

LAKELAND BANCORP INC  
Form 10-Q  
August 07, 2015  
Table of Contents

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 quarterly period ended June 30, 2015

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 number 000-17820

LAKELAND BANCORP, INC.

(Exact name of registrant as specified in its charter)

New Jersey  
(State or other jurisdiction of

incorporation or organization)

250 Oak Ridge Road, Oak Ridge, New Jersey  
(Address of principal executive offices)

22-2953275  
(I.R.S. Employer

Identification No.)

07438  
(Zip Code)

(973) 697-2000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)

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

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, any Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act: (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting Company

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

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of July 31, 2015, there were 37,903,909 outstanding shares of Common Stock, no par value.

**Table of Contents**

LAKELAND BANCORP, INC.

Form 10-Q Index

|   | PAGE |
|---|------|
| <b>Part I Financial Information</b>   |      |
| Item 1. Financial Statements:   |      |
| <u>Consolidated Balance Sheets - June 30, 2015 (unaudited) and December 31, 2014</u>  | 3    |
| <u>Consolidated Statements of Income - Unaudited Three and Six Months Ended June 30, 2015 and 2014</u>                      | 4    |
| <u>Consolidated Statements of Comprehensive Income (Loss) - Unaudited Three and Six Months Ended June 30, 2015 and 2014</u> | 5    |
| <u>Consolidated Statements of Changes in Stockholders' Equity - Unaudited Six Months Ended June 30, 2015</u>                | 6    |
| <u>Consolidated Statements of Cash Flows - Unaudited Six Months Ended June 30, 2015 and 2014</u>                            | 7    |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>   | 8    |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 33   |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 47   |
| Item 4. <u>Controls and Procedures</u>  | 48   |
| <b><u>Part II Other Information</u></b>   |      |
| Item 1. <u>Legal Proceedings</u>  | 49   |
| Item 1A. <u>Risk Factors</u>  | 49   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 49   |
| Item 3. <u>Defaults Upon Senior Securities</u>  | 49   |
| Item 4. <u>Mine Safety Disclosures</u>  | 49   |
| Item 5. <u>Other Information</u>  | 49   |
| Item 6. <u>Exhibits</u>   | 49   |
| <u>Signatures</u>   | 50   |

The Securities and Exchange Commission maintains a web site which contains reports, proxy and information statements and other information relating to registrants that file electronically

at the address:

<http://www.sec.gov>.

**Table of Contents****Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

|   | June 30, 2015   | December 31,       |
|---|---|--------------------|
|   | (unaudited)   | 2014               |
|   | (dollars in thousands except share and per share amounts) |                    |
| <b>ASSETS:</b>  |   |                    |
| Cash  | \$118,207   | \$102,549          |
| Interest-bearing deposits due from banks  | 19,359  | 6,767              |
| Total cash and cash equivalents   | 137,566   | 109,316            |
| Investment securities available for sale, at fair value   | 461,686   | 457,449            |
| Investment securities held to maturity; fair value of \$123,585 at June 30, 2015 and \$109,030 at December 31, 2014 | 123,133   | 107,976            |
| Federal Home Loan Bank and other membership bank stock, at cost   | 12,779  | 9,846              |
| Loans held for sale   | 3,348   | 592                |
| Loans, net of deferred costs (fees)   | 2,754,517   | 2,653,826          |
| Less: allowance for loan and lease losses   | 30,174  | 30,684             |
| Net loans   | 2,724,343   | 2,623,142          |
| Premises and equipment, net   | 35,524  | 35,675             |
| Accrued interest receivable   | 8,911   | 8,896              |
| Goodwill  | 109,974   | 109,974            |
| Other identifiable intangible assets  | 1,742   | 1,960              |
| Bank owned life insurance   | 61,869  | 57,476             |
| Other assets  | 18,252  | 16,023             |
| <b>TOTAL ASSETS</b>   | <b>\$3,699,127</b>  | <b>\$3,538,325</b> |

**LIABILITIES**

|  |                  |                  |
|--|------------------|------------------|
| Deposits:  |                  |                  |
| Noninterest bearing  | \$714,227        | \$646,052        |
| Savings and interest-bearing transaction accounts                          | 1,822,295        | 1,864,805        |
| Time deposits under \$100 thousand   | 165,105          | 165,625          |
| Time deposits \$100 thousand and over                                      | 141,326          | 114,337          |
| Total deposits   | 2,842,953        | 2,790,819        |
| Federal funds purchased and securities sold under agreements to repurchase | 146,249          | 108,935          |
| Other borrowings   | 262,728          | 202,498          |
| Subordinated debentures  | 41,238           | 41,238           |
| Other liabilities  | 15,099           | 15,397           |
| <b>TOTAL LIABILITIES</b>   | <b>3,308,267</b> | <b>3,158,887</b> |

**STOCKHOLDERS EQUITY**

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|   |                    |                    |
|---|--------------------|--------------------|
| Common stock, no par value; authorized shares, 70,000,000;<br>issued 37,903,282 shares at June 30, 2015 and 37,910,840<br>shares at December 31, 2014 | 385,565            | 384,731            |
| Retained earnings (Accumulated deficit)   | 3,281              | (6,816)            |
| Accumulated other comprehensive income  | 2,014              | 1,523              |
| <b>TOTAL STOCKHOLDERS EQUITY</b>  | <b>390,860</b>     | <b>379,438</b>     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS<br/>EQUITY</b>  | <b>\$3,699,127</b> | <b>\$3,538,325</b> |

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

**Table of Contents****Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF INCOME - UNAUDITED**

For the Three Months Ended June 30 For the Six Months Ended June 30,  
2015 2014 2015 2014  
(In thousands, except per share data)

|  | 2015          | 2014          | 2015          | 2014          |
|--|---------------|---------------|---------------|---------------|
| <b>INTEREST INCOME</b>   |               |               |               |               |
| Loans, leases and fees   | \$28,211      | \$27,558      | \$56,107      | \$54,456      |
| Federal funds sold and interest-bearing deposits with banks                | 11            | 9             | 23            | 22            |
| Taxable investment securities and other                                    | 2,688         | 2,515         | 5,362         | 5,061         |
| Tax-exempt investment securities   | 398           | 467           | 808           | 940           |
| <b>TOTAL INTEREST INCOME</b>   | <b>31,308</b> | <b>30,549</b> | <b>62,300</b> | <b>60,479</b> |
| <b>INTEREST EXPENSE</b>  |               |               |               |               |
| Deposits   | 1,346         | 1,243         | 2,629         | 2,506         |
| Federal funds purchased and securities sold under agreements to repurchase | 37            | 35            | 59            | 50            |
| Other borrowings   | 1,256         | 852           | 2,425         | 1,659         |
| <b>TOTAL INTEREST EXPENSE</b>  | <b>2,639</b>  | <b>2,130</b>  | <b>5,113</b>  | <b>4,215</b>  |
| <b>NET INTEREST INCOME</b>   | <b>28,669</b> | <b>28,419</b> | <b>57,187</b> | <b>56,264</b> |
| Provision for loan and lease losses  | 740           | 1,593         | 1,610         | 3,082         |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES</b>       | <b>27,929</b> | <b>26,826</b> | <b>55,577</b> | <b>53,182</b> |
| <b>NONINTEREST INCOME</b>  |               |               |               |               |
| Service charges on deposit accounts  | 2,450         | 2,663         | 4,790         | 5,222         |
| Commissions and fees   | 1,196         | 1,082         | 2,503         | 2,095         |
| Gains on sales and calls of investment securities                          | 17            | ---           | 17            | 2             |
| Gains on sales of loans  | 464           | 152           | 729           | 235           |
| Income on bank owned life insurance  | 388           | 365           | 1,087         | 725           |
| Other income   | 443           | 109           | 570           | 165           |
| <b>TOTAL NONINTEREST INCOME</b>  | <b>4,958</b>  | <b>4,371</b>  | <b>9,696</b>  | <b>8,444</b>  |
| <b>NONINTEREST EXPENSE</b>   |               |               |               |               |
| Salaries and employee benefits   | 12,144        | 11,200        | 23,894        | 22,013        |
| Net occupancy expense  | 2,273         | 2,041         | 4,821         | 4,658         |
| Furniture and equipment  | 1,629         | 1,660         | 3,285         | 3,353         |
| Stationery, supplies and postage   | 377           | 334           | 742           | 688           |
| Marketing expense  | 416           | 476           | 656           | 862           |
| FDIC insurance expense   | 531           | 511           | 1,049         | 1,012         |
| Legal expense  | 325           | 219           | 441           | 492           |
| Expenses on other real estate owned and other repossessed assets           | 27            | 100           | 19            | 115           |
| Core deposit intangible amortization                                       | 107           | 119           | 218           | 242           |
| Other expenses   | 3,366         | 2,870         | 6,112         | 5,837         |

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|  |                |                |                 |                 |
|--|----------------|----------------|-----------------|-----------------|
| TOTAL NONINTEREST EXPENSE                | 21,195         | 19,530         | 41,237          | 39,272          |
| Income before provision for income taxes | 11,692         | 11,667         | 24,036          | 22,354          |
| Income tax expense                       | 3,830          | 3,886          | 7,844           | 7,410           |
| <b>NET INCOME</b>                        | <b>\$7,862</b> | <b>\$7,781</b> | <b>\$16,192</b> | <b>\$14,944</b> |

**PER SHARE OF COMMON STOCK**

|                  |         |         |         |         |
|------------------|---------|---------|---------|---------|
| Basic earnings   | \$0.21  | \$0.20  | \$0.42  | \$0.39  |
| Diluted earnings | \$0.21  | \$0.20  | \$0.42  | \$0.39  |
| Dividends        | \$0.085 | \$0.071 | \$0.160 | \$0.142 |

