        | Nonaccrual  | Interest |
| Primary residential mortgage          | \$ 2,804  | \$ —     |
| Home equity lines of credit           | 111   | —        |
| Junior lien loan on residence         | 225   | —        |
| Owner-occupied commercial real estate | 3,390   | —        |
| Commercial and industrial             | 361   | —        |
| Total                                 | \$ 6,891  | \$ —     |

|                                       | December 31, 2012                                       |          |
|---------------------------------------|---|----------|
|                                       | Loans Past Due<br>Over 90 Days<br>And Still<br>Accruing |          |
| (In thousands)                        | Nonaccrual  | Interest |
| Primary residential mortgage          | \$ 6,519  | \$ —     |
| Home equity lines of credit           | 110   | —        |
| Junior lien loan on residence         | 562   | —        |
| Owner-occupied commercial real estate | 4,317   | —        |
| Investment commercial real estate     | 224   | —        |
| Total                                 | \$ 11,732   | \$ —     |

The following tables present the aging of the recorded investment in past due loans as of September 30, 2013 and December 31, 2012 by class of loans, excluding nonaccrual loans:

|                              | September 30, 2013           |                           |                                     |                   |
|------------------------------|------------------------------|---------------------------|-------------------------------------|-------------------|
|                              | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total<br>Past Due |
| (In thousands)               |                              |                           |                                     |                   |
| Primary residential mortgage | \$ 1,661                     | \$ 96                     | \$ —                                | \$ 1,757          |

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|                                   |         |        |    |            |
|-----------------------------------|---------|--------|----|------------|
| Home equity lines of credit       | 24      | —      | —  | 24         |
| Investment commercial real estate | —       | 244    | —  | 244        |
| Consumer and other loans          | 13      | 1      | —  | 14         |
| Total                             | \$1,698 | \$ 341 | \$ | — \$ 2,039 |

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|                                       | December 31, 2012            |                           |                                     |                   |
|---------------------------------------|------------------------------|---------------------------|-------------------------------------|-------------------|
|                                       | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total<br>Past Due |
| (In thousands)                        |                              |                           |                                     |                   |
| Primary residential mortgage          | \$2,513                      | \$ 203                    | \$                                  | — \$ 2,716        |
| Home equity lines of credit           | 25                           | —                         |                                     | — 25              |
| Junior lien loan on residence         | 31                           | —                         |                                     | — 31              |
| Owner-occupied commercial real estate | 407                          | —                         |                                     | — 407             |
| Investment commercial real estate     | 592                          | —                         |                                     | — 592             |
| Commercial and industrial             | 15                           | —                         |                                     | — 15              |
| Total                                 | \$3,583                      | \$ 203                    | \$                                  | — \$ 3,786        |

**Credit Quality Indicators:**

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. The risk rating analysis of loans is performed (i) when the loan is initially underwritten, (ii) annually for loans in excess of \$500,000, (iii) on a random quarterly basis from either internal reviews with the Senior Credit Officer or externally through an independent loan review firm, or (iv) whenever Management otherwise identifies a potentially negative trend or issue relating to a borrower. In addition, for all loan types, the Corporation evaluates credit quality based on the aging status of the loan, which was previously presented.

The Corporation uses the following definitions for risk ratings:

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

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

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

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Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass-rated loans. As of September 30, 2013, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (In thousands)                        | Pass        | Special<br>Mention | Substandard | Doubtful |
|---------------------------------------|-------------|--------------------|-------------|----------|
| Primary residential mortgage          | \$533,479   | \$1,101            | \$ 4,178    | \$ —     |
| Home equity lines of credit           | 46,909      | —                  | 111         | —        |
| Junior lien loan on residence         | 12,916      | —                  | 253         | —        |
| Multifamily property                  | 393,374     | 515                | —           | —        |
| Farmland                              | 201         | —                  | —           | —        |
| Owner-occupied commercial real estate | 72,369      | 653                | 9,415       | —        |
| Investment commercial real estate     | 234,645     | 15,654             | 14,217      | —        |
| Agricultural production loans         | —           | —                  | —           | —        |
| Commercial and industrial             | 31,585      | 24                 | 486         | —        |
| Commercial construction               | 3,067       | 1,553              | 3,770       | —        |
| Consumer and other loans              | 11,931      | 852                | —           | —        |
| Total                                 | \$1,340,476 | \$20,352           | \$ 32,430   | \$ —     |

As of December 31, 2012, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (In thousands)                        | Pass        | Special<br>Mention | Substandard | Doubtful |
|---------------------------------------|-------------|--------------------|-------------|----------|
| Primary residential mortgage          | \$517,336   | \$3,152            | \$ 7,315    | \$ —     |
| Home equity lines of credit           | 49,525      | —                  | 110         | —        |
| Junior lien loan on residence         | 11,294      | 37                 | 562         | —        |
| Multifamily property                  | 161,229     | 476                | —           | —        |
| Owner-occupied commercial real estate | 73,809      | 334                | 10,577      | —        |
| Investment commercial real estate     | 216,394     | 13,237             | 12,955      | —        |
| Agricultural production loans         | 14          | —                  | —           | —        |
| Commercial and industrial             | 25,191      | 134                | 495         | —        |
| Secured by farmland                   | 207         | —                  | —           | —        |
| Commercial construction               | 3,999       | 5,324              | —           | —        |
| Consumer and other loans              | 15,480      | —                  | —           | —        |
| Total                                 | \$1,074,478 | \$22,694           | \$ 32,014   | \$ —     |

At September 30, 2013, \$16.8 million of the \$32.4 million of the substandard loans were also considered impaired compared to December 31, 2012, when \$18.1 million of the \$32.0 million of the substandard loans were also impaired.

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The activity in the allowance for loan losses for the three months ended September 30, 2013 is summarized below:

| (In thousands)                        | July 1,<br>2013<br>Beginning |             |            |           | September 30,<br>2013<br>Ending |
|---------------------------------------|------------------------------|-------------|------------|-----------|---------------------------------|
|                                       | ALLL                         | Charge-Offs | Recoveries | Provision | ALLL                            |
| Primary residential mortgage          | \$ 3,062                     | \$ (155 )   | \$ 35      | \$ (40 )  | \$ 2,902                        |
| Home equity lines of credit           | 253                          | —           | —          | (15 )     | 238                             |
| Junior lien loan on residence         | 71                           | (50 )       | 2          | 179       | 202                             |
| Multifamily property                  | 2,159                        | —           | —          | 751       | 2,910                           |
| Owner-occupied commercial real estate | 2,414                        | —           | 19         | (358 )    | 2,075                           |
| Investment commercial real estate     | 4,160                        | —           | 6          | 402       | 4,568                           |
| Agricultural production loans         | —                            | —           | —          | —         | —                               |
| Commercial and industrial             | 1,130                        | —           | 12         | (159 )    | 983                             |
| Secured by farmland                   | 3                            | —           | —          | (1 )      | 2                               |
| Commercial construction               | 112                          | —           | —          | (2 )      | 110                             |
| Consumer and other loans              | 74                           | (3 )        | 2          | (7 )      | 66                              |
| Total ALLL                            | \$ 13,438                    | \$ (208 )   | \$ 76      | \$ 750    | \$ 14,056                       |

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The activity in the allowance for loan losses for the nine months ended September 30, 2013 is summarized below:

|                                       | January 1,<br>2013<br>Beginning |             |            | September 30,<br>2013<br>Ending |           |
|---------------------------------------|---------------------------------|-------------|------------|---------------------------------|-----------|
| (In thousands)                        | ALLL                            | Charge-Offs | Recoveries | Provision                       | ALLL      |
| Primary residential mortgage          | \$ 3,047                        | \$ (611 )   | \$ 48      | \$ 418                          | \$ 2,902  |
| Home equity lines of credit           | 267                             | —           | —          | (29 )                           | 238       |
| Junior lien loan on residence         | 314                             | (345 )      | 9          | 224                             | 202       |
| Multifamily property                  | 1,305                           | —           | 11         | 1,594                           | 2,910     |
| Owner-occupied commercial real estate | 2,509                           | —           | 57         | (491 )                          | 2,075     |
| Investment commercial real estate     | 4,155                           | —           | 18         | 395                             | 4,568     |
| Agricultural production loans         | —                               | —           | —          | —                               | —         |
| Commercial and industrial             | 803                             | (15 )       | 49         | 146                             | 983       |
| Secured by farmland                   | 3                               | —           | —          | (1 )                            | 2         |
| Commercial construction               | 240                             | —           | 1          | (131 )                          | 110       |
| Consumer and other loans              | 92                              | (7 )        | 6          | (25 )                           | 66        |
| Total ALLL                            | \$ 12,735                       | \$ (978 )   | \$ 199     | \$ 2,100                        | \$ 14,056 |

The activity in the allowance for loan losses for the three months ended September 30, 2012 is summarized below:

|                                       | July 1,<br>2012<br>Beginning |             |            | September 30,<br>2012<br>Ending |           |
|---------------------------------------|------------------------------|-------------|------------|---------------------------------|-----------|
| (In thousands)                        | ALLL                         | Charge-Offs | Recoveries | Provision                       | ALLL      |
| Primary residential mortgage          | \$ 2,602                     | \$ (183 )   | \$ 1       | \$ 499                          | \$ 2,919  |
| Home equity lines of credit           | 208                          | —           | —          | 45                              | 253       |
| Junior lien loan on residence         | 55                           | —           | 1          | 10                              | 66        |
| Multifamily property                  | 839                          | (18 )       | —          | 154                             | 975       |
| Farmland                              | 3                            | —           | —          | —                               | 3         |
| Owner-occupied commercial real estate | 3,418                        | (345 )      | 19         | 271                             | 3,363     |
| Investment commercial real estate     | 4,784                        | (64 )       | 2          | (122 )                          | 4,600     |
| Agricultural production loans         | 1                            | —           | —          | —                               | 1         |
| Commercial and industrial             | 917                          | —           | 51         | (152 )                          | 816       |
| Commercial construction               | 234                          | —           | —          | 57                              | 291       |
| Consumer and other loans              | 77                           | (8 )        | 1          | 8                               | 78        |
| Unallocated                           | 548                          | —           | —          | (20 )                           | 528       |
| Total ALLL                            | \$ 13,686                    | \$ (618 )   | \$ 75      | \$ 750                          | \$ 13,893 |

The activity in the allowance for loan losses for the nine months ended September 30, 2012 is summarized below:

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|                                       | January 1,<br>2012<br>Beginning | Charge-Offs | Recoveries | Provision | September 30,<br>2012<br>Ending |
|---------------------------------------|---------------------------------|-------------|------------|-----------|---------------------------------|
| (In thousands)                        | ALLL                            |             |            |           | ALLL                            |
| Primary residential mortgage          | \$ 2,414                        | \$ (1,171 ) | \$ 2       | \$ 1,674  | \$ 2,919                        |
| Home equity lines of credit           | 204                             | (91 )       | —          | 140       | 253                             |
| Junior lien loan on residence         | 64                              | (57 )       | 5          | 54        | 66                              |
| Multifamily property                  | 705                             | (393 )      | —          | 663       | 975                             |
| Farmland                              | —                               | —           | —          | 3         | 3                               |
| Owner-occupied commercial real estate | 3,108                           | (1,261 )    | 145        | 1,371     | 3,363                           |
| Investment commercial real estate     | 4,181                           | (120 )      | 11         | 528       | 4,600                           |
| Agricultural production loans         | 1                               | —           | —          | —         | 1                               |
| Commercial and industrial             | 1,291                           | (112 )      | 55         | (418 )    | 816                             |
| Commercial construction               | 669                             | (72 )       | —          | (306 )    | 291                             |
| Consumer and other loans              | 78                              | (28 )       | 7          | 21        | 78                              |
| Unallocated                           | 508                             | —           | —          | 20        | 528                             |
| Total ALLL                            | \$ 13,223                       | \$ (3,305 ) | \$ 225     | \$ 3,750  | \$ 13,893                       |

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The Corporation has allocated \$919 thousand and \$483 thousand of specific reserves, on accruing TDR's, to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2013 and December 31, 2012, respectively. There were no unfunded commitments to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

During the nine month period ending September 30, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three-month period ending September 30, 2013:

|                              |                        | Pre-<br>Modification<br>Outstanding<br>Recorded<br>Investment | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment |
|------------------------------|------------------------|---|--|
| (Dollars in thousands)       | Number of<br>Contracts |   |  |
| Primary residential mortgage | 1                      | \$ 278  | \$ 278   |
| Total                        | 1                      | \$ 278  | \$ 278   |

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine month period ending September 30, 2013:

|                              |                        | Pre-<br>Modification<br>Outstanding<br>Recorded<br>Investment | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment |
|------------------------------|------------------------|---|--|
| (Dollars in thousands)       | Number of<br>Contracts |   |  |
| Primary residential mortgage | 4                      | \$ 760  | \$ 760   |
| Total                        | 4                      | \$ 760  | \$ 760   |

The identification of the troubled debt restructured loans did not have a significant impact on the allowance for loan losses. There were no loans modified as troubled debt restructurings that occurred during the three month period



ending September 30, 2012.