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



**Table of Contents****Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME-UNAUDITED**

|  | For the Three Months Ended June 30, |                 | For the Six Months Ended June 30, |                 |
|--|-------------------------------------|-----------------|-----------------------------------|-----------------|
|  | 2015                                | 2014            | 2015                              | 2014            |
|  | (in thousands)                      |                 | (in thousands)                    |                 |
| <b>NET INCOME</b>                                  | <b>\$7,862</b>                      | <b>\$7,781</b>  | <b>\$16,192</b>                   | <b>\$14,944</b> |
| <b>OTHER COMPREHENSIVE INCOME, NET OF TAX:</b>     |                                     |                 |                                   |                 |
| Unrealized securities (losses) gains during period | (2,177)                             | 2,797           | 498                               | 5,785           |
| Reclassification for gains included in net income  | (17)                                | ---             | (17)                              | (2)             |
| Change in pension liability, net                   | 5                                   | 5               | 10                                | 10              |
| Other Comprehensive Income (Loss)                  | (2,189)                             | 2,802           | 491                               | 5,793           |
| <b>TOTAL COMPREHENSIVE INCOME</b>                  | <b>\$5,673</b>                      | <b>\$10,583</b> | <b>\$16,683</b>                   | <b>\$20,737</b> |

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

Table of Contents**Lakeland Bancorp, Inc. and Subsidiaries**

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY - UNAUDITED

**Six Months Ended June 30, 2015**

|  | Common<br>Stock | Retained<br>Earnings<br>(Accumulated<br>deficit)<br>(dollars in thousands) | Accumulated<br>Other<br>Comprehensive<br>Income | Total     |
|--|-----------------|--|---|-----------|
| BALANCE January 1, 2015                                  | \$384,731       | (\$6,816)  | \$1,523   | \$379,438 |
| Net Income   | ---             | 16,192   | ---   | 16,192    |
| Other comprehensive income, net of tax                   | ---             | ---  | 491   | 491       |
| Stock based compensation                                 | 912             | ---  | ---   | 912       |
| Retirement of restricted stock                           | (250)           | ---  | ---   | (250)     |
| Exercise of stock options, net of excess tax<br>benefits | 172             | ---  | ---   | 172       |
| Cash dividends, common stock                             | ---             | (6,095)  | ---   | (6,095)   |
| BALANCE June 30, 2015<br>(UNAUDITED)                     | \$385,565       | \$3,281  | \$2,014   | \$390,860 |

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

Table of Contents**Lakeland Bancorp, Inc. and Subsidiaries**

## CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

|  | For the Six Months Ended<br>June 30, |                  |
|--|--------------------------------------|------------------|
|  | 2015                                 | 2014             |
|  | (dollars in thousands)               |                  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                                      |                  |
| Net income   | \$16,192                             | \$14,944         |
| Adjustments to reconcile net income to net cash provided by operating activities:      |                                      |                  |
| Net amortization of premiums, discounts and deferred loan fees and costs               | 2,009                                | 1,808            |
| Depreciation and amortization  | 1,914                                | 1,807            |
| Amortization of intangible assets  | 218                                  | 242              |
| Provision for loan and lease losses  | 1,610                                | 3,082            |
| Loans originated for sale  | (34,649)                             | (8,450)          |
| Proceeds from sales of loans   | 32,622                               | 9,492            |
| Gains on sales and calls of securities   | (17)                                 | (2)              |
| Gains on sales of loans held for sale  | (729)                                | (235)            |
| Gains on other real estate and other repossessed assets                                | (144)                                | (65)             |
| Losses on sales of premises and equipment  | 2                                    | 19               |
| Stock-based compensation   | 912                                  | 638              |
| Increase in other assets   | (3,535)                              | (813)            |
| Decrease in other liabilities  | (281)                                | (1,863)          |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                       | <b>16,124</b>                        | <b>20,604</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                                      |                  |
| Proceeds from repayments on and maturity of securities:                                |                                      |                  |
| Available for sale   | 37,946                               | 24,738           |
| Held to maturity   | 8,804                                | 11,217           |
| Proceeds from sales of securities  |                                      |                  |
| Available for sale   | 11,472                               | 15,646           |
| Held to maturity   | ---                                  | 1,374            |
| Purchase of securities:  |                                      |                  |
| Available for sale   | (54,241)                             | (17,133)         |
| Held to maturity   | (24,245)                             | (16,497)         |
| Purchase of bank owned life insurance  | (4,078)                              | ---              |
| Proceeds from bank owned life insurance policy   | 772                                  | ---              |
| Net increase in Federal Home Loan Bank Stock   | (2,933)                              | (1,873)          |
| Net increase in loans and leases   | (103,750)                            | (143,585)        |
| Proceeds from sales of other real estate and repossessed assets                        | 853                                  | 455              |
| Proceeds from dispositions of premises and equipment                                   | 4                                    | ---              |
| Capital expenditures   | (2,053)                              | (1,056)          |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>   | <b>(131,449)</b>                     | <b>(126,714)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                                      |                  |
| Net increase in deposits   | 52,204                               | 17,737           |
| Increase in federal funds purchased and securities sold under agreements to repurchase | 37,314                               | 74,520           |
| Proceeds from other borrowings   | 70,230                               | 130,000          |

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|  |                  |                  |
|--|------------------|------------------|
| Repayments of other borrowings                                     | (10,000)         | (75,000)         |
| Excess tax benefits  | 59               | 65               |
| Exercise of stock options  | 113              | 142              |
| Retirement of restricted stock                                     | (250)            | (56)             |
| Issuance of stock to dividend reinvestment and stock purchase plan | ---              | 64               |
| Dividends paid   | (6,095)          | (5,118)          |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>                   | <b>143,575</b>   | <b>142,354</b>   |
| Net increase in cash and cash equivalents                          | 28,250           | 36,244           |
| Cash and cash equivalents, beginning of period                     | 109,316          | 102,721          |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>                    | <b>\$137,566</b> | <b>\$138,965</b> |

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

**Table of Contents**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 1. Significant Accounting Policies**

*Basis of Presentation.*

This quarterly report presents the consolidated financial statements of Lakeland Bancorp, Inc. (the Company) and its subsidiary, Lakeland Bank (Lakeland). The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America (U.S. GAAP) and predominant practices within the banking industry.

The Company's unaudited interim financial statements reflect all adjustments, such as normal recurring accruals that are, in the opinion of management, necessary for the fair presentation of the results of the interim periods. The results of operations for the six months ended June 30, 2015 do not necessarily indicate the results that the Company will achieve for all of 2015. You should read these interim financial statements in conjunction with the audited consolidated financial statements and accompanying notes that are presented in the Lakeland Bancorp, Inc. Annual Report on Form 10-K for the year ended December 31, 2014.

On May 21, 2014, the Company's Board of Directors authorized a 5% stock dividend which was distributed on June 17, 2014 to holders of record as of June 3, 2014. All weighted average, actual share and per share information set forth in this Quarterly Report on Form 10-Q have been adjusted retroactively for the effects of the stock dividend.

The financial information in this quarterly report has been prepared in accordance with the Company's customary accounting practices. Certain information and footnote disclosures required under U.S. GAAP have been condensed or omitted, as permitted by rules and regulations of the Securities and Exchange Commission.

Certain reclassifications have been made to prior period financial statements to conform to the 2015 presentation.

**Note 2. Share-Based Compensation**

The Company grants stock options, restricted stock and restricted stock units (RSUs) under the 2009 Equity Compensation Program. Share-based compensation expense of \$912,000 and \$638,000 was recognized for the six months ended June 30, 2015 and 2014, respectively. As of June 30, 2015, there was unrecognized compensation cost of \$441,000 related to unvested restricted stock; that cost is expected to be recognized over a weighted average period of approximately 1.8 years. Unrecognized compensation expense related to unvested stock options was approximately \$67,000 as of June 30, 2015 and is expected to be recognized over a period of 1.9 years. Unrecognized compensation expense related to RSUs was approximately \$1.5 million as of June 30, 2015, and that cost is expected to be recognized over a period of 1.7 years.

In the first six months of 2014, the Company granted 1,942 shares of restricted stock at a grant date fair value of \$11.21 per share under the 2009 Equity Compensation Program. Compensation expense on these shares is expected to average approximately \$4,000 per year over a five year period.

In the first six months of 2015, the Company granted 129,509 RSUs at a weighted average grant date fair value of \$11.06 per share under the Company's 2009 Equity Compensation Program. These units vest within a range of two to three years. A portion of these RSUs will vest subject to certain performance conditions in the restricted stock unit agreement. There are also certain provisions in the compensation program which state that if a holder of the RSUs reaches a certain age and years of service, the person has effectively earned a portion of the RSUs at that time.

Compensation expense on these restricted stock units is expected to average approximately \$477,000 per year over a three year period. In the first six months of 2014, the Company granted 127,797 RSUs at a weighted average grant date fair value of \$10.66 per share under the Company's 2009 Equity Compensation Program. Compensation expense on these RSUs is expected to average approximately \$453,000 per year over a three year period.

There were no grants of stock options in the first six months of 2015 or 2014.

**Table of Contents**

Option activity under the Company's stock option plans is as follows:

|                                      | Number of shares | Weighted average exercise price | Weighted remaining average contractual term (in years) | Aggregate intrinsic value |
|--------------------------------------|------------------|---------------------------------|--|---------------------------|
| Outstanding, January 1, 2015         | 311,705          | \$9.69                          |  | \$681,861                 |
| Issued                               | ---              | ---                             |  |                           |
| Exercised                            | (15,500)         | 7.30                            |  |                           |
| Forfeited                            | (3,462)          | 12.28                           |  |                           |
| Expired                              | ---              | ---                             |  |                           |
| Outstanding, June 30, 2015           | 292,743          | \$9.78                          | 3.76   | \$653,340                 |
| Options exercisable at June 30, 2015 | 271,743          | \$9.80                          | 3.43   | \$601,293                 |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the first half of 2015 and the exercise price, multiplied by the number of in-the-money options).

The aggregate intrinsic value of stock options exercised during the six months ended June 30, 2015 and 2014 was \$63,000 and \$42,000, respectively. Exercise of stock options during the first six months of 2015 and 2014 resulted in cash receipts of \$113,000 and \$86,000, respectively.

Information regarding the Company's restricted stock and changes during the six months ended June 30, 2015 is as follows:

|                              | Number of shares | Weighted average price |
|------------------------------|------------------|------------------------|
| Outstanding, January 1, 2015 | 160,284          | \$9.21                 |
| Granted                      | ---              | ---                    |
| Vested                       | (86,470)         | 9.11                   |
| Forfeited                    | (88)             | 9.39                   |
| Outstanding, June 30, 2015   | 73,726           | \$9.32                 |

Information regarding the Company's RSUs (all unvested) and changes during the six months ended June 30, 2015 is as follows:

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|                              | Number of<br>shares | Weighted<br>average<br>price |
|------------------------------|---------------------|------------------------------|
| Outstanding, January 1, 2015 | 98,535              | \$ 10.64                     |
| Granted                      | 129,509             | 11.06                        |
| Vested                       | (25,566)            | 11.02                        |
| Forfeited                    | (515)               | 10.74                        |
| Outstanding, June 30, 2015   | 201,963             | \$ 10.86                     |



**Table of Contents****Note 3. Comprehensive Income**

The components of other comprehensive income are as follows:

|   | June 30, 2015           |  |                      | June 30, 2014           |  |                         |
|---|-------------------------|--|----------------------|-------------------------|--|-------------------------|
|   | Before<br>tax<br>amount | Tax Benefit<br>(Expense)<br>(in thousands) | Net of<br>tax amount | Before<br>tax<br>amount | Tax Benefit<br>(Expense)<br>(in thousands) | Net of<br>tax<br>amount |
| For the quarter ended:  |                         |  |                      |                         |  |                         |
| Net unrealized gains on available for sale securities               |                         |  |                      |                         |  |                         |
| Net unrealized holding gains (losses) arising during period         | (\$3,466)               | \$1,289                                    | (\$2,177)            | \$4,325                 | (\$1,528)                                  | \$2,797                 |
| Reclassification adjustment for net gains arising during the period | (26)                    | 9  | (17)                 | ---                     | ---  | ---                     |
| Net unrealized gains (losses)                                       | (\$3,492)               | \$1,298                                    | (\$2,194)            | \$4,325                 | (\$1,528)                                  | \$2,797                 |
| Change in minimum pension liability                                 | 8                       | (3)  | 5                    | 8                       | (3)  | 5                       |
| Other comprehensive income (loss), net                              | (\$3,484)               | \$1,295                                    | (\$2,189)            | \$4,333                 | (\$1,531)                                  | \$2,802                 |
| For the six months ended:   |                         |  |                      |                         |  |                         |
| Net unrealized gains on available for sale securities               |                         |  |                      |                         |  |                         |
| Net unrealized holding gains arising during period                  | \$759                   | (\$261)                                    | \$498                | \$9,040                 | (\$3,255)                                  | \$5,785                 |
| Reclassification adjustment for net gains arising during the period | (26)                    | 9  | (17)                 | (3)                     | 1  | (2)                     |
| Net unrealized gains  | \$733                   | (\$252)                                    | \$481                | \$9,037                 | (\$3,254)                                  | \$5,783                 |
| Change in minimum pension liability                                 | 16                      | (6)  | 10                   | 16                      | (6)  | 10                      |
| Other comprehensive income, net                                     | \$749                   | (\$258)                                    | \$491                | \$9,053                 | (\$3,260)                                  | \$5,793                 |

The following table shows the changes in the balances of each of the components of other comprehensive income for the periods presented:

**Table of Contents**

## Changes in Accumulated Other Comprehensive Income by Component (a)

|   | For the Three Months Ended<br>June 30, 2015                   |                  |         | For the Three Months Ended<br>June 30, 2014                            |                  |           |
|---|---|------------------|---------|--|------------------|-----------|
|   | Unrealized<br>Gains<br>on<br>Available-for-sale<br>Securities | Pension<br>Items | Total   | Unrealized Gains<br>(Losses)<br>on<br>Available-for-sale<br>Securities | Pension<br>Items | Total     |
| Beginning Balance   | \$4,206   | (\$3)            | \$4,203 | (\$1,661)  | (\$23)           | (\$1,684) |
| (in thousands)  |   |                  |         |  |                  |           |
| Other comprehensive income (loss) before<br>classifications         | (2,177)   | 5                | (2,172) | 2,797  | 5                | 2,802     |
| Amounts reclassified from accumulated other<br>comprehensive income | (17)  | ---              | (17)    | ---  | ---              | ---       |
| Net current period other comprehensive income<br>(loss)             | (2,194)   | 5                | (2,189) | 2,797  | 5                | 2,802     |
| Ending balance  | \$2,012   | \$2              | \$2,014 | \$1,136  | (\$18)           | \$1,118   |

(a) All amounts are net of tax.

## Changes in Accumulated Other Comprehensive Income by Component (a)

|   | For the Six Months Ended<br>June 30, 2015                                      |                  |         | For the Six Months Ended<br>June 30, 2014                                      |                  |           |
|---|--|------------------|---------|--|------------------|-----------|
|   | Unrealized<br>Gains<br>and<br>Losses<br>on<br>Available-for-sale<br>Securities | Pension<br>Items | Total   | Unrealized<br>Gains<br>and<br>Losses<br>on<br>Available-for-sale<br>Securities | Pension<br>Items | Total     |
| Beginning Balance   | \$1,531  | (\$8)            | \$1,523 | (\$4,647)  | (\$28)           | (\$4,675) |
| (in thousands)  |  |                  |         |  |                  |           |
| Other comprehensive income before<br>classifications                | 498  | 10               | 508     | 5,785  | 10               | 5,795     |
| Amounts reclassified from accumulated other<br>comprehensive income | (17)   | ---              | (17)    | (2)  | ---              | (2)       |

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|   |         |     |         |         |        |         |
|---|---------|-----|---------|---------|--------|---------|
| Net current period other comprehensive income | 481     | 10  | 491     | 5,783   | 10     | 5,793   |
| Ending balance                                | \$2,012 | \$2 | \$2,014 | \$1,136 | (\$18) | \$1,118 |

(a) All amounts are net of tax.

**Table of Contents****Note 4. Statement of Cash Flow Information, Supplemental Information**

|  | For the Six Months Ended |         |
|--|--------------------------|---------|
|  | June 30,                 | 2014    |
|  | 2015                     |         |
| Supplemental schedule of noncash investing and financing activities:                   |                          |         |
|  | (in thousands)           |         |
| Cash paid during the period for income taxes   | \$7,645                  | \$6,657 |
| Cash paid during the period for interest   | 5,016                    | 4,225   |
| Transfer of loans and leases into other repossessed assets and other real estate owned | 760                      | 722     |

**Note 5. Earnings Per Share**

The following schedule shows the Company's earnings per share for the periods presented:

| (In thousands, except per share data)                            | For the Three Months Ended |         | For the Six Months Ended |          |
|--|----------------------------|---------|--------------------------|----------|
|  | June 30,                   | 2014    | June 30,                 | 2014     |
|  | 2015                       |         | 2015                     |          |
| Net income available to common shareholders                      | \$7,862                    | \$7,781 | \$16,192                 | \$14,944 |
| Less: earnings allocated to participating securities             | 68                         | 62      | 120                      | 97       |
| Net income allocated to common shareholders                      | \$7,794                    | \$7,719 | \$16,072                 | \$14,847 |
| Weighted average number of common shares outstanding - basic (1) | 37,854                     | 37,740  | 37,827                   | 37,711   |
| Share-based plans (1)  | 134                        | 110     | 134                      | 117      |
| Weighted average number of common shares - diluted (1)           | 37,988                     | 37,850  | 37,961                   | 37,828   |
| Basic earnings per share   | \$0.21                     | \$0.20  | \$0.42                   | \$0.39   |
| Diluted earnings per share                                       | \$0.21                     | \$0.20  | \$0.42                   | \$0.39   |

(1) Adjusted for 5% stock dividend distributed June 17, 2014 to shareholders of record on June 3, 2014 .

Options to purchase 83,437 shares of common stock at a weighted average price of \$12.29 per share were outstanding and were not included in the computations of diluted earnings per share for the three and six months ended June 30, 2015 because the exercise price was greater than the average market price.

Options to purchase 357,163 shares of common stock at a weighted average price of \$11.91 per share were outstanding and were not included in the computation of diluted earnings per share for the three and six months ended June 30, 2014 because the exercise price was greater than the average market price.