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine month period ending September 30, 2012:

| (Dollars in thousands)                | Number of<br>Contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
|---------------------------------------|------------------------|---|--|
| Primary residential mortgage          | 4                      | 603   | \$ 603   |
| Junior lien on residence              | 1                      | 240   | 240  |
| Owner-occupied commercial real estate | 1                      | 2,177   | 2,177  |
| Total                                 | 6                      | 3,020   | \$ 3,020   |

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The following table presents loans by class modified as troubled debt restructurings for which there was a payment default, within twelve months of modification, during the nine month period ended September 30, 2013:

| (Dollars in thousands)       | Number of<br>Contracts | Recorded<br>Investment |
|------------------------------|------------------------|------------------------|
| Primary residential mortgage | 1                      | \$ 59                  |
| Total                        | 1                      | \$ 59                  |

There were no loans modified as troubled debt restructurings for which there was a payment default, within twelve months of modification, during the nine months ended September 30, 2012.

The default that occurred during the nine months ended September 30, 2013 did not have a significant impact on the allowance for loan losses.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Corporation's internal underwriting policy. At the time a loan is restructured, the Bank performs a full re-underwriting analysis, which includes, at a minimum, obtaining current financial statements and tax returns, copies of all leases, and an updated independent appraisal of the property. A loan will continue to accrue interest if it can be reasonably determined that the borrower should be able to perform under the modified terms, that the loan has not been chronically delinquent (both to debt service and real estate taxes) or in nonaccrual status since its inception, and that there have been no charge-offs on the loan. Restructured loans with previous charge-offs would not accrue interest at the time of the troubled debt restructuring. At a minimum, six months of contractual payments would need to be made on a restructured loan before returning a loan to accrual status. Once a loan is classified as a TDR, the loan is reported as a TDR until the loan is paid in full, sold or charged-off. In rare circumstances, a loan may be removed from TDR status, if it meets the requirements of ASC 310-40-50-2.

#### **4. FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS**

Advances from the Federal Home Loan Bank of New York (FHLB) totaled \$47.7 million and \$12.2 million at September 30, 2013 and December 31, 2012, respectively, with a weighted average interest rate of 1.95 and 3.03 percent, respectively. Advances totaling \$35.7 million, with a weighted average interest rate of 1.59 percent at September 30, 2013, have fixed maturity dates. These advances are secured by blanket pledges of certain 1-4 family residential mortgages totaling \$389.5 million at September 30, 2013.

Also at September 30, 2013, the Corporation had \$12.0 million in variable rate advances, with a weighted average rate of 3.01 percent, that are noncallable for one, two or three years and then callable quarterly with final maturities of five , seven or ten years from the original date of the advance. All of these advances are beyond their initial noncallable periods. These advances are secured by pledges of investment securities totaling \$14.0 million at September 30, 2013.

There were overnight borrowings of \$30.4 million at September 30, 2013. There were no overnight borrowings at December 31, 2012. Overnight borrowings from the FHLB averaged \$18.9 million and \$6.4 million with a weighted average interest rate of 0.35 percent and 0.34 percent for the three and nine months ended September 30, 2013, respectively.

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

(In thousands)

|              |          |
|--------------|----------|
| 2013         | \$—      |
| 2014         | —        |
| 2015         | —        |
| 2016         | 11,897   |
| 2017         | 14,897   |
| Over 5 years | 20,898   |
| Total        | \$47,692 |

## 5. BUSINESS SEGMENTS

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

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

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

The following table presents the statements of income and total assets for the Corporation's reportable segments for the three and nine months ended September 30, 2013 and 2012.

Three Months Ended September 30, 2013  
Peapack-  
Gladstone  
Bank Trust

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| (In thousands)                   | Banking   | & Investments | Total     |
|----------------------------------|-----------|---------------|-----------|
| Net interest income              | \$ 12,537 | \$ 836        | \$ 13,373 |
| Noninterest income               | 1,427     | 3,355         | 4,782     |
| Total income                     | 13,964    | 4,191         | 18,155    |
| Provision for loan losses        | 750       | —             | 750       |
| Salaries and benefits            | 6,975     | 1,952         | 8,927     |
| Premises and equipment expense   | 2,181     | 144           | 2,325     |
| Other noninterest expense        | 1,894     | 1,019         | 2,913     |
| Total noninterest expense        | 11,800    | 3,115         | 14,915    |
| Income before income tax expense | 2,164     | 1,076         | 3,240     |
| Income tax expense               | 850       | 426           | 1,276     |
| Net income                       | \$ 1,314  | \$ 650        | \$ 1,964  |

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|                                  | Three Months Ended September 30, 2012 |  |           |
|----------------------------------|---------------------------------------|--|-----------|
| (In thousands)                   | Banking                               | Peapack-<br>Gladstone<br>Bank Trust<br>& Investments | Total     |
| Net interest income              | \$ 12,011                             | \$ 839   | \$ 12,850 |
| Noninterest income               | 1,564                                 | 2,995  | 4,559     |
| Total income                     | 13,575                                | 3,834  | 17,409    |
| Provision for loan losses        | 750                                   | —  | 750       |
| Salaries and benefits            | 5,696                                 | 1,333  | 7,029     |
| Premises and equipment expense   | 2,149                                 | 141  | 2,290     |
| Other noninterest expense        | 1,837                                 | 837  | 2,674     |
| Total noninterest expense        | 10,432                                | 2,311  | 12,743    |
| Income before income tax expense | 3,143                                 | 1,523  | 4,666     |
| Income tax expense               | 1,235                                 | 599  | 1,834     |
| Net income                       | \$ 1,908                              | \$ 924   | \$ 2,832  |

|                                  | Nine Months Ended September 30, 2013 |  |              |
|----------------------------------|--------------------------------------|--|--------------|
| (In thousands)                   | Banking                              | Peapack-<br>Gladstone<br>Bank Trust<br>& Investments | Total        |
| Net interest income              | \$ 35,602                            | \$ 2,646   | \$ 38,248    |
| Noninterest income               | 5,051                                | 10,571   | 15,622       |
| Total income                     | 40,653                               | 13,217   | 53,870       |
| Provision for loan losses        | 2,100                                | —  | 2,100        |
| Salaries and benefits            | 19,464                               | 4,477  | 23,941       |
| Premises and equipment expense   | 6,531                                | 436  | 6,967        |
| Other noninterest expense        | 6,311                                | 3,318  | 9,629        |
| Total noninterest expense        | 34,406                               | 8,231  | 42,637       |
| Income before income tax expense | 6,247                                | 4,986  | 11,233       |
| Income tax expense               | 2,429                                | 1,938  | 4,367        |
| Net income                       | \$ 3,818                             | \$ 3,048   | \$ 6,866     |
| Total assets for period end      | \$ 1,796,440                         | \$ 1,264   | \$ 1,797,704 |

|                     | Nine Months Ended September 30, 2012 |  |           |
|---------------------|--------------------------------------|--|-----------|
| (In thousands)      | Banking                              | Peapack-<br>Gladstone<br>Bank Trust<br>& Investments | Total     |
| Net interest income | \$ 36,116                            | \$ 2,528   | \$ 38,644 |
| Noninterest income  | 4,390                                | 9,563  | 13,953    |

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|                                  |              |          |              |
|----------------------------------|--------------|----------|--------------|
| Total income                     | 40,506       | 12,091   | 52,597       |
| Provision for loan losses        | 3,750        | —        | 3,750        |
| Salaries and benefits            | 15,631       | 3,919    | 19,550       |
| Premises and equipment expense   | 6,604        | 430      | 7,034        |
| Other noninterest expense        | 5,395        | 2,798    | 8,193        |
| Total noninterest expense        | 31,380       | 7,147    | 38,527       |
| Income before income tax expense | 9,126        | 4,944    | 14,070       |
| Income tax expense               | 3,524        | 1,908    | 5,432        |
| Net income                       | \$ 5,602     | \$ 3,036 | \$ 8,638     |
| <br>                             |              |          |              |
| Total assets for period end      | \$ 1,582,127 | \$ 1,363 | \$ 1,583,490 |

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**6. FAIR VALUE**

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

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

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

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

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

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Loans Held for Sale, at Fair Value: The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

Loans Held for Sale, at Lower of Cost or Fair Value: The fair value of this category of loans held for sale is determined using the lower of book value or estimated sale price as calculated by a third-party broker for each loan (Level 2).

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



determining fair value.

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

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by Management. Once received, a member of the Credit Department reviews the assumptions and approaches utilized in the appraisal, as well as, the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals on collateral dependent impaired loans and other real estate owned (consistent for all loan types) are obtained on an annual basis, unless a significant change in the market or other factors warrants a more frequent appraisal. On an annual basis, Management compares the actual selling price of any collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value for other properties. The most recent analysis performed indicated that a discount of up to 15 percent should be applied to appraisals on properties. The discount is determined based on the nature of the underlying properties, aging of appraisal and other factors. For each collateral dependent impaired loans we consider other factors, such as certain indices or other market information, as well as property specific circumstances to determine if an adjustment to the appraised value is needed. In situations where there is evidence of change in value, the Bank will determine if there is need for an adjustment to the specific reserve on the collateral dependent impaired loans. When the Bank applies an interim adjustment, it generally shows the adjustment as an incremental specific reserve against the loan until it has received the full updated appraisal. As of September 30, 2013, all collateral dependent impaired loans and other real estate owned valuations were supported by an appraisal less than 12 months old.

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

**Assets Measured on a Recurring Basis**

|  | Fair Value Measurements Using |  |   |   |
|--|-------------------------------|--|---|---|
|  | September 30, 2013            | Quoted Prices in Active Markets For Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (In thousands)                         |                               |  |   |   |
| Assets:                                |                               |  |   |   |
| Available for sale:                    |                               |  |   |   |
| U.S. government-sponsored entities     | \$ 15,214                     | \$ —   | \$ 15,214                                     | \$ —                                      |
| Mortgage-backed securities-residential | 196,302                       | —  | 196,302                                       | —   |
| State and political subdivisions       | 57,108                        | —  | 57,108  | —   |
| Single-issuer trust preferred          | 2,400                         | —  | 2,400   | —   |
| CRA investment fund                    | 2,928                         | 2,928  | —   | —   |
| Total                                  | \$ 273,952                    | \$ 2,928   | \$ 271,024                                    | \$ —                                      |

|  | December 31, 2012 |          |            |      |
|--|-------------------|----------|------------|------|
| (In thousands)                         |                   |          |            |      |
| Assets:                                |                   |          |            |      |
| Available for sale:                    |                   |          |            |      |
| U.S. government-sponsored entities     | \$ 26,845         | \$ —     | \$ 26,845  | \$ — |
| Mortgage-backed securities-residential | 221,440           | —        | 221,440    | —    |
| State and political subdivisions       | 50,632            | —        | 50,632     | —    |
| Single-Issuer Trust Preferred          | 2,289             | —        | 2,289      | —    |
| CRA investment fund                    | 3,062             | 3,062    | —          | —    |
| Marketable equity securities           | 211               | 211      | —          | —    |
| Total                                  | \$ 304,479        | \$ 3,273 | \$ 301,206 | \$ — |

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The Corporation has elected the fair value option for loans held for sale. These loans are intended for sale and the Corporation believes that the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Corporation's policy on loans held for investment. None of these loans are 90 days or more past due nor on nonaccrual as of September 30, 2013 and December 31, 2012.

There were no transfers between Level 1 and Level 2 during the three or nine months ended September 30, 2013.

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

## Assets Measured on a Non-Recurring Basis

|                | Fair Value Measurements Using |  |   |   |
|----------------|-------------------------------|--|---|---|
|                | September 30, 2013            | Quoted Prices in Active Markets For Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (In thousands) |                               |  |   |   |
| Assets:        |                               |  |   |   |
| OREO           | \$ 1,060                      | \$ —   | \$ —  | \$ 1,060                                  |

|                                    | December 31, 2012 |      |       |        |
|------------------------------------|-------------------|------|-------|--------|
| (In thousands)                     |                   |      |       |        |
| Assets:                            |                   |      |       |        |
| Impaired loans:                    |                   |      |       |        |
| Primary residential mortgage       | \$ 346            | \$ — | \$ —  | \$ 346 |
| Investment commercial real estate  | 160               | —    | —     | 160    |
| Loans held for sale:               |                   |      |       |        |
| Primary residential mortgage       | 592               | —    | 592   | —      |
| Multifamily                        | 282               | —    | 282   | —      |
| Owner-occupied commercial mortgage | 5,960             | —    | 5,960 | —      |
| Investment commercial real estate  | 6,652             | —    | 6,652 | —      |
| Commercial and industrial          | 263               | —    | 263   | —      |

|      |       |   |   |       |
|------|-------|---|---|-------|
| OREO | 1,990 | — | — | 1,990 |
|------|-------|---|---|-------|

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a recorded investment of \$1 thousand, with a valuation allowance of \$1 thousand at September 30, 2013.  
Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a recorded investment of \$596 thousand, with a valuation allowance of \$90 thousand at December 31, 2012.