**Table of Contents****Note 6. Investment Securities**

| AVAILABLE FOR SALE                               | June 30, 2015                    |                        |                         | Fair Value | December 31, 2014                |                        |                         | Fair Value |
|--|----------------------------------|------------------------|-------------------------|------------|----------------------------------|------------------------|-------------------------|------------|
|  | Amortized Cost<br>(in thousands) | Gross Unrealized Gains | Gross Unrealized Losses |            | Amortized Cost<br>(in thousands) | Gross Unrealized Gains | Gross Unrealized Losses |            |
| U.S. treasury and U.S. government agencies       | \$100,385                        | \$419                  | \$(593)                 | \$100,211  | \$94,466                         | \$261                  | \$(807)                 | \$93,920   |
| Mortgage-backed securities, residential          | 300,443                          | 2,771                  | (1,815)                 | 301,399    | 309,162                          | 2,868                  | (2,075)                 | 309,955    |
| Mortgage-backed securities, multifamily          | 10,277                           | 11                     | (68)                    | 10,220     | 4,973                            | 3                      | ---                     | 4,976      |
| Obligations of states and political subdivisions | 30,597                           | 723                    | (232)                   | 31,088     | 29,764                           | 888                    | (133)                   | 30,519     |
| Other debt securities                            | 496                              | 7                      | ---                     | 503        | 494                              | 11                     | ---                     | 505        |
| Equity securities                                | 16,361                           | 2,145                  | (241)                   | 18,265     | 16,196                           | 1,589                  | (211)                   | 17,574     |
|  | \$458,559                        | \$6,076                | \$(2,949)               | \$461,686  | \$455,055                        | \$5,620                | \$(3,226)               | \$457,449  |

| HELD TO MATURITY                                 | June 30, 2015                    |                        |                         | Fair Value | December 31, 2014                |                        |                         | Fair Value |
|--|----------------------------------|------------------------|-------------------------|------------|----------------------------------|------------------------|-------------------------|------------|
|  | Amortized Cost<br>(in thousands) | Gross Unrealized Gains | Gross Unrealized Losses |            | Amortized Cost<br>(in thousands) | Gross Unrealized Gains | Gross Unrealized Losses |            |
| U.S. government agencies                         | \$35,509                         | \$317                  | \$(164)                 | \$35,662   | \$20,477                         | \$232                  | \$(84)                  | \$20,625   |
| Mortgage-backed securities, residential          | 38,950                           | 564                    | (372)                   | 39,142     | 42,309                           | 645                    | (385)                   | 42,569     |
| Mortgage-backed securities, multifamily          | 2,209                            | ---                    | (63)                    | 2,146      | 2,259                            | ---                    | (60)                    | 2,199      |
| Obligations of states and political subdivisions | 44,940                           | 434                    | (379)                   | 44,995     | 41,401                           | 658                    | (90)                    | 41,969     |
| Other debt securities                            | 1,525                            | 115                    | ---                     | 1,640      | 1,530                            | 138                    | ---                     | 1,668      |
|  | \$123,133                        | \$1,430                | \$(978)                 | \$123,585  | \$107,976                        | \$1,673                | \$(619)                 | \$109,030  |

**Table of Contents**

The following table shows investment securities by stated maturity. Securities backed by mortgages have expected maturities that differ from contractual maturities because borrowers have the right to call or prepay, and are, therefore, classified separately with no specific maturity date (in thousands):

|  | June 30, 2015             |               |                         |               |
|--|---------------------------|---------------|-------------------------|---------------|
|  | <u>Available for Sale</u> |               | <u>Held to Maturity</u> |               |
|  | Amortized<br>Cost         | Fair<br>Value | Amortized<br>Cost       | Fair<br>Value |
| Due in one year or less                | \$3,312                   | \$3,362       | \$6,345                 | \$6,357       |
| Due after one year through five years  | 85,465                    | 85,836        | 12,108                  | 12,462        |
| Due after five years through ten years | 41,319                    | 41,272        | 56,707                  | 56,749        |
| Due after ten years                    | 1,382                     | 1,332         | 6,814                   | 6,729         |
|  | 131,478                   | 131,802       | 81,974                  | 82,297        |
| Mortgage-backed securities             | 310,720                   | 311,619       | 41,159                  | 41,288        |
| Equity securities                      | 16,361                    | 18,265        | ---                     | ---           |
| Total securities                       | \$458,559                 | \$461,686     | \$123,133               | \$123,585     |

The following table shows proceeds from sales of securities, gross gains and gross losses on sales or calls of securities and other than temporary impairments for the periods indicated (in thousands):

|               | For the Three Months Ended |          | For the Six Months Ended |          |
|---------------|----------------------------|----------|--------------------------|----------|
|               | June 30,                   |          | June 30,                 |          |
|               | 2015                       | 2014     | 2015                     | 2014     |
| Sale proceeds | \$11,472                   | \$17,020 | \$11,472                 | \$17,020 |
| Gross gains   | 28                         | 340      | 28                       | 346      |
| Gross losses  | (11)                       | (340)    | (11)                     | (344)    |

The above sales in 2014 include sales of \$1.4 million in held to maturity mortgage-backed securities of which the Company had already collected over 90% of the principal outstanding. The Company realized \$73,000 in gains on sales of these securities.

Gains or losses on sales of investment securities are based on the net proceeds and the adjusted carrying amount of the securities sold using the specific identification method.

Securities with a carrying value of approximately \$351.5 million and \$356.1 million at June 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and for other purposes required by applicable laws and regulations.

**Table of Contents**

The following table indicates the length of time individual securities have been in a continuous unrealized loss position at June 30, 2015 and December 31, 2014:

| June 30, 2015<br>AVAILABLE FOR SALE                         | Less than 12 months<br>Unrealized |          | 12 months or longer<br>Unrealized |          | Number of<br>securities | Total<br>Unrealized |          |
|---|-----------------------------------|----------|-----------------------------------|----------|-------------------------|---------------------|----------|
|   | Fair value                        | Losses   | Fair value                        | Losses   |                         | Fair value          | Losses   |
| (dollars in thousands)                                      |                                   |          |                                   |          |                         |                     |          |
| <b>U.S. treasury and<br/>U.S. government agencies</b>       | \$ 60,180                         | \$ 571   | \$ 3,978                          | \$ 22    | 13                      | \$ 64,158           | \$ 593   |
| <b>Mortgage-backed securities,<br/>residential</b>          | 78,644                            | 537      | 54,895                            | 1,278    | 37                      | 133,539             | 1,815    |
| <b>Mortgage-backed securities,<br/>multifamily</b>          | 5,235                             | 68       | ---                               | ---      | 1                       | 5,235               | 68       |
| <b>Obligations of states and<br/>political subdivisions</b> | 6,852                             | 139      | 1,436                             | 93       | 17                      | 8,288               | 232      |
| <b>Equity securities</b>                                    | ---                               | ---      | 4,868                             | 241      | 2                       | 4,868               | 241      |
|   | \$ 150,911                        | \$ 1,315 | \$ 65,177                         | \$ 1,634 | 70                      | \$ 216,088          | \$ 2,949 |

**HELD TO MATURITY**

|   |           |        |          |        |    |           |        |
|---|-----------|--------|----------|--------|----|-----------|--------|
| <b>U.S. government agencies</b>                             | \$ 15,688 | \$ 164 | \$ ---   | \$ --- | 3  | \$ 15,688 | \$ 164 |
| <b>Mortgage-backed securities,<br/>residential</b>          | 16,372    | 189    | 7,382    | 183    | 9  | 23,754    | 372    |
| <b>Mortgage-backed securities,<br/>multifamily</b>          | 1,259     | 12     | 887      | 51     | 2  | 2,146     | 63     |
| <b>Obligations of states and<br/>political subdivisions</b> | 16,594    | 325    | 1,599    | 54     | 29 | 18,193    | 379    |
|   | \$ 49,913 | \$ 690 | \$ 9,868 | \$ 288 | 43 | \$ 59,781 | \$ 978 |

| December 31, 2014<br>AVAILABLE FOR SALE                     | Less than 12 months<br>Unrealized |        | 12 months or longer<br>Unrealized |          | Number of<br>securities | Total<br>Unrealized |          |
|---|-----------------------------------|--------|-----------------------------------|----------|-------------------------|---------------------|----------|
|   | Fair value                        | Losses | Fair value                        | Losses   |                         | Fair value          | Losses   |
| (dollars in thousands)                                      |                                   |        |                                   |          |                         |                     |          |
| <b>U.S. government agencies</b>                             | \$ 5,057                          | \$ 28  | \$ 46,135                         | \$ 779   | 11                      | \$ 51,192           | \$ 807   |
| <b>Mortgage-backed securities,<br/>residential</b>          | 34,832                            | 177    | 74,414                            | 1,898    | 28                      | 109,246             | 2,075    |
| <b>Obligations of states and<br/>political subdivisions</b> | 1,266                             | 29     | 5,033                             | 104      | 12                      | 6,299               | 133      |
| <b>Other debt securities</b>                                | ---                               | ---    | ---                               | ---      | ---                     | ---                 | ---      |
| <b>Equity securities</b>                                    | ---                               | ---    | 4,819                             | 211      | 2                       | 4,819               | 211      |
|   | \$ 41,155                         | \$ 234 | \$ 130,401                        | \$ 2,992 | 53                      | \$ 171,556          | \$ 3,226 |



## HELD TO MATURITY

|   |    |       |    |     |    |        |    |     |    |    |        |    |     |
|---|----|-------|----|-----|----|--------|----|-----|----|----|--------|----|-----|
| U.S. government agencies                            | \$ | ---   | \$ | --- | \$ | 5,736  | \$ | 84  | 1  | \$ | 5,736  | \$ | 84  |
| Mortgage-backed securities,<br>residential          |    | 6,236 |    | 50  |    | 17,557 |    | 335 | 8  |    | 23,793 |    | 385 |
| Mortgage-backed securities,<br>multifamily          |    | ---   |    | --- |    | 2,199  |    | 60  | 2  |    | 2,199  |    | 60  |
| Obligations of states and<br>political subdivisions |    | 1,290 |    | 7   |    | 4,206  |    | 83  | 13 |    | 5,496  |    | 90  |
|   | \$ | 7,526 | \$ | 57  | \$ | 29,698 | \$ | 562 | 24 | \$ | 37,224 | \$ | 619 |

Management has evaluated the securities in the above table and has concluded that none of the securities are other-than-temporarily impaired. The cause of the fair values being below cost is due to interest rate movements and is deemed temporary. All investment securities are evaluated on a periodic basis to identify any factors that would require a further analysis. In evaluating the Company's securities, management considers the following items:

**Table of Contents**

The Company's ability and intent to hold the securities, including an evaluation of the need to sell the security to meet certain liquidity measures, or whether the Company has sufficient levels of cash to hold the identified security in order to recover the entire amortized cost of the security;  
 The financial condition of the underlying issuer;  
 The credit ratings of the underlying issuer and if any changes in the credit rating have occurred;  
 The length of time the security's fair value has been less than amortized cost; and  
 Adverse conditions related to the security or its issuer if the issuer has failed to make scheduled payments or other factors.

If the above factors indicate that an additional analysis is required, management will perform and consider the results of a discounted cash flow analysis.

As of June 30, 2015, the equity securities include investments in other financial institutions for market appreciation purposes. Those equities had a purchase price of \$2.7 million and a market value of \$4.8 million as of June 30, 2015.

As of June 30, 2015, equity securities also included \$13.5 million in investment funds that do not have a quoted market price but use net asset value per share or its equivalent to measure fair value.

The funds include \$2.9 million in funds that are primarily invested in community development loans that are guaranteed by the Small Business Administration (SBA). Because the funds are primarily guaranteed by the federal government there are minimal changes in market value between accounting periods. These funds can be redeemed with 60 days notice at the net asset value less unpaid management fees with the approval of the fund manager. As of June 30, 2015, the net amortized cost equaled the market value of the investment. There are no unfunded commitments related to this investment.

The funds also include \$10.6 million in funds that are invested in government guaranteed loans, mortgage-backed securities, small business loans and other instruments supporting affordable housing and economic development. The Company may redeem these funds at the net asset value calculated at the end of the current business day less any unpaid management fees. As of June 30, 2015, the amortized cost of these securities was \$10.8 million and the fair value was \$10.6 million. There are no restrictions on redemptions for the holdings in these investments other than the notice required by the fund manager. There are no unfunded commitments related to this investment.

**Note 7. Loans, Leases and Other Real Estate.**

The following sets forth the composition of Lakeland's loan and lease portfolio as of June 30, 2015 and December 31, 2014:

|                                    | June 30,<br>2015 | December 31,<br>2014 |
|------------------------------------|------------------|----------------------|
|                                    | (in thousands)   |                      |
| Commercial, secured by real estate | \$1,613,011      | \$1,529,761          |
| Commercial, industrial and other   | 262,617          | 238,252              |
| Leases                             | 53,798           | 54,749               |
| Real estate-residential mortgage   | 414,339          | 431,190              |
| Real estate-construction           | 82,265           | 64,020               |
| Home equity and consumer           | 330,664          | 337,642              |
| Total loans                        | 2,756,694        | 2,655,614            |

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|                             |             |             |
|-----------------------------|-------------|-------------|
| Less: deferred fees         | (2,177)     | (1,788)     |
| Loans, net of deferred fees | \$2,754,517 | \$2,653,826 |

**Table of Contents**

At June 30, 2015 and December 31, 2014, home equity and consumer loans included overdraft deposit balances of \$498,000 and \$791,000, respectively. At June 30, 2015 and December 31, 2014, the Company had \$667.8 million and \$338.5 million in loans pledged for actual and potential borrowings at the Federal Home Loan Bank of New York (FHLB).

*Non-Performing Assets and Past Due Loans*

The following schedule sets forth certain information regarding the Company's non-performing assets and its accruing troubled debt restructurings:

| (in thousands)                                 | June 30, December 31, |                 |
|--|-----------------------|-----------------|
|  | 2015                  | 2014            |
| Commercial, secured by real estate             | \$5,307               | \$7,424         |
| Commercial, industrial and other               | 1,354                 | 308             |
| Leases   | 79                    | 88              |
| Real estate - residential mortgage             | 9,098                 | 9,246           |
| Real estate - construction                     | ---                   | 188             |
| Home equity and consumer                       | 3,143                 | 3,415           |
| <b>Total non-accrual loans and leases</b>      | <b>\$18,981</b>       | <b>\$20,669</b> |
| Other real estate and other repossessed assets | 1,078                 | 1,026           |
| <b>TOTAL NON-PERFORMING ASSETS</b>             | <b>\$20,059</b>       | <b>\$21,695</b> |
| <br>   |                       |                 |
| Troubled debt restructurings, still accruing   | \$12,419              | \$10,579        |

Non-accrual loans included \$2.0 million and \$1.3 million of troubled debt restructurings as of June 30, 2015 and December 31, 2014, respectively. As of June 30, 2015, the Company had \$8.3 million in residential mortgages and consumer home equity loans that were in the process of foreclosure.

**Table of Contents**

An age analysis of past due loans, segregated by class of loans as of June 30, 2015 and December 31, 2014, is as follows:

|                                    | 30-59 Day<br><u>Past Due</u> | 60-89 Days<br><u>Past Due</u> | Greater<br>Than<br><u>89 Days</u> | Total<br><u>Past Due</u><br>(in thousands) | <u>Current</u> | Total<br>Loans<br><u>and Leases</u> | Recorded<br>Investment greater<br>than 89<br>Days<br>and<br><u>still<br/>accruing</u> |
|------------------------------------|------------------------------|-------------------------------|-----------------------------------|--|----------------|-------------------------------------|---|
| June 30, 2015                      |                              |                               |                                   |  |                |                                     |   |
| Commercial, secured by real estate | \$ 2,712                     | \$ 3,055                      | \$ 4,264                          | \$ 10,031                                  | \$ 1,602,980   | \$ 1,613,011                        | \$ -  |
| Commercial, industrial and other   | 307                          | 859                           | 224                               | 1,390                                      | 261,227        | 262,617                             | -   |
| Leases                             | 175                          | 51                            | 79                                | 305  | 53,493         | 53,798                              | -   |
| Real estate--residential mortgage  | 993                          | 216                           | 8,125                             | 9,334                                      | 405,005        | 414,339                             | 47  |
| Real estate--construction          | -                            | -                             | -                                 | -  | 82,265         | 82,265                              | -   |
| Home equity and consumer           | 1,156                        | 352                           | 2,574                             | 4,082                                      | 326,582        | 330,664                             | 55  |
|                                    | \$ 5,343                     | \$ 4,533                      | \$ 15,266                         | \$ 25,142                                  | \$ 2,731,552   | \$ 2,756,694                        | \$ 102  |
| December 31, 2014                  |                              |                               |                                   |  |                |                                     |   |
| Commercial, secured by real estate | \$ 2,714                     | \$ 2,999                      | \$ 5,972                          | \$ 11,685                                  | \$ 1,518,076   | \$ 1,529,761                        | \$ -  |
| Commercial, industrial and other   | 944                          | 2                             | 308                               | 1,254                                      | 236,998        | 238,252                             | -   |
| Leases                             | 108                          | 24                            | 88                                | 220  | 54,529         | 54,749                              | -   |
| Real estate--residential mortgage  | 3,325                        | 354                           | 6,710                             | 10,389                                     | 420,801        | 431,190                             | -   |
| Real estate--construction          | 224                          | -                             | 188                               | 412  | 63,608         | 64,020                              | -   |
| Home equity and consumer           | 1,583                        | 598                           | 2,951                             | 5,132                                      | 332,510        | 337,642                             | 66  |
|                                    | \$ 8,898                     | \$ 3,977                      | \$ 16,217                         | \$ 29,092                                  | \$ 2,626,522   | \$ 2,655,614                        | \$ 66   |

**Table of Contents***Impaired Loans*

The Company defines impaired loans as all non-accrual loans and leases with recorded investments of \$500,000 or greater. Impaired loans also includes all loans modified in troubled debt restructurings. Impaired loans as of June 30, 2015, June 30, 2014 and December 31, 2014 are as follows:

| June 30, 2015                            | Recorded<br>Investment in<br>Impaired loans | Contractual<br>Unpaid<br>Principal<br>Balance | Specific<br>Allowance<br>(in thousands) | Interest<br>Income<br>Recognized | Average<br>Investment in<br>Impaired loans |
|--|---|---|---|----------------------------------|--|
| <b>Loans without specific allowance:</b> |   |   |   |                                  |  |
| Commercial, secured by real estate       | \$12,178                                    | \$13,210                                      | \$-                                     | \$203                            | \$13,001                                   |
| Commercial, industrial and other         | 2,015                                       | 3,404   | -                                       | 10                               | 661  |
| Real estate-residential mortgage         | 2,329                                       | 2,329   | -                                       | -                                | 2,100                                      |
| Real estate-construction                 | -   | -   | -                                       | -                                | 99   |
| Home equity and consumer                 | 764   | 764   | -                                       | -                                | 752  |
| <b>Loans with specific allowance:</b>    |   |   |   |                                  |  |
| Commercial, secured by real estate       | 5,466                                       | 5,487   | 346                                     | 114                              | 5,430                                      |
| Commercial, industrial and other         | 1,082                                       | 1,082   | 42                                      | 11                               | 442  |
| Leases                                   | 11  | 11  | 11                                      | -                                | 6  |
| Real estate-residential mortgage         | 728   | 728   | 63                                      | 19                               | 742  |
| Real estate-construction                 | 391   | 391   | 1                                       | 5                                | 242  |
| Home equity and consumer                 | 1,044                                       | 1,044   | 809                                     | 32                               | 1,230                                      |
| <b>Total:</b>                            |   |   |   |                                  |  |
| Commercial, secured by real estate       | \$17,644                                    | \$18,697                                      | \$346                                   | \$317                            | \$18,431                                   |
| Commercial, industrial and other         | 3,097                                       | 4,486   | 42                                      | 21                               | 1,103                                      |
| Leases                                   | 11  | 11  | 11                                      | -                                | 6  |
| Real estate--residential mortgage        | 3,057                                       | 3,057   | 63                                      | 19                               | 2,842                                      |
| Real estate-construction                 | 391   | 391   | 1                                       | 5                                | 341  |
| Home equity and consumer                 | 1,808                                       | 1,808   | 809                                     | 32                               | 1,982                                      |
|  | \$26,008                                    | \$28,450                                      | \$1,272                                 | \$394                            | \$24,705                                   |