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At both September 30, 2013 and December 31, 2012, OREO at fair value represents one commercial property. Provision for OREO on this property totaled \$930 thousand during the nine months ended September 30, 2013. There was no provision on OREO made on this property during the three months ended September 30, 2013 and 2012 and during the nine months ended September 30, 2012.

The carrying amounts and estimated fair values of financial instruments at September 30, 2013 are as follows:

| (In thousands)                          | Carrying Amount | Fair Value Measurements at September 30, 2013 Using |           |           |             |
|---|-----------------|---|-----------|-----------|-------------|
|   |                 | Level 1   | Level 2   | Level 3   | Total       |
| <b>Financial assets</b>                 |                 |   |           |           |             |
| Cash and cash equivalents               | \$39,515        | \$38,266  | \$1,249   | \$—       | \$39,515    |
| Securities available for sale           | 273,952         | 2,928   | 271,024   | —         | 273,952     |
| FHLB and FRB stock                      | 7,707           | —   | —         | —         | N/A         |
| Loans held for sale                     | 724             | —   | 724       | —         | 724         |
| Loans, net of allowance for loan losses | 1,382,893       | —   | —         | 1,361,362 | 1,361,362   |
| Accrued interest receivable             | 4,017           | —   | 820       | 3,197     | 4,017       |
| <b>Financial liabilities</b>            |                 |   |           |           |             |
| Deposits                                | \$1,572,563     | \$1,411,431   | \$161,694 | \$—       | \$1,573,125 |
| Overnight borrowings                    | 30,361          | —   | 30,361    | —         | 30,361      |
| Federal home loan bank advances         | 47,692          | —   | 48,763    | —         | 48,763      |
| Accrued interest payable                | 299             | 45  | 254       | —         | 299         |

The carrying amounts and estimated fair values of financial instruments at December 31, 2012 are as follows:

| (In thousands)                          | Carrying Amount | Fair Value Measurements at December 31, 2012 Using |           |           |             |
|---|-----------------|--|-----------|-----------|-------------|
|   |                 | Level 1  | Level 2   | Level 3   | Total       |
| <b>Financial assets</b>                 |                 |  |           |           |             |
| Cash and cash equivalents               | \$119,228       | \$116,284  | \$2,944   | \$—       | \$119,228   |
| Securities available for sale           | 304,479         | 3,273  | 301,206   | —         | 304,479     |
| FHLB and FRB stock                      | 4,639           | —  | —         | —         | N/A         |
| Loans held for sale                     | 20,210          | —  | 20,210    | —         | 20,210      |
| Loans, net of allowance for loan losses | 1,119,849       | —  | —         | 1,120,537 | 1,120,537   |
| Accrued interest receivable             | 3,864           | —  | 958       | 2,906     | 3,864       |
| <b>Financial liabilities</b>            |                 |  |           |           |             |
| Deposits                                | \$1,516,427     | \$1,337,855  | \$180,505 | \$—       | \$1,518,360 |
| Federal home loan bank advances         | 12,218          | —  | 13,518    | —         | 13,518      |
| Accrued interest payable                | 306             | 37   | 269       | —         | 306         |

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

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values and are classified as either Level 1 or Level 2.

FHLB and FRB stock: It is not practicable to determine the fair value of FHLB or FRB stock due to restrictions placed on its transferability.

Loans: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

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Deposits: The fair values disclosed for demand deposits (e.g., interest and noninterest checking, savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date, (i.e., the carrying amount) resulting in a Level 1 classification. The carrying amounts of certificates of deposit approximate the fair values at the reporting date resulting in Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Overnight borrowings: The carrying amounts of overnight borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

Federal Home Loan Bank advances: The fair values of the Corporation's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Accrued interest receivable/payable: The carrying amounts of accrued interest approximate fair value resulting in a Level 2 or Level 3 classification.

Off-balance sheet instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

**7. OTHER OPERATING EXPENSES**

The following table presents the major components of other operating expenses for the periods indicated:

| (In thousands)                 | Three Months Ended |          | Nine Months Ended |          |
|--------------------------------|--------------------|----------|-------------------|----------|
|                                | September 30,      |          | September 30,     |          |
|                                | 2013               | 2012     | 2013              | 2012     |
| FDIC assessment                | \$ 275             | \$ 299   | \$ 835            | \$ 941   |
| Trust department expense       | 384                | 276      | 1,285             | 1,130    |
| Professional and legal fees    | 525                | 369      | 1,455             | 855      |
| Loan expense                   | 120                | 201      | 482               | 711      |
| Provision for ORE losses       | —                  | —        | 930               | —        |
| Other operating expenses       | 1,609              | 1,529    | 4,642             | 4,556    |
| Total other operating expenses | \$ 2,913           | \$ 2,674 | \$ 9,629          | \$ 8,193 |





Table of Contents**8. OTHER COMPREHENSIVE INCOME**

The following is a summary of the accumulated other comprehensive income/(loss) balances, net of tax, for the three months ended September 30, 2013 and 2012:

| (In thousands)   | Balance at<br>June 30,<br>2013 | Other<br>Comprehensive<br>Income/(Loss)<br>Before<br>Reclassifications | Amount<br>Reclassified<br>From<br>Accumulated<br>Other<br>Comprehensive<br>Income | Other<br>Comprehensive<br>Income/(Loss)<br>Three Months<br>Ended<br>September 30,<br>2013 | Balance at<br>September<br>30,<br>2013 |
|--|--------------------------------|--|---|---|--|
| Net unrealized holding gain/(loss)<br>on securities available for sale,<br>net of tax  | \$ 952                         | \$ (110 )  | \$ (122 )   | \$ (232 )   | \$ 720                                 |
| Accumulated other<br>comprehensive income/(loss),<br>net of tax  | \$ 952                         | \$ (110 )  | \$ (122 )   | \$ (232 )   | \$ 720                                 |
|  |                                |  |   |   |  |
| (In thousands)   | Balance at<br>June 30, 2012    | Other<br>Comprehensive<br>Income<br>Before<br>Reclassifications        | Amount<br>Reclassified<br>from<br>Accumulated<br>Other<br>Comprehensive<br>Income | Other<br>Comprehensive<br>Income<br>Three Months<br>Ended<br>September 30,<br>2012        | Balance at<br>September<br>30,<br>2012 |
| Net unrealized holding gain/(loss)<br>on securities available for sale,<br>net of tax  | \$ 3,574                       | \$ 710   | \$ (153 )   | \$ 557  | \$ 4,131                               |
| Unrealized losses on the<br>noncredit, other-than-<br>temporarily impaired held to<br>maturity securities and on<br>securities transferred from<br>available for sale to held<br>to maturity | (3,035 )                       | 35   | —   | 35  | (3,000 )                               |
| Accumulated other<br>comprehensive income/<br>(loss), net of tax   | \$ 539                         | \$ 745   | \$ (153 )   | \$ 592  | \$ 1,131                               |

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The following represents the reclassifications out of accumulated other comprehensive income for the three months ended September 30, 2013 and 2012:

| (In thousands)  | Three Months Ended |       | Affected Line Item in Statements of Income |
|---|--------------------|-------|--|
|   | 2012               | 2013  |  |
| Unrealized gains/(losses) on securities available for sale: |                    |       |  |
| Realized gain on securities sales                           | 188                | 235   | Securities gains, net                      |
| Income tax expense  | (66 )              | (82 ) | Income tax expense                         |
| Total reclassifications, net of tax                         | 122                | 153   |  |

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The following is a summary of the accumulated other comprehensive income/(loss) balances, net of tax, for the nine months ended September 30, 2013 and 2012:

| (In thousands)   | Balance at<br>December<br>31,<br>2012 | Other<br>Comprehensive<br>Income/(Loss)<br>Before<br>Reclassifications | Amount<br>Reclassified<br>From<br>Accumulated<br>Other<br>Comprehensive<br>Income | Other<br>Comprehensive<br>Income/(Loss)<br>Nine Months<br>Ended<br>September 30,<br>2013 | Balance at<br>September<br>30,<br>2013 |
|--|---------------------------------------|--|---|--|--|
| Net unrealized holding gain/(loss)<br>on securities available for sale,<br>net of tax  | \$ 4,299                              | \$ (3,114  | ) \$ (465   | ) \$ (3,579  | ) \$ 720                               |
| Accumulated other<br>comprehensive income/(loss),<br>net of tax  | \$ 4,299                              | \$ (3,114  | ) \$ (465   | ) \$ (3,579  | ) \$ 720                               |
|  |                                       |  |   |  |  |
| (In thousands)   | Balance at<br>December<br>31,<br>2011 | Other<br>Comprehensive<br>Income<br>Before<br>Reclassifications        | Amount<br>Reclassified<br>from<br>Accumulated<br>Other<br>Comprehensive<br>Income | Other<br>Comprehensive<br>Income<br>Nine Months<br>Ended<br>September 30,<br>2012        | Balance at<br>September<br>30,<br>2012 |
| Net unrealized holding gain/(loss)<br>on securities available for sale,<br>net of tax  | \$ 3,206                              | \$ 1,401   | \$ (476   | ) \$ 925   | \$ 4,131                               |
| Unrealized losses on the<br>noncredit, other-than-<br>temporarily impaired held to<br>maturity securities and on<br>securities transferred from<br>available for sale to held<br>to maturity | (3,102                                | ) 102  | —   | 102  | (3,000                                 |
| Accumulated other<br>comprehensive income/<br>(loss), net of tax   | \$ 104                                | \$ 1,503   | \$ (476   | ) \$ 1,027   | ) \$ 1,131                             |

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The following represents the reclassifications out of accumulated other comprehensive income for the nine months ended September 30, 2013 and 2012:

| (In thousands)  | Nine Months Ended |        | Affected Line Item in Statements of Income |
|---|-------------------|--------|--|
|   | 2012              | 2013   |  |
| Unrealized gains/(losses) on securities available for sale: |                   |        |  |
| Realized gain on securities sales                           | 715               | 732    | Securities gains, net                      |
| Income tax expense  | (250 )            | (256 ) | Income tax expense                         |
| Total reclassifications, net of tax                         | 465               | 476    |  |

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Item 2

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

**GENERAL:** The following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about Management's view of future interest income and net loans, Management's confidence and strategies and Management's expectations about new and existing programs and products, relationships, opportunities and market conditions. These statements may be identified by such forward-looking terminology as "expect", "look", "believe", "anticipate", "may", "will", or similar statements or variations of such terms. Actual results may differ materially from such forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, those risk factors identified in the Corporation's Form 10-K for the year ended December 31, 2012 and the following:

- inability to successfully grow our business and implement our strategic plan including an inability to generate revenues to offset the increased personnel and other costs related to the strategic plan;
- inability to manage our growth;
- inability to successfully integrate our expanded employee base;
- a continued or unexpected decline in the economy, in particular in our New Jersey and New York market areas;
- declines in value in our investment portfolio;
- higher than expected increases in our allowance for loan losses;
- higher than expected increases in loan losses or in the level of non-performing loans;
- declines in our net interest margin caused by the low interest rate environment and highly competitive market;
- unexpected changes in interest rates;
- a continued or unexpected decline in real estate values within our market areas;
- legislative and regulatory actions (including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Basel III and related regulations) subject us to additional regulatory oversight which may result in increased compliance costs;
- successful cyber-attacks against our IT infrastructure or that of our IT providers;
- higher than expected FDIC insurance premiums;
- adverse weather conditions;
- inability to successfully generate new business in new geographic markets;
- inability to execute upon new business initiatives;
- lack of liquidity to fund our various cash obligations;
- reduction in our lower-cost funding sources;
- our inability to adapt to technological changes;
- claims and litigation pertaining to fiduciary responsibility, environmental laws and other matters; and
- other unexpected material adverse changes in our operations or earnings.

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

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES:** Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon the Corporation's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Corporation's Audited Consolidated Financial Statements for the year ended December 31, 2012, contains a summary of the Corporation's significant accounting policies.

Management believes that the Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often requires assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical policy and its application are periodically reviewed with the Audit Committee and the Board of Directors.

The provision for loan losses is based upon Management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated fair value of any underlying collateral and guarantees securing the loans, and current economic and market conditions.

Although Management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Corporation's loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Corporation's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values continue to decline or New Jersey experience continuing adverse economic conditions. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation's control.

The Corporation accounts for its securities in accordance with "Accounting for Certain Investments in Debt and Equity Securities," which was codified into ASC 320. Debt securities are classified as held to maturity and carried at amortized cost when Management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity due to changes in interest rates, prepayment,

risk, liquidity or other factors. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. As of September 30, 2013 and December 31, 2012, the Corporation no longer had debt securities classified as held to maturity.

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

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Securities are evaluated on at least a quarterly basis to determine whether a decline in their values is other-than-temporary. To determine whether a loss in value is other-than-temporary, Management utilizes criteria such as the reasons underlying the decline, the magnitude and the duration of the decline and whether the Corporation intends to sell or is likely to be required to sell the security before its anticipated recovery. "Other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. The Corporation recognized no other-than-temporary impairment charges in the nine months ended September 30, 2013 and 2012.

**EXECUTIVE SUMMARY:** The Corporation recorded net income of \$2.0 million for the third quarter of 2013 compared to \$2.8 million for the same quarter of 2012. Diluted earnings per common share were \$0.22 and \$0.32 for the third quarters of 2013 and 2012, respectively. Annualized return on average assets was 0.45 percent and annualized return on average common equity was 6.28 percent for the third quarter of 2013. For the 2013 quarter, net income includes a \$933 thousand compensation expense accrual related to certain staff restructurings, resulting in an after-tax charge of approximately \$569 thousand or approximately \$0.06 per fully diluted share.

For the third quarter of 2013, net interest income, on a fully tax-equivalent basis, was \$13.5 million compared to \$13.0 million for the same quarter of 2012, an increase of \$523 thousand or 4.0 percent. The net interest margin, on a fully tax-equivalent basis, was 3.28 percent and 3.50 percent, for the three months ended September 30, 2013 and 2012, respectively.

Loans averaged \$1.32 billion for the third quarter of 2013, increasing \$224.0 million, or 20.4 percent, from \$1.10 billion for the same quarter of 2012. The yield on loans was 3.95 percent and 4.36 percent for the third quarters of 2013 and 2012, respectively, declining 41 basis points from the 2012 quarter to the 2013 quarter.

Average deposits for the third quarters of 2013 and 2012, were \$1.55 billion and \$1.44 billion, respectively, increasing \$112.8 million or 7.9 percent. The average cost of interest-bearing deposits was 0.27 percent for the third quarter of 2013, compared to 0.32 percent for the same quarter in 2012, a decline of five basis points.

For the nine months ended September 30, 2013 and 2012, the Corporation recorded net income of \$6.9 million and \$8.6 million, respectively, a decline of \$1.8 million or 20.5 percent from the same period of 2012. Diluted earnings per common share were \$0.76 for the nine months ended September 30, 2013 compared to \$0.93 for the same period in 2012, after giving effect for the preferred dividend in 2012. Annualized return on average assets was 0.55 percent and annualized return on average common equity was 7.35 percent for the first nine months of 2013. The nine months ended September 30, 2013 included a \$930 thousand provision for REO on one property, resulting in an after-tax charge of approximately \$595 thousand, or approximately \$0.07 per fully diluted share as well as a \$933 thousand compensation expense accrual related to certain staff restructurings, resulting in an after-tax charge of approximately \$569 thousand or approximately \$0.06 per fully diluted share. The 2013 year-to-date net income includes a decline in the provision for loan losses and increases in trust fee income and gain on sale of loans, offset by an increase in



operating expenses, principally due to compensation expense accruals and the implementation of the Corporation's strategic plan.

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Net interest income, on a fully tax-equivalent basis, was \$38.7 million and \$39.1 million for the nine months ended September 30, 2013 and 2012, respectively, a decrease of \$427 thousand or 1.1 percent. The net interest margin, on a fully tax-equivalent basis, was 3.26 percent for the nine months ended September 30, 2013 compared to 3.52 for the same period of 2012.

Loans averaged \$1.22 billion for the nine months ended September 30, 2013, increasing \$138.0 million or 12.7 percent, from the \$1.08 billion average for the same period of 2012. For the nine months ended September 30, 2013 and 2012, the yield on loans was 4.02 percent and 4.43 percent, respectively, declining 41 basis points from the 2012 year-to-date compared to the 2013 year-to-date.

For the nine months ended September 30, 2013, deposits averaged \$1.51 billion compared to \$1.42 billion for the same period of 2012, increasing \$88.4 million or 6.2 percent. The average cost of interest-bearing deposits was 0.27 percent and 0.34 percent for the first nine months of 2013 and 2012, respectively.

**CONTRACTUAL OBLIGATIONS:** For a discussion of our contractual obligations, see the information set forth in the Corporation's 2012 Annual Report on Form 10-K under the heading "Management's Discussion and Analysis – Contractual Obligations" which is incorporated herein by reference.

**OFF-BALANCE SHEET ARRANGEMENTS:** For a discussion of our off-balance sheet arrangements, see the information set forth in the Corporation's 2012 Annual Report on Form 10-K under the heading "Management's Discussion and Analysis – Off-Balance Sheet Arrangements" which is incorporated herein by reference.

## **EARNINGS ANALYSIS**

**NET INTEREST INCOME:** For the third quarter of 2013, the Corporation recorded net interest income, on a fully tax-equivalent basis, of \$13.5 million, an increase of \$523 thousand or 4.0 percent, compared to the same period of 2012. The net interest margin was 3.28 percent and 3.50 percent, for the third quarters of 2013 and 2012, respectively. For the third quarter of 2013, net interest income increased due to the positive effect of increased loan growth, partially offset by the effect of lower market yields when compared to the same quarter in 2012. The net interest margin, however, declined from the same quarter last year, due to the effect of the lower market yields, which compressed asset yields more than deposit costs.

For the third quarters of 2013 and 2012, interest-earning deposits averaged \$35.2 million and \$53.6 million, declining \$18.4 million and average investments declined \$36.9 million or 11.2 percent, to \$292.0 million, for the third quarter of 2013 compared to the year ago period as the Corporation funded loan growth during the period.

For the third quarter of 2013, average loans totaled \$1.32 billion, increasing \$224.0 million, or 20.4 percent, when compared to \$1.10 billion for the same quarter of 2012, with much of the growth in the commercial mortgage portfolio which increased \$212.7 million, or 55.6 percent, from the year ago period, averaging \$595.1 million for the third quarter of 2013. The Corporation has increased its emphasis on multifamily lending, as well as continuing to provide mortgage loans on a variety of properties to creditworthy borrowers. While the Corporation utilizes attractive pricing techniques to generate additional volume, the Corporation believes that credit standards have not been compromised.

The residential mortgage portfolio increased \$22.8 million to an average of \$543.7 million, or 4.4 percent, for the third quarter of 2013 compared to the same quarter of 2012. While residential mortgage originations continued to be strong due to the lower interest rate environment and related refinancing activity, the Corporation sells a large portion of its originations, servicing released.

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For the third quarters of 2013 and 2012, the commercial loan portfolio averaged \$108.0 million and \$114.8 million, respectively, a decline of \$6.8 million, or 5.9 percent, when comparing the two quarters. This change in the loan portfolio is due in part to the Corporation's transfer of \$19.2 million of classified loans to loans held for sale at the end of 2012. The loans were subsequently sold in the first quarter of 2013, resulting in a gain of approximately \$522 thousand.

Average deposits totaled \$1.55 billion for the three months ended September 30, 2013 compared to \$1.44 billion for the same period in 2012, an increase of \$112.8 million, or 7.9 percent. Noninterest-bearing demand deposits increased \$32.5 million, or 10.6 percent, over the third quarter of 2012 to an average of \$337.7 million for the third quarter of 2013. For the third quarters of 2013 and 2012, interest-bearing checking accounts averaged \$349.4 million and \$335.0 million, respectively, increasing by \$14.4 million, or 4.3 percent from the 2012 period. Checking growth is attributable to the Corporation's continued focus on business and personal core deposit growth.

Savings accounts averaged \$115.7 million for the third quarter of 2013, increasing \$11.4 million or 11.0 percent from the same quarter of 2012. For the third quarter of 2013, money market accounts averaged \$580.8 million compared to \$503.2 million for the same period in 2012, increasing \$77.6 million, or 15.4 percent from 2012 quarter. Overall, the Corporation has seen an increase in savings and money market accounts as customers tend to "park funds" in a lower or uncertain interest rate environment, to wait for a higher or a more certain rate environment.

For the third quarter of 2013, average certificates of deposit decreased \$23.2 million, or 12.3 percent to \$165.3 million for the 2013 quarter from \$188.6 million for the 2012 quarter. The Corporation has opted not to pay higher rates on maturing certificates of deposit and instead has utilized lower cost alternative funding, such as Federal Home Loan Bank borrowings.

Overnight borrowings from the Federal Home Loan Bank of New York averaged \$18.9 million for the three months ended September 30, 2013, while they averaged \$1.7 million for the same quarter of 2012. Average short-term and other borrowings totaled \$26.2 million for the third quarter of 2013, increasing \$12.6 million from \$13.6 million when compared to the same quarter of 2012.

For the third quarter of 2013, average yields on interest-earning assets, on a tax-equivalent basis, were 3.53 percent, declining 28 basis points from 3.81 percent for the same quarter of 2012. Average yields earned on investments securities were 2.01 percent and 2.57 percent, for the third quarters of 2013 and 2012, respectively, a decline of 56 basis points. The average yield on the loan portfolio declined 41 basis points to 3.95 percent for the third quarter of 2013, from the same quarter in 2012. Asset yields continue to experience downward pressure due to competitive pressures and the lower rate environment.

The cost of funds, including the effect of noninterest-earning demand deposits, was 26 basis points for the third quarter of 2013 compared to 31 basis points for the same 2012 quarter, decreasing five basis points. For the third quarters of 2013 and 2012, the average cost of interest-bearing checking deposits was eight basis points and 11 basis points, respectively, a decline of three basis points. The cost of money market products averaged 19 basis points for the third quarter of 2013 compared to 21 basis points for the same quarter of 2012, declining two basis points when comparing the 2013 quarter to the 2012 quarter. Certificates of deposit costs declined ten basis points to 1.07 percent in the third quarter of 2013 from 1.17 percent for the same quarter of 2012. The continued lower rate environment contributed to the declines in costs of deposits.

The Corporation recorded net interest income, on a fully tax-equivalent basis, of \$38.7 million for the first nine months of 2013 compared to \$39.1 million for the same period of 2012, a decline of \$427 thousand or 1.1 percent. The net interest margin was 3.26 percent for the nine months ended September 30, 2013, compared to 3.52 percent for the same period of 2012. Net interest income and the net interest margin reflected declines from the same period last year, due to the effect of the lower market yields, which compressed asset yields more than deposit costs. This was partially offset by the positive effect of increased loans funded by cash flows from lower yielding investment securities, which benefitted both net interest income and margin in 2013. Additionally, a much higher overnight cash balance position maintained during the nine months ended September 30, 2013 also contributed to the compressed margin as rates remained very low on invested cash.

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For the first nine months of 2013 and 2012, interest-earning deposits averaged \$68.2 million and \$32.7 million, respectively, reflecting an increase of \$35.5 million, as the Corporation maintained a higher overnight cash position in the 2013 period in anticipation of funding future loan volumes. Average investments were \$287.3 million for the nine months ended September 30, 2013 compared to \$362.2 million for the same period of 2012, declining \$74.9 million or 20.7 percent. The decline in investments primarily funded loan growth in the first nine months of 2013.

For the nine months ended September 30, 2013, average loans totaled \$1.22 billion compared to \$1.08 billion for the same period in 2012 increasing \$138.0 million, or 12.7 percent, when comparing the 2013 period to the 2012 period. The commercial mortgage portfolio reflected most of the growth, increasing \$140.8 million, or 38.7 percent, from the year ago period, to an average of \$504.4 million for the first nine months of 2013. The Corporation has increased its emphasis on multifamily lending, as well as continuing to provide mortgage loans on a variety of properties to creditworthy borrowers utilizing attractive pricing techniques to generate additional volume. The Corporation believes that credit standards have not been compromised.

The average residential mortgage portfolio increased \$12.6 million, or 2.4 percent, to \$533.7 million for the first nine months of 2013, from \$521.1 million for the same period in 2012. While residential mortgage originations had been very strong due to the lower interest rate environment and related refinancing activity, the Corporation has recently experienced lower volumes due to increasing mortgage loan market rates. In addition, the Corporation sells a large portion of its originations.

The commercial loan portfolio averaged \$107.1 million and \$118.1 million, for the nine months ended September 30, 2013 and 2012, respectively, a decline of \$11.0 million, or 9.3 percent, when comparing the two periods. The commercial construction portfolio declined \$2.0 million, or 18.8 percent, averaging \$8.9 million in the first nine months of 2013 compared to the same period in 2012, due to the conversion of some loans to permanent loans and also due to the resolution of some problem loans. As noted above, the changes in the loan portfolios are due in part to the Corporation's transfer of \$19.2 million of classified loans to loans held for sale at the end of 2012. The loans were subsequently sold in the first quarter of 2013, resulting in a gain of approximately \$522 thousand.

For the nine months ended September 30, 2013, average deposits totaled \$1.51 billion compared to \$1.42 billion for the same period in 2012, an increase of \$88.4 million, or 6.2 percent. For the first nine months of 2013 and 2012, interest-bearing checking accounts averaged \$352.0 million and \$332.8 million, respectively, increasing by \$19.2 million, or 5.8 percent from the 2012 period. Noninterest-bearing demand deposits increased \$22.4 million, or 7.7 percent, over the first nine months of 2012 to an average of \$313.4 million for the same period of 2013. Checking growth is attributable to the Corporation's continued focus on business and personal core deposit growth.