**Table of Contents**

| June 30, 2014                      | Recorded<br>Investment in<br>Impaired loans | Contractual<br>Unpaid<br>Principal<br>Balance | Specific<br>Allowance | Interest<br>Income<br>Recognized | Average<br>Investment in<br>Impaired loans |
|------------------------------------|---|---|-----------------------|----------------------------------|--|
| (in thousands)                     |   |   |                       |                                  |  |
| Loans without specific allowance:  |   |   |                       |                                  |  |
| Commercial, secured by real estate | \$15,564                                    | \$16,445                                      | \$-                   | \$205                            | \$15,170                                   |
| Commercial, industrial and other   | 542   | 923   | -                     | 42                               | 1,850                                      |
| Real estate-residential mortgage   | 255   | 304   | -                     | -                                | 276  |
| Real estate-construction           | 465   | 2,411   | -                     | -                                | 483  |
| Home equity and consumer           | -   | -   | -                     | -                                | -  |
| Loans with specific allowance:     |   |   |                       |                                  |  |
| Commercial, secured by real estate | 4,023                                       | 4,179   | 285                   | 87                               | 4,418                                      |
| Commercial, industrial and other   | 151   | 151   | 5                     | 4                                | 183  |
| Real estate-residential mortgage   | -   | -   | -                     | -                                | -  |
| Real estate-construction           | -   | -   | -                     | -                                | -  |
| Home equity and consumer           | 1,267                                       | 1,283   | 493                   | 30                               | 1,219                                      |
| Total:                             |   |   |                       |                                  |  |
| Commercial, secured by real estate | \$19,587                                    | \$20,624                                      | \$285                 | \$292                            | \$19,588                                   |
| Commercial, industrial and other   | 693   | 1,074   | 5                     | 46                               | 2,033                                      |
| Real estate--residential mortgage  | 255   | 304   | -                     | -                                | 276  |
| Real estate-construction           | 465   | 2,411   | -                     | -                                | 483  |
| Home equity and consumer           | 1,267                                       | 1,283   | 493                   | 30                               | 1,219                                      |
|                                    | \$22,267                                    | \$25,696                                      | \$783                 | \$368                            | \$23,599                                   |

**Table of Contents**

| December 31, 2014                        | Recorded<br>Investment in<br>Impaired | Contractual<br>Unpaid<br>Principal<br>Balance | Specific<br>Allowance<br>(in thousands) | Interest<br>Income<br>Recognized | Average<br>Investment in<br>Impaired loans |
|--|---------------------------------------|---|---|----------------------------------|--|
| <b>Loans without specific allowance:</b> |                                       |   |   |                                  |  |
| Commercial, secured by real estate       | \$14,172                              | \$15,520                                      | \$-                                     | \$436                            | \$16,092                                   |
| Commercial, industrial and other         | 327                                   | 1,697   | -                                       | 43                               | 1,513                                      |
| Real estate-residential mortgage         | 1,681                                 | 1,681   | -                                       | -                                | 308  |
| Real estate-construction                 | 188                                   | 552   | -                                       | -                                | 464  |
| Home equity and consumer                 | 741                                   | 741   | -                                       | 7                                | 153  |
| <b>Loans with specific allowance:</b>    |                                       |   |   |                                  |  |
| Commercial, secured by real estate       | 5,666                                 | 5,818   | 634                                     | 156                              | 3,858                                      |
| Commercial, industrial and other         | 425                                   | 425   | 10                                      | 9                                | 342  |
| Real estate-residential mortgage         | 1,238                                 | 1,238   | 217                                     | 19                               | 438  |
| Real estate-construction                 | -                                     | -   | -                                       | -                                | -  |
| Home equity and consumer                 | 1,255                                 | 1,255   | 1,031                                   | 41                               | 975  |
| <b>Total:</b>                            |                                       |   |   |                                  |  |
| Commercial, secured by real estate       | \$19,838                              | \$21,338                                      | \$634                                   | \$592                            | \$19,950                                   |
| Commercial, industrial and other         | 752                                   | 2,122   | 10                                      | 52                               | 1,855                                      |
| Real estate--residential mortgage        | 2,919                                 | 2,919   | 217                                     | 19                               | 746  |
| Real estate-construction                 | 188                                   | 552   | -                                       | -                                | 464  |
| Home equity and consumer                 | 1,996                                 | 1,996   | 1,031                                   | 48                               | 1,128                                      |
|  | \$25,693                              | \$28,927                                      | \$1,892                                 | \$711                            | \$24,143                                   |

Interest that would have been accrued on impaired loans during the first six months of 2015 and 2014 had the loans been performing under original terms would have been \$794,000 and \$885,000, respectively. Interest that would have accrued for the year ended December 31, 2014 was \$1.8 million.

*Credit Quality Indicators*

The class of loans are determined by internal risk rating. Management closely and continually monitors the quality of its loans and leases and assesses the quantitative and qualitative risks arising from the credit quality of its loans and leases. It is the policy of Lakeland to require that a Credit Risk Rating be assigned to all commercial loans and loan commitments. The Credit Risk Rating System has been developed by management to provide a methodology to be used by Loan Officers, department heads and Senior Management in identifying various levels of credit risk that exist within Lakeland's loan portfolios. The risk rating system assists Senior Management in evaluating Lakeland's commercial loan portfolio, analyzing trends, and determining the proper level of required reserves to be recommended to the Board. In assigning risk ratings, management considers, among other things, a borrower's debt service coverage, earnings strength, loan to value ratios, industry conditions and economic conditions. Management categorizes commercial loans and commitments into a one (1) to nine (9) numerical structure with rating 1 being the strongest rating and rating 9 being the weakest. Ratings 1 through 5W are considered "Pass" ratings.



**Table of Contents**

The following table shows the Company's commercial loan portfolio as of June 30, 2015 and December 31, 2014, by the risk ratings discussed above (in thousands):

| June 30, 2015                         | Commercial,<br>secured by<br>real estate | Commercial,<br>industrial<br>and other | Real<br>estate-<br>construction |
|---------------------------------------|--|--|---------------------------------|
| Risk Rating                           |  |  |                                 |
| 1                                     | \$---                                    | \$1,543                                | \$---                           |
| 2                                     | ---                                      | 9,845                                  | ---                             |
| 3                                     | 65,458                                   | 51,222                                 | ---                             |
| 4                                     | 542,648                                  | 90,047                                 | 10,866                          |
| 5                                     | 871,014                                  | 77,814                                 | 66,877                          |
| 5W - Watch                            | 51,083                                   | 13,349                                 | 113                             |
| 6 - Other Assets Especially Mentioned | 38,173                                   | 5,330                                  | 1,996                           |
| 7 - Substandard                       | 44,635                                   | 13,467                                 | 2,413                           |
| 8 - Doubtful                          | ---                                      | -                                      | ---                             |
| 9 - Loss                              | ---                                      | -                                      | ---                             |
| <b>Total</b>                          | <b>\$1,613,011</b>                       | <b>\$262,617</b>                       | <b>\$82,265</b>                 |

| December 31, 2014                     | Commercial,<br>secured by<br>real estate | Commercial,<br>industrial<br>and other | Real<br>estate-<br>construction |
|---------------------------------------|--|--|---------------------------------|
| Risk Rating                           |  |  |                                 |
| 1                                     | \$---                                    | \$1,040                                | \$---                           |
| 2                                     | ---                                      | 8,755                                  | ---                             |
| 3                                     | 69,243                                   | 30,386                                 | ---                             |
| 4                                     | 479,667                                  | 91,836                                 | 7,527                           |
| 5                                     | 867,023                                  | 69,723                                 | 51,833                          |
| 5W - Watch                            | 40,991                                   | 15,572                                 | 225                             |
| 6 - Other Assets Especially Mentioned | 27,764                                   | 8,057                                  | 2,710                           |
| 7 - Substandard                       | 45,073                                   | 12,883                                 | 1,725                           |
| 8 - Doubtful                          | ---                                      | ---                                    | ---                             |
| 9 - Loss                              | ---                                      | ---                                    | ---                             |
| <b>Total</b>                          | <b>\$1,529,761</b>                       | <b>\$238,252</b>                       | <b>\$64,020</b>                 |

The risk rating tables above do not include consumer or residential loans or leases because they are evaluated on their payment status.