For the nine months ended September 30, 2013, savings accounts averaged \$113.5 million, increasing \$13.8 million or 13.9 percent from \$99.7 million for the same period of 2012. Money market accounts averaged \$561.7 million and \$508.3 million for the nine months ended September 30, 2013 and 2012, respectively, increasing \$53.4 million, or 10.5 percent from the 2012 period to the 2013 period. Overall, the Corporation has seen an increase in savings and

money market accounts as customers tend to "park funds" in a lower or uncertain interest rate environment, to wait for a higher or a more certain rate environment. For the first nine months of 2013, average certificates of deposit totaled \$171.2 million compared to \$191.6 million for the same period of 2012, decreasing \$20.4 million, or 10.6 percent, over the 2012 year-to-date. As noted above, the Corporation has utilized lower cost funding options, such as Federal Home Loan Bank advances, instead of paying higher rates on maturing certificates of deposit.

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For the nine months ended September 30, 2013 and 2012, overnight borrowings from the Federal Home Loan Bank of New York averaged \$6.4 million and \$13.6 million, respectively, declining \$7.2 million from the year ago period. For the nine months ended September 30, 2013, average short-term and other borrowings totaled \$16.8 million, increasing \$782 thousand or 4.9 percent when compared to the same period of 2012. As loan growth increases, the Corporation expects to borrow additional funds from the Federal Home Loan Bank and other sources.

On a tax-equivalent basis, average yields on interest-earning assets declined 34 basis points to 3.51 percent for the nine months ended September 30, 2013, from 3.85 percent for the same period of 2012. For the nine months ended September 30, 2013 and 2012, average yields earned on investments securities were 2.08 percent and 2.45 percent, respectively, a decline of 37 basis points. The average yield on the loan portfolio declined 41 basis points to 4.02 percent for the nine months ended September 30, 2013, from 4.43 for the same period in 2012. Asset yields continue to experience downward pressure due to the utilization of attractive pricing techniques.

For the first nine months of 2013, the cost of funds, including the effect of noninterest-earning demand deposits, was 26 basis points compared to 33 basis points for the same 2012 period, decreasing seven basis points. The average cost of interest-bearing checking deposits was nine basis points for the nine months ended September 30, 2013 compared to 12 basis points for the same period of 2012, a decline of three basis points. For the first nine months of 2013, the cost of money market products averaged 17 basis points, declining five basis points from 22 basis points for the same period of 2012. Certificates of deposit costs averaged 1.11 percent for the nine months ended September 30, 2013, compared to 1.19 percent for the same period of 2012, declining eight basis points, from the prior year period. The continued lower rate environment contributed to the declines in costs of deposits.



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

**Average Balance Sheet**

Unaudited

Three Months Ended

(Tax-Equivalent Basis, Dollars in Thousands)

|   | September 30, 2013 |                    |        | September 30, 2012 |                    |        |
|---|--------------------|--------------------|--------|--------------------|--------------------|--------|
|   | Average<br>Balance | Income/<br>Expense | Yield  | Average<br>Balance | Income/<br>Expense | Yield  |
| <b>ASSETS:</b>                            |                    |                    |        |                    |                    |        |
| Interest-earning assets:                  |                    |                    |        |                    |                    |        |
| Investments:                              |                    |                    |        |                    |                    |        |
| Taxable (1)                               | \$237,559          | \$1,141            | 1.92 % | \$284,440          | \$1,787            | 2.51 % |
| Tax-exempt (1) (2)                        | 54,465             | 328                | 2.41   | 44,481             | 322                | 2.90   |
| Loans held for sale                       | 1,617              | 21                 | 5.27   | 2,829              | 34                 | 4.77   |
| Loans (2) (3)                             | 1,322,842          | 13,065             | 3.95   | 1,098,857          | 11,965             | 4.36   |
| Federal funds sold                        | 101                | —                  | 0.10   | 100                | —                  | 0.10   |
| Interest-earning deposits                 | 35,168             | 21                 | 0.24   | 53,560             | 27                 | 0.20   |
| Total interest-earning assets             | 1,651,752          | 14,576             | 3.53 % | 1,484,267          | 14,135             | 3.81 % |
| Noninterest-earning assets:               |                    |                    |        |                    |                    |        |
| Cash and due from banks                   | 5,962              |                    |        | 5,611              |                    |        |
| Allowance for loan losses                 | (13,615 )          |                    |        | (14,005 )          |                    |        |
| Premises and equipment                    | 28,984             |                    |        | 30,820             |                    |        |
| Other assets                              | 65,163             |                    |        | 77,232             |                    |        |
| Total noninterest-earning assets          | 86,494             |                    |        | 99,658             |                    |        |
| Total assets                              | \$1,738,246        |                    |        | \$1,583,925        |                    |        |
| <b>LIABILITIES:</b>                       |                    |                    |        |                    |                    |        |
| Interest-bearing deposits:                |                    |                    |        |                    |                    |        |
| Checking                                  | \$349,392          | \$73               | 0.08 % | \$334,982          | \$89               | 0.11 % |
| Money markets                             | 580,819            | 275                | 0.19   | 503,180            | 259                | 0.21   |
| Savings                                   | 115,711            | 15                 | 0.05   | 104,273            | 14                 | 0.05   |
| Certificates of deposit                   | 165,347            | 444                | 1.07   | 188,568            | 550                | 1.17   |
| Total interest-bearing deposits           | 1,211,269          | 807                | 0.27   | 1,131,003          | 912                | 0.32   |
| Borrowings                                | 45,149             | 138                | 1.22   | 15,281             | 113                | 2.96   |
| Capital lease obligation                  | 8,828              | 105                | 4.76   | 9,043              | 107                | 4.73   |
| Total interest-bearing liabilities        | 1,265,246          | 1,050              | 0.33   | 1,155,327          | 1,132              | 0.39   |
| Noninterest-bearing liabilities:          |                    |                    |        |                    |                    |        |
| Demand deposits                           | 337,684            |                    |        | 305,192            |                    |        |
| Accrued expenses and<br>other liabilities | 10,241             |                    |        | 7,434              |                    |        |
| Total noninterest-bearing                 |                    |                    |        |                    |                    |        |

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|   |             |          |             |          |
|---|-------------|----------|-------------|----------|
| liabilities                                   | 347,925     |          | 312,626     |          |
| Shareholders' equity                          | 125,075     |          | 115,972     |          |
| Total liabilities and<br>shareholders' equity | \$1,738,246 |          | \$1,583,925 |          |
| Net interest income<br>(tax-equivalent basis) |             | 13,526   |             | 13,003   |
| Net interest spread                           |             |          | 3.20 %      | 3.42 %   |
| Net interest margin (4)                       |             |          | 3.28 %      | 3.50 %   |
| Tax equivalent adjustment                     |             | (153 )   |             | (153 )   |
| Net interest income                           |             | \$13,373 |             | \$12,850 |

(1) Average balances for available for sale securities are based on amortized cost.

(2) Interest income is presented on a tax-equivalent basis using a 35 percent federal tax rate.

(3) Loans are stated net of unearned income and include nonaccrual loans.

(4) Net interest income on a tax-equivalent basis as a percentage of total average interest-earning assets.

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Unaudited

Nine Months Ended

(Tax-Equivalent Basis, Dollars in Thousands)

|   | September 30, 2013 |                    |        | September 30, 2012 |                    |        |
|---|--------------------|--------------------|--------|--------------------|--------------------|--------|
|   | Average<br>Balance | Income/<br>Expense | Yield  | Average<br>Balance | Income/<br>Expense | Yield  |
| <b>ASSETS:</b>                            |                    |                    |        |                    |                    |        |
| Interest-earning assets:                  |                    |                    |        |                    |                    |        |
| Investments:                              |                    |                    |        |                    |                    |        |
| Taxable (1)                               | \$235,677          | \$3,503            | 1.98 % | \$315,589          | \$5,609            | 2.37 % |
| Tax-exempt (1) (2)                        | 51,582             | 974                | 2.52   | 46,619             | 1,036              | 2.96   |
| Loans held for sale                       | 6,950              | 268                | 5.14   | 1,859              | 75                 | 5.37   |
| Loans (2) (3)                             | 1,222,369          | 36,889             | 4.02   | 1,084,357          | 36,005             | 4.43   |
| Federal funds sold                        | 101                | —                  | 0.10   | 100                | —                  | 0.10   |
| Interest-earning deposits                 | 68,211             | 135                | 0.26   | 32,694             | 58                 | 0.24   |
| Total interest-earning assets             | 1,584,890          | 41,769             | 3.51 % | 1,481,218          | 42,783             | 3.85 % |
| Noninterest-earning assets:               |                    |                    |        |                    |                    |        |
| Cash and due from banks                   | 5,887              |                    |        | 6,378              |                    |        |
| Allowance for loan losses                 | (13,406 )          |                    |        | (13,916 )          |                    |        |
| Premises and equipment                    | 29,344             |                    |        | 31,284             |                    |        |
| Other assets                              | 70,674             |                    |        | 77,323             |                    |        |
| Total noninterest-earning assets          | 92,499             |                    |        | 101,069            |                    |        |
| Total assets                              | \$1,677,389        |                    |        | \$1,582,287        |                    |        |
| <b>LIABILITIES:</b>                       |                    |                    |        |                    |                    |        |
| Interest-bearing deposits:                |                    |                    |        |                    |                    |        |
| Checking                                  | \$351,975          | \$225              | 0.09 % | \$332,822          | \$292              | 0.12 % |
| Money markets                             | 561,713            | 729                | 0.17   | 508,337            | 820                | 0.22   |
| Savings                                   | 113,486            | 44                 | 0.05   | 99,671             | 56                 | 0.07   |
| Certificates of deposit                   | 171,235            | 1,430              | 1.11   | 191,596            | 1,709              | 1.19   |
| Total interest-bearing deposits           | 1,198,409          | 2,428              | 0.27   | 1,132,426          | 2,877              | 0.34   |
| Borrowings                                | 23,226             | 322                | 1.85   | 29,649             | 453                | 2.04   |
| Capital lease obligation                  | 8,882              | 317                | 4.76   | 9,094              | 324                | 4.75   |
| Total interest-bearing liabilities        | 1,230,517          | 3,067              | 0.33   | 1,171,169          | 3,654              | 0.42   |
| Noninterest-bearing liabilities:          |                    |                    |        |                    |                    |        |
| Demand deposits                           | 313,420            |                    |        | 290,988            |                    |        |
| Accrued expenses and<br>other liabilities | 8,887              |                    |        | 6,592              |                    |        |
| Total noninterest-bearing<br>liabilities  | 322,307            |                    |        | 297,580            |                    |        |
| Shareholders' equity                      | 124,565            |                    |        | 113,538            |                    |        |
| Total liabilities and                     |                    |                    |        |                    |                    |        |

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|                           |             |        |             |        |
|---------------------------|-------------|--------|-------------|--------|
| shareholders' equity      | \$1,677,389 |        | \$1,582,287 |        |
| Net interest income       |             |        |             |        |
| (tax-equivalent basis)    | 38,702      |        | 39,129      |        |
| Net interest spread       |             | 3.18 % |             | 3.43 % |
| Net interest margin (4)   |             | 3.26 % |             | 3.52 % |
| Tax equivalent adjustment | (454 )      |        | (485 )      |        |
| Net interest income       | \$38,248    |        | \$38,644    |        |

(1) Average balances for available for sale securities are based on amortized cost.

(2) Interest income is presented on a tax-equivalent basis using a 35 percent federal tax rate.

(3) Loans are stated net of unearned income and include nonaccrual loans.

(4) Net interest income on a tax-equivalent basis as a percentage of total average interest-earning assets.

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**OTHER INCOME:** For the third quarter of 2013 and 2012, other income, excluding fee income from the Bank's wealth management division, totaled \$1.5 million and \$1.6 million, respectively, a decrease of \$154 thousand or 9.4 percent. The third quarter of 2013 included \$277 thousand of income from the sale of newly originated, longer-duration residential mortgage loans, compared to \$358 thousand in the same 2012 quarter, a decrease of \$81 thousand or 22.6 percent, which was due largely to a decrease in mortgage volume as a result of higher interest rates. For the third quarter of 2013, net securities gains from strategic sale of securities was \$188 thousand, compared to \$235 thousand for the same quarter of 2012. The Corporation also recorded a net loss of \$22 thousand in the third quarter of 2013 on the sale of OREO properties as compared to a gain of \$22 thousand for the same quarter in 2012.

The Corporation recorded other income, excluding fee income from the Bank's wealth management division, of \$5.3 million and \$4.6 million for the nine months ended September 30, 2013 and 2012, respectively, an increase of \$731 thousand or 15.9 percent. For the first three quarters of 2013, gain on sale of loans was \$1.7 million, compared to \$825 thousand for the same period in 2012. The increase was largely due to a \$522 thousand gain reported on the sale of classified loans in the first quarter of 2013 and the increased sales of newly originated longer duration residential mortgage loans.

**OPERATING EXPENSES:** The Corporation recorded operating expenses of \$14.1 million and \$11.9 million, for the third quarters of 2013 and 2012, respectively, an increase of \$2.2 million or 18.1 percent. Salary and benefit expense was \$8.9 million for the third quarter of 2013, compared to \$7.0 million in the same quarter of 2012, an increase of \$1.9 million or 27.0 percent. The 2013 quarter included a \$933 thousand compensation expense accrual related to certain staff restructurings and an increase of \$965 thousand from the third quarter of 2012 due to additional staff as we begin to implement the Strategic Plan; normal salary increases; and increased bonus/incentive and profit-sharing accruals. Professional and legal fees totaled \$525 thousand and \$369 thousand, for the third quarters of 2013 and 2012, respectively, an increase of \$156 thousand due to various training and consulting expenses, some of which was associated with the Strategic Plan. Loan expense for the third quarters of 2013 and 2012 were \$120 thousand and \$201 thousand, respectively, a decrease of \$81 thousand. This is attributed to a decline in problem loan expense.

The Corporation recorded operating expenses of \$40.5 million for the nine months of 2013 compared to \$34.8 million for the same period of 2012, an increase of \$5.8 million or 16.6 percent. The Corporation recorded a \$930 thousand provision for REO on one large property held in other real estate owned during the second quarter of 2013. Salary and benefit expense was \$23.9 million and \$19.6 million for the nine months ended September 30, 2013 and 2012, respectively, an increase of \$4.4 million or 22.5 percent due to the accrual related to staff restructurings, additions to staff as a result of the Strategic Plan; increased commissions related to loan originations; normal salary increases; and increased bonus/incentive and profit-sharing accruals. For the nine months of 2013, professional and legal fees increased approximately \$600 thousand, or 70.2 percent, to \$1.5 million from \$855 thousand for the nine months ended September 30, 2012 due to various professional and other fees associated with the Delaware subsidiary; the Amended Stock Incentive Plan; the filing of the Corporation's registration statement with the SEC; and various training and consulting, some of which was associated with the Strategic Plan. For the nine months ended September 30, 2013 loan expense, which includes costs associated with problem loan expense, decreased by approximately \$229 thousand or 32.2 percent compared to the same period in 2012. The Corporation also recorded expense on other real estate owned of \$133 thousand and \$272 thousand for the nine months ended September 30, 2013 and 2012, respectively.

The Corporation expected higher operating expenses in the first nine months of 2013 and expects that trend to continue as it implements its Strategic Plan. The Corporation also expects revenue and related profitability associated with the Strategic Plan to generally lag expenses by several quarters.

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The following table presents the components of operating expenses for the periods indicated:

| (In thousands)                  | Three Months |          | Nine Months |          |
|---------------------------------|--------------|----------|-------------|----------|
|                                 | Ended        |          | Ended       |          |
|                                 | September,   |          | September,  |          |
|                                 | 2013         | 2012     | 2013        | 2012     |
| Salaries and employee benefits  | \$8,927      | \$7,029  | \$23,941    | \$19,550 |
| Premises and equipment          | 2,325        | 2,290    | 6,967       | 7,034    |
| FDIC assessment                 | 275          | 299      | 835         | 941      |
| Trust department expense        | 384          | 276      | 1,285       | 1,131    |
| Professional and legal fees     | 525          | 369      | 1,455       | 855      |
| Loan expense                    | 120          | 201      | 482         | 711      |
| Telephone                       | 170          | 180      | 528         | 483      |
| Advertising                     | 131          | 109      | 394         | 356      |
| Stationery and supplies         | 122          | 112      | 279         | 280      |
| Postage                         | 95           | 85       | 299         | 249      |
| Other real estate owned expense | 60           | 45       | 133         | 272      |
| Provision for ORE losses        | —            | —        | 930         | —        |
| Other expense                   | 1,031        | 998      | 3,009       | 2,915    |
| Total operating expenses        | \$14,165     | \$11,993 | \$40,537    | \$34,777 |

**PEAPACK-GLADSTONE BANK TRUST & INVESTMENTS:** Peapack-Gladstone Bank Trust & Investments, a division of the Bank, has served in the roles of executor and trustee while providing investment management, custodial, tax, retirement and financial services to its growing client base. Officers from Peapack-Gladstone Bank Trust & Investments are available to provide trust and investment services at the Bank's corporate headquarters in Bedminster, at two branch locations, Morristown and Summit, New Jersey and at the Bank's new subsidiary, PGB Trust & Investments of Delaware in Greenville, Delaware.

The market value of trust assets under administration for Peapack-Gladstone Bank Trust & Investments was approximately \$2.58 billion at September 30, 2013 compared to \$2.15 billion at September 30, 2012, an increase of 20 percent over the prior year.

Peapack-Gladstone Bank Trust & Investments generated fee income of \$3.3 million for the third quarter of 2013 compared to \$2.9 million for the same quarter of 2012, an increase of \$377 thousand or 12.9 percent. The increase reflects increased relationships, a greater mix of higher margin business and an improvement in the market value of assets under management.

While the "Operating Expenses" section above offers an overall discussion of the Corporation's expenses including Peapack-Gladstone Bank Trust & Investments, other expenses relative to Peapack-Gladstone Bank Trust & Investments totaled \$3.1 million and \$2.3 million for the third quarters of 2013 and 2012, respectively, an increase of

\$804 thousand or 34.8 percent. For the third quarter of 2013, salaries and benefits expense increased \$619 thousand, or 46.4 percent when compared to the same period in 2012. During the same time periods, total operating expenses increased \$182 thousand, or 21.7 percent, due in part to increased system expenses related to increased volume.

For the nine months ended September 30, 2013, Peapack-Gladstone Bank Trust and Investments generated fee income of \$10.3 million, an increase of \$938 thousand, or 10.0 percent, when compared to \$9.4 million for the same 2012 period. The increase reflects increased relationships and a greater mix of higher margin business, in addition to an improvement in the market value of assets under management.



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For the first three quarters of 2013, other expenses for Peapack-Gladstone Bank Trust and Investments totaled \$8.2 million compared to \$7.1 million for the same period in 2012, an increase of \$1.1 million, or 15.2 percent. For the nine months ended September 30, 2013, salaries and benefits expense increased \$558 thousand, or 14.2 percent to \$4.5 million when compared to the same period in 2012, while other operating expenses increased \$520 thousand, or 18.6 percent for the nine months ended September 30, 2013 when compared to the same period in 2012.

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

**NONPERFORMING ASSETS:** Other real estate owned (OREO), loans past due in excess of 90 days and still accruing, and nonaccrual loans are considered nonperforming assets. These assets totaled \$9.7 million and \$15.2 million at September 30, 2013 and December 31, 2012, respectively.

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

|   | September 30,<br>2013 | June 30,<br>2013 | March 31,<br>2013 | December 31,<br>2012 | September 30,<br>2012 |
|---|-----------------------|------------------|-------------------|----------------------|-----------------------|
| Loans past due over 90 days<br>and still accruing                             | \$ —                  | \$ —             | \$ —              | \$ —                 | \$ —                  |
| Nonaccrual loans  | 6,891                 | 8,075            | 11,290            | 11,732               | 16,958                |
| Other real estate owned   | 2,759                 | 3,347            | 4,141             | 3,496                | 3,392                 |
| Total nonperforming assets  | \$ 9,650              | \$ 11,422        | \$ 15,431         | \$ 15,228            | \$ 20,350             |
| Accruing TDR's  | \$ 6,133              | \$ 6,131         | \$ 5,986          | \$ 6,415             | \$ 7,625              |
| Loans past due 30 through 89 days<br>and still accruing                       | \$ 2,039              | \$ 1,544         | \$ 1,791          | \$ 3,786             | \$ 2,244              |
| Classified loans (A)  | \$ 32,430             | \$ 32,123        | \$ 35,945         | \$ 32,014            | \$ 47,017             |
| Impaired loans (A)  | \$ 16,794             | \$ 17,977        | \$ 21,046         | \$ 18,147            | \$ 24,584             |
| Nonperforming loans as a % of<br>total loans                                  | 0.49                  | % 0.64           | % 0.97            | % 1.04               | % 1.55                |
| Nonperforming assets as a % of<br>total assets                                | 0.54                  | % 0.68           | % 0.94            | % 0.91               | % 1.29                |
| Nonperforming assets as a % of<br>total loans plus other real<br>estate owned | 0.69                  | % 0.91           | % 1.32            | % 1.34               | % 1.85                |

(A) Classified loans include all impaired loans. Impaired loans include all nonaccrual loans and all TDRs.

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

**PROVISION FOR LOAN LOSSES:** The provision for loan losses was \$750 thousand for both the third quarter of 2013 and the same quarter of 2012. The provision for loan losses was \$2.1 million for the first three quarters of 2013 compared to \$3.8 million for the same 2012 period. The amount of the loan loss provision and the level of the allowance for loan losses are based upon a number of factors including Management’s evaluation of probable losses inherent in the portfolio, after consideration of appraised collateral values, financial condition and past credit history of the borrowers as well as prevailing economic conditions. Commercial credits carry a higher risk profile, which is reflected in Management’s determination of the proper level of the allowance for loan losses.

The provision for loan losses of \$750 thousand in the third quarter of 2013 was primarily related to the changes in the specific reserves on impaired loans, net charge-offs and loan growth experienced by the Corporation.

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The overall allowance for loan losses was \$14.1 million as of September 30, 2013 compared to \$12.7 million at December 31, 2012. As a percentage of loans, the allowance for loan losses was 1.01 percent as of September 30, 2013 and 1.12 percent as of December 31, 2012. The specific reserves on impaired loans have increased to \$1.2 million at September 30, 2013 compared to \$813 thousand as of December 31, 2012. Total impaired loans were \$16.8 million and \$18.1 million as of September 30, 2013 and December 31, 2012, respectively. The general component of the allowance increased from \$11.9 million at December 31, 2012 to \$12.9 million at September 30, 2013. As a percentage of non-impaired loans, the general reserve remained relatively stable and was 0.94 percent and 1.07 percent at September 30, 2013 and December 31, 2012, respectively. Although the Corporation has experienced loan growth, there has been a shift in the loan portfolio to less risky loans, such as multi-family, from the riskier construction and commercial loans that carried higher general reserves.

A summary of the allowance for loan losses for the quarterly periods indicated follows:

| (In thousands)  | Sept 30,<br>2013 | June 30,<br>2013 | March 31,<br>2013 | Dec 31,<br>2012 | Sept 30,<br>2012 |
|---|------------------|------------------|-------------------|-----------------|------------------|
| Allowance for loan losses:                              |                  |                  |                   |                 |                  |
| Beginning of period                                     | \$ 13,438        | \$ 13,279        | \$ 12,735         | \$ 13,893       | \$ 13,686        |
| Provision for loan losses                               | 750              | 500              | 850               | 4,525           | 750              |
| Charge-offs, net  | (132 )           | (341 )           | (306 )            | (5,683 )        | (543 )           |
| End of period   | \$ 14,056        | \$ 13,438        | \$ 13,279         | \$ 12,735       | \$ 13,893        |
| Allowance for loan losses as a % of total loans         | 1.01 %           | 1.07 %           | 1.14 %            | 1.12 %          | 1.27 %           |
| Allowance for loan losses as a % of nonperforming loans | 203.98 %         | 166.41 %         | 117.62 %          | 108.55 %        | 81.93 %          |

**INCOME TAXES:** For the third quarters of 2013 and 2012, income tax expense as a percentage of pre-tax income was 39 percent for both periods. Income tax expense as a percentage of pre-tax income was 39 percent for the nine months ended September 30, 2013 and 2012.

**CAPITAL RESOURCES:** The Corporation's total shareholders' equity at September 30, 2013, was \$126.4 million compared to \$122.1 million at December 31, 2012. The primary reason for the increase is due to an increase in the Corporation's retained earnings in the first three quarters of 2013, offset by a decline in accumulated other comprehensive income.

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier 1 capital to risk-weighted assets and of Tier 1 Capital to average assets. For the third quarter of 2013, the Bank's capital ratios met or exceeded the minimum to be categorized as well capitalized under the regulatory framework for prompt corrective action. Tier 1 Capital consists of common stock, retained earnings, minority interests in the equity accounts of consolidated subsidiaries, non-cumulative preferred stock, and cumulative preferred stock issued to the U.S. Treasury in the Capital Purchase Program, less goodwill and certain other intangibles. The remainder of capital may consist of other preferred stock, certain other instruments and a portion of the allowance for loan loss. At September 30, 2013, the Bank's Tier 1 Capital and Total Capital ratios to risk-weighted assets were 11.01 percent and 12.26 percent, respectively, both in excess of the well-capitalized standards of 6.0 percent and 10.0 percent, respectively.