**Table of Contents***Allowance for Loan and Lease Losses*

The following table details activity in the allowance for loan and lease losses by portfolio segment for the three and six months ended June 30, 2015 and 2014:

| <b>Three Months Ended<br/>June 30, 2015</b> | Commercial,<br>secured<br>by industrial<br>real estate and<br>other |   | Leases  | Real estate-<br>residential<br>mortgage | Real<br>estate-<br>construction | Home<br>equity and<br>consumer | Unallocated | Total    |
|---|---|---|---------|---|---------------------------------|--------------------------------|-------------|----------|
|   | Commercial,<br>secured<br>by industrial<br>real estate and<br>other | Commercial,<br>secured<br>by industrial<br>real estate and<br>other |         |   |                                 |                                |             |          |
| Beginning Balance                           | \$12,560  | \$3,307   | \$1,038 | \$3,298                                 | \$637                           | \$6,924                        | \$2,741     | \$30,505 |
| Charge-offs                                 | (805)   | (64)  | (102)   | (89)                                    | -                               | (415)                          | -           | (1,475)  |
| Recoveries                                  | 325   | 42  | -       | 2                                       | 6                               | 29                             | -           | 404      |
| Provision                                   | 1,839   | (417)   | 18      | (195)                                   | 82                              | (619)                          | 32          | 740      |
| Ending Balance                              | \$13,919  | \$2,868   | \$954   | \$3,016                                 | \$725                           | \$5,919                        | \$2,773     | \$30,174 |

| <b>Three Months Ended<br/>June 30, 2014</b> | Commercial,<br>secured<br>by industrial<br>real estate and<br>other |   | Leases | Real estate-<br>residential<br>mortgage | Real<br>estate-<br>construction | Home<br>equity and<br>consumer | Unallocated | Total    |
|---|---|---|--------|---|---------------------------------|--------------------------------|-------------|----------|
|   | Commercial,<br>secured<br>by industrial<br>real estate and<br>other | Commercial,<br>secured<br>by industrial<br>real estate and<br>other |        |   |                                 |                                |             |          |
| Beginning Balance                           | \$14,135  | \$5,506   | \$460  | \$2,968                                 | \$483                           | \$2,612                        | \$3,356     | \$29,520 |
| Charge-offs                                 | (144)   | (599)   | (126)  | (354)                                   | (25)                            | (483)                          | -           | (1,731)  |
| Recoveries                                  | 320   | 88  | -      | 3                                       | 1                               | 72                             | -           | 484      |
| Provision                                   | (269)   | (1,394)   | 320    | 1,614                                   | 77                              | 1,910                          | (665)       | 1,593    |
| Ending Balance                              | \$14,042  | \$3,601   | \$654  | \$4,231                                 | \$536                           | \$4,111                        | \$2,691     | \$29,866 |

| <b>Six Months Ended<br/>June 30, 2015</b> | Commercial,<br>secured<br>by industrial<br>real estate and<br>other |   | Leases | Real estate-<br>residential<br>mortgage | Real<br>estate-<br>construction | Home<br>equity and<br>consumer | Unallocated | Total    |
|---|---|---|--------|---|---------------------------------|--------------------------------|-------------|----------|
|   | Commercial,<br>secured<br>by industrial<br>real estate and<br>other | Commercial,<br>secured<br>by industrial<br>real estate and<br>other |        |   |                                 |                                |             |          |
| Beginning Balance                         | \$13,577  | \$3,196   | \$582  | \$4,020                                 | \$553                           | \$6,333                        | \$2,423     | \$30,684 |
| Charge-offs                               | (1,351)   | (74)  | (529)  | (106)                                   | (20)                            | (676)                          | -           | (2,756)  |
| Recoveries                                | 364   | 84  | 20     | 3                                       | 106                             | 59                             | -           | 636      |
| Provision                                 | 1,329   | (338)   | 881    | (901)                                   | 86                              | 203                            | 350         | 1,610    |
| Ending Balance                            | \$13,919  | \$2,868   | \$954  | \$3,016                                 | \$725                           | \$5,919                        | \$2,773     | \$30,174 |

| <b>Six Months Ended<br/>June 30, 2014</b> | Commercial,<br>secured | Commercial,<br>industrial | Leases | Real<br>estate- | Real<br>estate- | Home<br>equity | Unallocated | Total |
|---|------------------------|---------------------------|--------|-----------------|-----------------|----------------|-------------|-------|
|---|------------------------|---------------------------|--------|-----------------|-----------------|----------------|-------------|-------|



**Table of Contents**

Loans receivable summarized by portfolio segment and impairment method are as follows:

| <b>At June 30, 2015</b>  | Commercial,<br>secured by<br>real estate | Commercial,<br>industrial<br>and other | Leases   | Real estate-<br>residential<br>mortgage | Real<br>estate-<br>construction | Home<br>equity and<br>consumer | Total       |
|--|--|--|----------|---|---------------------------------|--------------------------------|-------------|
| Ending Balance:<br>Individually<br>evaluated for<br>impairment | \$17,644                                 | \$3,097                                | \$11     | \$3,057                                 | \$391                           | \$1,808                        | \$26,008    |
| Ending Balance:<br>Collectively evaluated<br>for impairment    | 1,595,367                                | 259,520                                | 53,787   | 411,282                                 | 81,874                          | 328,856                        | \$2,730,686 |
| Ending Balance (1)   | \$1,613,011                              | \$262,617                              | \$53,798 | \$414,339                               | \$82,265                        | \$330,664                      | \$2,756,694 |

(1) Excludes deferred fees

| <b>At December 31, 2014</b>                                 | Commercial,<br>secured by<br>real estate | Commercial,<br>industrial<br>and other | Leases   | Real estate-<br>residential<br>mortgage | Real<br>estate-<br>construction | Home<br>equity and<br>consumer | Total       |
|---|--|--|----------|---|---------------------------------|--------------------------------|-------------|
| Ending Balance:<br>Individually evaluated<br>for impairment | \$19,838                                 | \$752                                  | \$-      | \$2,919                                 | \$188                           | \$1,996                        | \$25,693    |
| Ending Balance:<br>Collectively evaluated<br>for impairment | 1,509,923                                | 237,500                                | 54,749   | 428,271                                 | 63,832                          | 335,646                        | \$2,629,921 |
| Ending Balance(1)   | \$1,529,761                              | \$238,252                              | \$54,749 | \$431,190                               | \$64,020                        | \$337,642                      | \$2,655,614 |

(1) Excludes deferred fees

The allowance for loan and lease losses is summarized by portfolio segment and impairment classification as follows:

| <b>At June 30, 2015</b>                                     | Commercial,<br>secured<br>by<br>real<br>estate | Commercial,<br>industrial<br>and other | Leases | Real<br>estate-<br>residential<br>mortgage | Real<br>estate-<br>construction | Home<br>equity and<br>consumer | Unallocated | Total   |
|---|--|--|--------|--|---------------------------------|--------------------------------|-------------|---------|
| Ending Balance:<br>Individually evaluated for<br>impairment | \$346  | \$42                                   | \$11   | \$63                                       | \$1                             | \$809                          | \$---       | \$1,272 |

|   |          |         |       |         |       |         |         |          |
|---|----------|---------|-------|---------|-------|---------|---------|----------|
| Ending Balance:<br>Collectively evaluated for<br>impairment | 13,573   | 2,826   | 943   | 2,953   | 724   | 5,110   | 2,773   | \$28,902 |
| Ending Balance  | \$13,919 | \$2,868 | \$954 | \$3,016 | \$725 | \$5,919 | \$2,773 | \$30,174 |

| <b>At December 31, 2014</b>                                 | Commercial,<br>secured<br>by<br>real<br>estate | Commercial,<br>industrial<br>and other | Leases | Real estate-<br>residential<br>mortgage | Real<br>estate-<br>construction | Home<br>equity<br>and<br>consumer | Unallocated | Total    |
|---|--|--|--------|---|---------------------------------|-----------------------------------|-------------|----------|
|   | (in thousands)                                 |  |        |   |                                 |                                   |             |          |
| Ending Balance:<br>Individually evaluated for<br>impairment | \$634  | \$10                                   | \$-    | \$217                                   | \$-                             | \$1,031                           | \$-         | \$1,892  |
| Ending Balance:<br>Collectively evaluated for<br>impairment | 12,943   | 3,186                                  | 582    | 3,803                                   | 553                             | 5,302                             | 2,423       | \$28,792 |
| Ending Balance  | \$13,577                                       | \$3,196                                | \$582  | \$4,020                                 | \$553                           | \$6,333                           | \$2,423     | \$30,684 |

**Table of Contents**

Lakeland also maintains a reserve for unfunded lending commitments which is included in other liabilities. This reserve was \$1.4 million and \$1.1 million at June 30, 2015 and December 31, 2014, respectively. The Company analyzes the adequacy of the reserve for unfunded lending commitments in conjunction with its analysis of the adequacy of the allowance for loan and lease losses. For more information on this analysis, see Risk Elements in Management's Discussion and Analysis.

*Troubled Debt Restructurings*

Troubled debt restructurings are those loans where concessions have been made due to borrowers' financial difficulties. Restructured loans typically involve a modification of terms such as a reduction of the stated interest rate, a moratorium of principal payments and/or an extension of the maturity date at a stated interest rate lower than the current market rate of a new loan with similar risk. The Company considers the potential losses on these loans as well as the remainder of its impaired loans while considering the adequacy of the allowance for loan and lease losses.