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In addition, the Federal Reserve Board has established minimum leverage ratio guidelines. At September 30, 2013, the Bank's leverage ratio was 7.01 percent, in excess of the well-capitalized standard of 5.0 percent.

At September 30, 2013, the Corporation's Tier 1 Capital and Total Capital ratios to risk-weighted assets were 11.30 percent and 12.55 percent, respectively, while the Corporation's leverage ratio was 7.20 percent.

In addition, the Corporation's equity ratio at September 30, 2013, was 7.03 percent compared to 7.32 percent at December 31, 2012 and 7.42 percent at September 30, 2012.

As previously announced, on October 17, 2013, the Board of Directors declared a regular cash dividend of \$0.05 per share payable on November 14, 2013 to shareholders of record on October 31, 2013.

On July 2, 2013, the Federal Reserve Board approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. The rules included a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5 percent and a common equity Tier 1 capital conservation buffer of 2.5 percent of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0 percent to 6.0 percent and require a minimum leverage ratio of 4.0 percent. The final rules also implement strict eligibility criteria for regulatory capital instruments. The phase-in period for the final rules will begin for the Corporation on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule. Management's evaluation shows the Bank will continue to be well capitalized.

**LIQUIDITY:** Liquidity refers to an institution's ability to meet short-term requirements including loan fundings, deposit withdrawals and maturing obligations. Principal sources of liquidity include cash, temporary investments, brokered deposits, securities available for sale, deposit inflows and loan repayments.

Management actively monitors and manages the Corporation's liquidity position and feels it is sufficient to meet future needs. Cash and cash equivalents, including federal funds sold and interest-earning deposits, totaled \$39.5 million at September 30, 2013. In addition, the Corporation has \$274.0 million in securities designated as available for sale at September 30, 2013. These securities can be sold in response to liquidity concerns. In addition, the Corporation generates significant liquidity from scheduled and unscheduled principal repayments of loans and mortgage-backed securities.

Another source of liquidity is borrowing capacity. At September 30, 2013, unused short-term or overnight borrowing commitments totaled \$461.1 million from the FHLB and \$29.4 million from correspondent banks.

**ASSET/LIABILITY MANAGEMENT:** The Corporation's Asset/Liability Committee (ALCO) is responsible for developing, implementing and monitoring asset/liability management strategies and reports and advising the Board of Directors on such, as well as the related level of interest rate risk. In this regard, interest rate risk simulation models are prepared on a quarterly basis. These models have the ability to demonstrate balance sheet gaps, and predict changes to net interest income and economic/market value of portfolio equity under various interest rate scenarios.

ALCO is generally authorized to manage interest rate risk through management of capital and management of cash flows and duration of assets and liabilities, including sales and purchases of assets, as well as additions of wholesale borrowings. ALCO has also recently been authorized to engage in interest rate swaps as a means of extending the duration of shorter term liabilities.

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The following strategies are among those used to manage interest rate risk:

- Actively market commercial mortgage loans, which tend to have shorter terms and higher interest rates than residential mortgage loans, and which generate customer relationships that can result in higher core deposit accounts;
- Actively market commercial & industrial loans, which tend to have adjustable rate features, and which generate customer relationships that can result in higher core deposit accounts;
- Actively market adjustable-rate and/or shorter-term residential mortgage loans;
- Actively sell longer duration residential mortgage loans originated in the current low rate environment;
- Actively market core deposit relationships, which are generally longer duration liabilities;
- Utilize medium to longer term wholesale borrowings and/or brokered deposits to extend liability duration;
- Utilize medium to longer term interest rate swaps as a means of extending duration of shorter term liabilities;
- Closely monitor and actively manage the investment portfolio, including management of duration, prepayment and interest rate risk; and
- Maintain adequate levels of capital.

At this time, the Corporation is not engaged in hedging through the use of interest rate swaps, nor does it use interest rate caps and floors. However, as noted above, ALCO has recently been authorized to engage in interest rate swaps as a means of extending the duration of shorter term liabilities.

As noted above, ALCO uses simulation modeling to analyze the Corporation’s net interest income sensitivity, as well as the Corporation’s economic value of portfolio equity under various interest rate scenarios. The model is based on the actual maturity and repricing characteristics of rate sensitive assets and liabilities. The model incorporates certain prepayment and interest rate assumptions, which management believes to be reasonable. The model assumes changes in interest rates without any proactive change in the balance sheet by management. In the model, the forecasted shape of the yield curve remains static as of September 30, 2013.

In an immediate and sustained 200 basis point increase in market rates at September 30, 2013, net interest income in year one would decline approximately 6 percent while net interest income for year two would improve approximately 1 percent, compared to a flat interest rate scenario.

In an immediate and sustained 100 basis point decrease in market rates at September 30, 2013, net interest income would decline approximately 4 percent in year one and 7 percent for year 2, compared to a flat interest rate scenario.

The table below shows the estimated changes in the Corporation’s economic value of portfolio equity (“EVPE”) that would result from an immediate parallel change in the market interest rates at September 30, 2013.

|  |  |
|--|--|
| Estimated Increase/<br>(Dollars in thousands) Decrease in EVPE | EVPE as a Percentage of<br>Present Value of Assets (2) |
|--|--|

| Change In Interest Rates<br>(Basis Points) | Estimated EVPE (1) | Amount   | Percent | EVPE Ratio (3) | Increase/(Decrease)<br>(basis points) |
|--|--------------------|----------|---------|----------------|---------------------------------------|
| +200                                       | 160,360            | (31,590) | (16.46) | 9.71           | (114.4 )                              |
| +100                                       | 180,854            | (11,096) | (5.78 ) | 10.56          | (29.1 )                               |
| Flat interest rates                        | 191,949            | —        | —       | 10.85          | —                                     |
| -100                                       | 195,439            | 3,490    | 1.82    | 10.80          | (5.7 )                                |

(1) EVPE is the discounted present value of expected cash flows from assets and liabilities.

(2) Present value of assets represents the discounted present value of incoming cash flows on interest-earning assets.

(3) EVPE ratio represents EVPE divided by the present value of assets.



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Certain shortcomings are inherent in the methodologies used in determining interest rate risk. Simulation modeling requires making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the modeling assumes that the composition of our interest-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or repricing of specific assets and liabilities. Accordingly, although the information provides an indication of our interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

### **RECENT ACCOUNTING PRONOUNCEMENTS:**

In February 2013, the FASB issued an Accounting Standards Update (“ASU”) to finalize the reporting requirements for reclassifications of amounts out of accumulated other comprehensive income (“AOCI”). Items reclassified out of AOCI to net income in their entirety must have the effect of the reclassification disclosed according to the respective income statement line item. This information must be provided either on the face of the financial statements by income statement line item, or in a footnote. For public companies, the amendments in the update became effective for interim and annual periods beginning on or after December 15, 2012. As of March 31, 2013, the Corporation enhanced its disclosure on the statement of income to comply with this ASU.

### **ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

There have been no material changes to information required regarding quantitative and qualitative disclosures about market risk from the end of the preceding fiscal year to the date of the most recent interim financial statements (September 30, 2013).

### **ITEM 4. Controls and Procedures**

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

The Corporation’s Chief Executive Officer and Chief Financial Officer have also concluded that there have not been any changes in the Corporation’s internal control over financial reporting during the quarter ended September 30, 2013 that have materially affected, or are reasonable likely to materially affect, the Corporation’s internal control over

financial reporting.

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

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**PART II. OTHER INFORMATION**

**ITEM 1A. Risk Factors**

The Corporation's risk factors disclosed in Part I, Item 1A of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012 are hereby amended and restated in their entirety.

*We may not be able to continue to grow our business, which may adversely impact our results of operations.*

Our business strategy calls for continued expansion. Our ability to continue to grow depends, in part, upon our ability to successfully attract deposits to existing and identify favorable loan and investment opportunities. We expect to add personnel to assist in this growth. In the event that we do not continue to grow, or the new personnel do not produce sufficient new revenues, our results of operations could be adversely impacted.

*We may not be able to manage our growth, which may adversely impact our financial results.*

As part of our expansion strategy, we plan to broaden and expand our multi-family, commercial real estate lending, commercial and industrial lending and residential mortgage businesses in both our existing and new geographic markets. In addition, as part of our expansion strategy, we may add new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. We may invest significant time and resources to develop and market new lines of business and/or products and services. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting customer preferences may also impact the successful implementation of a new line of business or a new product or service. Additionally, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks could have a material adverse effect on our business, results of operations and financial condition.

Our ability to implement our expansion strategy will depend upon a variety of factors, including our ability to attract and retain experienced personnel, the continued availability of desirable business opportunities and locations, the competitive responses from other financial institutions in the new market areas and our ability to manage growth. In order to implement our expansion strategy, we plan to hire new personnel in our existing and target markets. However, we may be unable to hire qualified management. In addition, the organizational and overhead costs may be greater than we anticipated. Moreover, we may not be able to obtain the regulatory approvals necessary. New business

expansion efforts may take longer than expected to reach profitability, and we cannot assure that they will become profitable. The additional costs of adding new personnel may adversely impact our financial results.

Our ability to manage growth successfully will depend on whether we can continue to fund this growth while maintaining cost controls and asset quality, as well as on factors beyond our control, such as national and regional economic conditions and interest rate trends. If we are not able to control costs and maintain asset quality, such growth could adversely impact our earnings and financial condition.

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The Company is required by Federal regulatory authorities to maintain adequate levels of capital to support its operations. The Company may at some point need to raise additional capital to support continued growth. The Company's ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside the Company's control, and on its financial performance. Accordingly, the Company cannot assure you of its ability to raise additional capital if needed or on terms acceptable to the Company. If the Company cannot raise additional capital when needed, the ability to further expand its operations could be materially impaired.

***The Dodd-Frank Wall Street Reform and Consumer Protection Act may adversely affect our business activities, financial position and profitability by increasing our regulatory compliance burden and associated costs, placing restrictions on certain products and services, and limiting our future capital raising strategies.***

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), which implements significant changes in the financial regulatory landscape and will impact all financial institutions, including the Company and the Bank. The Act has and is likely to continue to increase our regulatory compliance burden.

Among the Act's significant regulatory changes, it created the CFPB that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer protection. The CFPB has exclusive authority to issue regulations, orders and guidance to administer and implement the objectives of federal consumer protection laws. Moreover, the Act permits states to adopt stricter consumer protection laws and state attorney generals may enforce consumer protection rules issued by the CFPB. The Act also changes the scope of federal deposit insurance coverage, and increases the FDIC assessment payable by the Bank. The CFPB and these other changes have increased, and will continue to increase, our regulatory compliance burden and costs and may restrict the financial products and services we offer to our customers.

The Act also imposed more stringent capital requirements on bank holding companies by, among other things, imposing leverage ratios on bank holding companies and prohibiting new trust preferred issuances from counting as Tier I capital. These restrictions may limit our future capital strategies. The Act also increases regulation of derivatives and hedging transactions, which could limit our ability to enter into, or increase the costs associated with, interest rate and other hedging transactions.

Although certain provisions of the Act, such as required direct supervision by the CFPB, will not apply to banking organizations with less than \$10 billion of assets, such as the Company and the Bank, the changes resulting from the legislation will impact our business. New consumer protection rules issued by the CFPB will apply to us. These changes will require us to invest significant management attention and resources to evaluate and make necessary changes.

*Negative developments in the financial services industry and U.S. and global credit markets may adversely impact our operations and results.*

Our businesses and operations, which primarily consist of lending money to customers in the form of loans, borrowing money from customers in the form of deposits and investing in securities, are sensitive to general business and economic conditions in the United States. If the U.S. economy weakens, our growth and profitability from our lending, deposit and investment operations could be constrained. Uncertainty about the federal fiscal policymaking process, the medium and long-term fiscal outlook of the federal government and future tax rates is a concern for businesses, consumers and investors in the United States. In addition, economic conditions in foreign countries could affect the stability of global financial markets, which could hinder U.S. economic growth. Weak economic conditions are often characterized by deflation, fluctuations in debt and equity capital markets, a lack of liquidity and/or depressed prices in the secondary market for mortgage loans, increased delinquencies on mortgage, consumer and commercial loans, residential and commercial real estate price declines and lower home sales and commercial activity.

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The current economic environment is also characterized by interest rates at historically low levels, which impacts our ability to attract deposits and to generate attractive earnings through our investment portfolio. All of these factors are detrimental to our business, and the interplay between these factors can be complex and unpredictable. Our business is also significantly affected by monetary and related policies of the U.S. federal government and its agencies. Changes in any of these policies are influenced by macroeconomic conditions and other factors that are beyond our control. Adverse economic conditions and government policy responses to such conditions could have a material adverse effect on our business, financial condition, results of operations and prospects.

Uncertainty in the financial markets in general with the expectation of the general economic downturn continued in 2012 and through much of 2013. Loan portfolio performances have deteriorated at many institutions resulting from, amongst other factors, a weak economy and a decline in the value of the collateral supporting their loans. The competition for our deposits has increased significantly due to liquidity concerns at many of these same institutions. Stock prices of bank holding companies, like ours, have been negatively affected by the current condition of the financial markets, as has our ability, if needed, to raise capital or borrow in the debt markets compared to recent years. As a result, there is potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and financial institution regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement actions. Negative developments in the financial services industry and the impact of new legislation in response to those developments could negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance.

***We are more sensitive than our more geographically diversified competitors to adverse changes in the local economy.***

Much of our business is with customers located within Morris, Somerset, Middlesex, Union and Hunterdon Counties and contiguous counties. Our business loans are generally made to small to mid-sized businesses, most of whose success depends on the regional economy. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. Adverse economic and business conditions in our market area could reduce our growth rate, affect our borrowers' ability to repay their loans and, consequently, adversely affect our financial condition and performance. Further, we place substantial reliance on real estate as collateral for our loan portfolio. A sharp downturn in real estate values in our market area could leave many of our loans under-secured, which could adversely affect our earnings.

***If our allowance for loan losses were not sufficient to cover actual loan losses, our earnings would decrease.***

We maintain an allowance for loan losses based on, among other things, the level of non-performing loans, loan growth, national and regional economic conditions, historical loss experience, delinquency trends among loan types and various qualitative factors. However, we cannot predict loan losses with certainty and we cannot assure you that charge-offs in future periods will not exceed the allowance for loan losses. In addition, regulatory agencies, as an

integral part of their examination process, review our allowance for loan losses and may require additions to the allowance based on their judgment about information available to them at the time of their examination. Factors that require an increase in our allowance for loan losses could reduce our earnings.



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***Changes in interest rates may adversely affect our earnings and financial condition.***

Our net income depends primarily upon our net interest income. Net interest income is the difference between interest income earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and borrowed funds.

Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. We expect that we will periodically experience “gaps” in the interest rate sensitivities of our assets and liabilities. That means either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets, an increase in market rates of interest could reduce our net interest income. Likewise, when interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could reduce our net interest income. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control, including inflation, recession, unemployment, money supply, domestic and international events and changes in the United States and other financial markets.

***Our exposure to credit risk could adversely affect our earnings and financial condition.***

There are certain risks inherent in making loans, including risks that the principal of or interest on the loan will not be repaid timely or at all or that the value of any collateral supporting the loan will be insufficient to cover our outstanding exposure. These risks may be affected by the strength of the borrower’s business sector and local, regional and national market and economic conditions. Our risk management practices, such as monitoring the concentration of our loans within specific industries and our credit approval practices, may not adequately reduce credit risk, and our credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of the loan portfolio. Finally, many of our loans are made to small and medium-sized businesses that are less able to withstand competitive, economic and financial pressures than larger borrowers. A failure to effectively measure and limit the credit risk associated with our loan portfolio could have a material adverse effect on our business, financial condition, results of operations and prospects.

***Competition from other financial institutions in originating loans and attracting deposits may adversely affect our profitability.***

We face substantial competition in originating loans. This competition comes principally from other banks, savings institutions, mortgage banking companies and other lenders. Many of our competitors enjoy advantages, including greater financial resources and higher lending limits, a wider geographic presence, and more accessible branch office locations.

In attracting deposits, we face substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of our competitors enjoy advantages, including greater financial resources, more aggressive marketing campaigns, better brand recognition and more branch locations. These competitors may offer higher interest rates than we do, which could decrease the deposits that we attract or require us to increase our rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect our ability to generate the funds necessary for lending operations and increase our cost of funds.

We also compete with non-bank providers of financial services, such as brokerage firms, consumer finance companies, insurance companies and governmental organizations, which may offer more favorable terms. Some of our non-bank competitors are not subject to the same extensive regulations that govern our operations. As a result, such non-bank competitors may have advantages over us in providing certain products and services. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our earnings and financial condition.

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***Our commercial real estate loan portfolio exposes us to risks that may be greater than the risks related to our other mortgage loans.***

Our loan portfolio includes non-owner-occupied commercial real estate loans for individuals and businesses for various purposes, which are secured by commercial properties, as well as real estate construction and development loans. These loans typically involve repayment dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service. This may be adversely affected by changes in the economy or local market conditions. These loans expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be liquidated as easily as residential real estate. If we foreclose on these loans, our holding period for the collateral typically is longer than for a single or multi-family residential property because there are fewer potential purchasers of the collateral. Additionally, non-owner-occupied commercial real estate loans generally involve relatively large balances to single borrowers or related groups of borrowers. Accordingly, charge-offs on non-owner-occupied commercial real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios. Unexpected deterioration in the credit quality of our commercial real estate loan portfolio would require us to increase our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition, results of operations and prospects.

***We are subject to environmental liability risk associated with our lending activities.***

In the course of our business, we may purchase real estate, or we may foreclose on and take title to real estate. As a result, we could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination or may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. Any significant environmental liabilities could cause a material adverse effect on our business, financial condition, results of operations and prospects.

***Lack of seasoning of our loan portfolio could increase risk of credit defaults in the future.***

A large portion of loans in our loan portfolio and of our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as “seasoning.” As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because a large portion of our portfolio is relatively new, the current level of delinquencies and defaults may not represent the level that may prevail as the portfolio becomes more seasoned. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which could materially adversely affect our business, financial condition, results of operations and prospects.

***Deterioration in the fiscal position of the U.S. federal government could adversely affect us and our banking operations.***

The long-term outlook for the fiscal position of the U.S. federal government is uncertain, as illustrated by the recent budget negotiations and partial shutdown of the U.S. government in October 2013. In addition to causing economic and financial market disruptions, any future failure to raise the U.S. statutory debt limit, or deterioration in the fiscal outlook of the U.S. federal government, could, among other things, materially adversely affect the market value of the U.S. and other government and governmental agency securities that we hold, the availability of those securities as collateral for borrowing, and our ability to access capital markets on favorable terms. In particular, it could increase interest rates and disrupt payment systems, money markets, and long-term or short-term fixed income markets, adversely affecting the cost and availability of funding, which could negatively affect our profitability. Any of these developments could materially adversely affect our business, financial condition, results of operations and prospects.

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***Government regulation significantly affects our business.***

The banking industry is extensively regulated. Banking regulations are intended primarily to protect depositors, and the FDIC deposit insurance funds, not the shareholders of the Company. We are subject to regulation and supervision by the New Jersey Department of Banking and Insurance and the Federal Reserve Bank. Regulatory requirements affect our lending practices, capital structure, investment practices, dividend policy and growth. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law. We are subject to various regulatory capital requirements, which involve both quantitative measures of our assets and liabilities and qualitative judgments by regulators regarding risks and other factors. Failure to meet minimum capital requirements or comply with other regulations could result in actions by regulators that could adversely affect our ability to pay dividends or otherwise adversely impact operations. In addition, changes in laws, regulations and regulatory practices affecting the banking industry may limit the manner in which we conduct our business. Such changes may adversely affect us, including our ability to offer new products and services, obtain financing, attract deposits, make loans and achieve satisfactory spreads and may impose additional costs on us.

The Bank is also subject to a number of Federal laws, which, among other things, require it to lend to various sectors of the economy and population, and establish and maintain comprehensive programs relating to anti-money laundering and customer identification. The Bank's compliance with these laws will be considered by the Federal banking regulators when reviewing bank merger and bank holding company acquisitions or commencing new activities or making new investments in reliance on the Gramm-Leach-Bliley Act. As a public company, we are also subject to the corporate governance standards set forth in the Sarbanes-Oxley Act, as well as any rules or regulations promulgated by the SEC or the NASDAQ Stock Market.

***The short-term and long-term impact of the newly proposed regulatory capital rules is uncertain.***

In July 2013, the Federal Reserve Board, or Federal Reserve, published final rules establishing a new comprehensive capital framework for U.S. banking organizations, referred to herein as the Rules. The Federal Deposit Insurance Corporation, or FDIC, and the Office of the Comptroller of the Currency, or OCC, have adopted substantially identical rules (in the case of the FDIC, as interim final rules). The Rules implement the Basel Committee's December 2010 framework, commonly referred to as Basel III, for strengthening international capital standards as well as certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act. Basel III creates a new regulatory capital standard based on Tier 1 common equity and increases the minimum leverage and risk-based capital ratios applicable to all banking organizations. Basel III also changes how a number of the regulatory capital components are calculated. A significant increase in our capital requirement could reduce our growth and profitability and materially adversely affect our business, financial condition, results of operations and prospects.

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

FDIC insurance premiums increased substantially in 2009 and we may have to pay significantly higher FDIC premiums in the future. Market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. The FDIC adopted a revised risk-based deposit insurance assessment schedule on February 27, 2009, which raised regular deposit insurance premiums. On May 22, 2009, the FDIC also implemented a five basis point special assessment of each insured depository institution's total assets minus Tier 1 capital as of June 30, 2009, but no more than 10 basis points times the institution's assessment base for the second quarter of 2009, collected by the FDIC on September 30, 2009. The amount of this special assessment for the Bank was \$672 thousand. Additional special assessments may be imposed by the FDIC for future quarters at the same or higher levels.

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The Dodd-Frank Act revised the assessment rate schedule to provide initial base assessment rates ranging from five to 35 basis points and total base assessment rates ranging from 2.5 to 45 basis points. These changes, along with the use of all of our remaining FDIC insurance assessment credits in early 2009, may cause the premiums charged by the FDIC to increase. These actions could significantly increase our noninterest expense in 2013, 2014 and in future periods.

***We are subject to liquidity risk.***

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

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

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

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole as banking organizations face turmoil and domestic and worldwide credit markets deteriorate.

***Our information systems may experience a security breach, computer virus, or disruption of service.***

We rely heavily on communications and information systems to conduct our business, and provide customers with various products and services, including the ability to bank online. Despite positioning our communications and information systems environment to be capable of controlling, monitoring and proactively preventing security breaches, our network could become vulnerable to unauthorized access, computer viruses, phishing schemes and other security problems. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent

that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any failure, interruption, or breach in security or operational integrity of our systems could also result in failures or disruptions in our general ledger, deposit, loan, and other systems, and could subject us to additional regulatory scrutiny. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation.

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***The price of our common stock may fluctuate.***

The price of our common stock on the NASDAQ Global Select Market constantly changes and recently, given the uncertainty in the financial markets, has fluctuated widely. We expect that the market price of our common stock will continue to fluctuate. Holders of our common stock will be subject to the risk of volatility and changes in prices.

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

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

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

***Our ability to pay dividends to our common shareholders is limited.***

Since the principal source of income for the Company is dividends paid to the Company by the Bank, the Company's ability to pay dividends to its shareholders will depend on whether the Bank pays dividends to it. As a practical matter, restrictions on the ability of the Bank to pay dividends act as restrictions on the amount of funds available for the payment of dividends by the Company. As a New Jersey-chartered commercial bank, the Bank is subject to the restrictions on the payment of dividends contained in the New Jersey Banking Act of 1948, as amended. Under the Banking Act, the Bank may pay dividends only out of retained earnings, and out of surplus to the extent that surplus exceeds 50% of stated capital. The Company is also subject to FRB policies, which may, in certain circumstances, limit its ability to pay dividends. The FRB policies require, among other things, that a bank holding company maintain a minimum capital base and the FRB in supervisory guidance has cautioned bank holding companies about paying out too much of their earnings in dividends and has stated that banks should not pay out more in dividends than they earn. The FRB would most likely seek to prohibit any dividend payment that would reduce a holding company's capital below these minimum amounts.



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***We may lose lower-cost funding sources.***

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

***There may be changes in accounting policies or accounting standards.***

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

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

***We encounter continuous technological change.***

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could

have a material adverse impact on our business and, in turn, our financial condition and results of operations.

*We are subject to operational risk.*

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

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

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

*There may be claims and litigation pertaining to fiduciary responsibility.*

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

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

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

## **ITEM 6. Exhibits**

- 3 Articles of Incorporation and By-Laws:
  - A. Certificate of Incorporation of the Registrant, as amended, incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q filed on November 9, 2009.
  - B. By-Laws of the Registrant, incorporated herein by reference to the Registrant's Current Report on Form 8-K filed on April 23, 2007 (File No. 001-16197).
- 31.1 Certification of Douglas L. Kennedy, Chief Executive Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).
- 31.2 Certification of Jeffrey J. Carfora, Chief Financial Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).

32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by Douglas L. Kennedy, Chief Executive Officer of the Corporation, and Jeffrey J. Carfora, Chief Financial Officer of the Corporation.

101 Interactive Data File \*

\* As provided in Rule 406T of Regulation S-T, this information is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933 and is deemed not filed for the purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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**SIGNATURES**

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

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**  
(Registrant)

DATE: November 1, 2013 By: /s/ Douglas L. Kennedy  
Douglas L. Kennedy  
President and Chief Executive Officer

DATE: November 1, 2013 By: /s/ Jeffrey J. Carfora  
Jeffrey J. Carfora  
Senior Executive Vice President and Chief Financial Officer and  
Chief Accounting Officer

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**EXHIBIT INDEX**

NumberDescription

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