The following table summarizes loans that have been restructured during the three and six months ended June 30, 2015 and 2014:

|                                      | For the Three Months Ended<br>June 30, 2015                   |  |  | For the Three Months Ended<br>June 30, 2014                   |  |  |
|--------------------------------------|---|--|--|---|--|--|
|                                      | Pre-<br>Modification<br>Outstanding<br>Number of<br>Contracts | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) | Pre-<br>Modification<br>Outstanding<br>Number of<br>Contracts | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) |
| <b>Troubled Debt Restructurings:</b> |   |  |  |   |  |  |
| Commercial, secured by real estate   | 2   | \$1,458  | \$1,458  | 2   | \$1,697  | \$1,697  |
| Commercial, industrial and other     | 2   | 784  | 784  | ---   | ---  | ---  |
|                                      | 4   | \$2,242  | \$2,242  | 2   | \$1,697  | \$1,697  |
|                                      | For the Six Months Ended<br>June 30, 2015                     |  |  | For the Six Months Ended<br>June 30, 2014                     |  |  |
|                                      | Pre-<br>Modification<br>Outstanding<br>Number of<br>Contracts | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) | Pre-<br>Modification<br>Outstanding<br>Number of<br>Contracts | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) | Post-<br>Modification<br>Outstanding<br>Recorded<br>Investment<br>(Dollars in thousands) |
| <b>Troubled Debt Restructurings:</b> |   |  |  |   |  |  |
| Commercial, secured by real estate   | 2   | \$1,458  | \$1,458  | 2   | \$1,697  | \$1,697  |
| Commercial, industrial and other     | 3   | 1,933  | 1,933  | ---   | ---  | ---  |
| Leases                               | 1   | 14   | 14   | ---   | ---  | ---  |
| Real estate--construction            | 1   | 396  | 396  | ---   | ---  | ---  |
| Home equity and consumer             | 1   | 9  | 9  | 3   | 335  | 335  |

|  |   |         |         |   |         |         |
|--|---|---------|---------|---|---------|---------|
|  | 8 | \$3,810 | \$3,810 | 5 | \$2,032 | \$2,032 |
|--|---|---------|---------|---|---------|---------|

**Table of Contents**

The following table summarizes as of June 30, 2015 and 2014, loans that were restructured within the previous 12 months that have subsequently defaulted:

|  | For the Six Months Ended |  |                        |   |
|--|--------------------------|--|------------------------|---|
|  | June 30, 2015            |  | June 30, 2014          |   |
|  | Number of<br>Contracts   | Recorded<br>Investment<br>(Dollars in thousands) | Number of<br>Contracts | Recorded<br>Investment<br>(Dollars in<br>thousands) |
| <b>Defaulted Troubled Debt Restructurings:</b> |                          |  |                        |   |
| Real estate--residential mortgage              | 1                        | \$483  | 1                      | \$174   |
| Home equity and consumer                       | ---                      | ---  | 1                      | 235   |
|  | 1                        | \$483  | 2                      | \$409   |

*Mortgages Held for Sale*

Residential mortgages originated by the bank and held for sale in the secondary market are carried at the lower of cost or fair market value. Fair market value is generally determined by the value of purchase commitments on individual loans. Losses are recorded as a valuation allowance and charged to earnings. As of June 30, 2015, the Company had \$3.3 million in mortgages held for sale compared to \$592,000 as of December 31, 2014.

*Other Real Estate and Other Repossessed Assets*

At June 30, 2015 the Company had other real estate owned and other repossessed assets of \$1.0 million and \$56,000, respectively. All of the other real estate owned that the Company held at June 30, 2015 was residential property acquired as a result of foreclosure proceedings or through a deed in lieu of foreclosure. At December 31, 2014, the Company had other real estate owned and other repossessed assets of \$977,000 and \$49,000, respectively.

**Note 8. Estimated Fair Value of Financial Instruments and Fair Value Measurement***Fair Value Measurement*

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. U.S. GAAP establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest level priority to unobservable inputs (level 3 measurements). The following describes the three levels of fair value hierarchy:

Level 1 unadjusted quoted prices in active markets for identical assets or liabilities; includes U.S. Treasury Notes, and other U.S. Government Agency securities that actively trade in over-the-counter markets; equity securities and mutual funds that actively trade in over-the-counter markets.

Level 2 quoted prices for similar assets or liabilities in active markets; or quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable for the asset or liability including yield curves, volatilities, and prepayment speeds.



Level 3 unobservable inputs for the asset or liability that reflect the Company's own assumptions about assumptions that market participants would use in the pricing of the asset or liability and that are consequently not based on market activity but upon particular valuation techniques.

The Company's assets that are measured at fair value on a recurring basis are its available for sale investment securities. The Company obtains fair values on its securities using information from a third party servicer. If quoted prices for securities are available in an active market, those securities are classified as Level 1 securities. The Company has U.S. Treasury Notes and certain equity securities that are classified as Level 1 securities. Level 2 securities were primarily comprised of U.S. Agency bonds, residential mortgage-backed securities, obligations of state and political subdivisions and corporate securities. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or

**Table of Contents**

through the use of pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, issuer spreads, bids and offers. On a quarterly basis, the Company reviews the pricing information received from the Company's third party pricing service. This review includes a comparison to non-binding third-party quotes.

The fair values of derivatives are based on valuation models from a third party using current market terms (including interest rates and fees), the remaining terms of the agreements and the credit worthiness of the counter party as of the measurement date (Level 2).

The following table sets forth the Company's financial assets that were accounted for at fair value on a recurring basis as of the periods presented by level within the fair value hierarchy. During the six months ended June 30, 2015, the Company did not make any transfers between any levels within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

|  | Quoted Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total<br>Fair Value |
|--|---|---|--|---------------------|
|  | (in thousands)  |   |  |                     |
| <b>June 30, 2015</b>                             |   |   |  |                     |
| <b>Assets:</b>                                   |   |   |  |                     |
| Investment securities, available for sale        |   |   |  |                     |
| U.S. treasury and government agencies            | \$4,892   | \$95,319  | \$---  | \$100,211           |
| Mortgage backed securities                       | ---   | 311,619   | ---  | 311,619             |
| Obligations of states and political subdivisions | ---   | 31,088  | ---  | 31,088              |
| Other debt securities                            | ---   | 503   | ---  | 503                 |
| Equity securities                                | 4,775   | 13,490  | ---  | 18,265              |
| Total securities available for sale              | 9,667   | 452,019   | ---  | 461,686             |
| Non-hedging interest rate derivatives            | ---   | 517   | ---  | 517                 |
| Total Assets                                     | \$9,667   | \$452,536   | \$---  | \$462,203           |
| Non-hedging interest rate derivatives            | \$---   | \$517   | \$---  | \$517               |
| Total Liabilities                                | \$---   | \$517   | \$---  | \$517               |
| <b>December 31, 2014</b>                         |   |   |  |                     |
| <b>Assets:</b>                                   |   |   |  |                     |
| Investment securities, available for sale        |   |   |  |                     |
| U.S. treasury and government agencies            | \$8,321   | \$85,599  | \$---  | \$93,920            |
| Mortgage backed securities                       | ---   | 314,931   | ---  | 314,931             |
| Obligations of states and political subdivisions | ---   | 30,519  | ---  | 30,519              |
| Other debt securities                            | ---   | 505   | ---  | 505                 |
| Equity securities                                | 4,154   | 13,420  | ---  | 17,574              |
| Total securities available for sale              | 12,475  | 444,974   | ---  | 457,449             |
| Non-hedging interest rate derivatives            | ---   | 37  | ---  | 37                  |

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|                                       |          |           |       |           |
|---------------------------------------|----------|-----------|-------|-----------|
| Total Assets                          | \$12,475 | \$445,011 | \$--- | \$457,486 |
| Non-hedging interest rate derivatives | \$---    | \$37      | \$--- | \$37      |
| Total Liabilities                     | \$---    | \$37      | \$--- | \$37      |

**Table of Contents**

The following table sets forth the Company's assets subject to fair value adjustments (impairment) on a nonrecurring basis. Assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

|  | Quoted Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total<br>Fair Value |
|--|---|---|--|---------------------|
| <u>June 30, 2015</u>                                 |   |   |  |                     |
| <b>Assets:</b>                                       |   |   |  | (in thousands)      |
| Impaired Loans and Leases                            | \$---   | \$---   | \$26,008   | \$26,008            |
| Loans held for sale                                  | ---   | 3,348   | ---  | 3,348               |
| Other real estate owned and other repossessed assets | ---   | ---   | 1,078  | 1,078               |
| <u>December 31, 2014</u>                             |   |   |  |                     |
| <b>Assets:</b>                                       |   |   |  |                     |
| Impaired Loans and Leases                            | \$---   | \$---   | \$25,693   | \$25,693            |
| Loans held for sale                                  | ---   | 592   | ---  | 592                 |
| Other real estate owned and other repossessed assets | ---   | ---   | 1,026  | 1,026               |

Impaired loans are evaluated and valued at the time the loan is identified as impaired at the lower of cost or market value of the underlying collateral. Because most of Lakeland's impaired loans are collateral dependent, fair value is generally measured based on the value of the collateral, less estimated costs to sell, securing these loans and leases and is classified at a level 3 in the fair value hierarchy. Collateral may be real estate, accounts receivable, inventory, equipment and/or other business assets. The value of the real estate is assessed based on appraisals by qualified third party licensed appraisers. The appraisers may use the sales comparison approach, the cost approach or the income approach to value the collateral using discount rates (with ranges of 5-11%) or capitalization rates (with ranges of 3-8%) to evaluate the property. The value of the equipment may be determined by an appraiser, if significant, inquiry through a recognized valuation resource, or by the value on the borrower's financial statements. Field examiner reviews on business assets may be conducted based on the loan exposure and reliance on this type of collateral. Appraised and reported values may be adjusted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Loans that are not collateral dependent are evaluated based on a discounted cash flow method. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

The Company has a held for sale loan portfolio that consists of residential mortgages that are being sold in the secondary market. The Company records these mortgages at the lower of cost or market value. Fair value is generally determined by the value of purchase commitments.

Other real estate owned (OREO) and other repossessed assets, representing property acquired through foreclosure, are recorded at fair value less estimated disposal costs of the acquired property on the date of acquisition and thereafter remeasured and carried at lower of cost or fair market value. Fair value on other real estate owned is based on the appraised value of the collateral using the sales comparison approach or the income approach with discount rates or capitalization rates similar to those used in impaired loan valuation. The fair value of other repossessed assets is estimated by inquiry through recognized valuation resources.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Changes in economic conditions, locally or nationally, could impact the value of the estimated amounts of impaired loans, OREO and other repossessed assets.

***Fair Value of Certain Financial Instruments***

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. Management is concerned that there may not be reasonable

## **Table of Contents**

comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

The estimation methodologies used, the estimated fair values, and recorded book balances at June 30, 2015 and December 31, 2014 are outlined below.

This summary, as well as the table below, excludes financial assets and liabilities for which carrying value approximates fair value. For financial assets, these include cash and cash equivalents. For financial liabilities, these include noninterest bearing demand deposits, savings and interest-bearing transaction accounts and federal funds sold and securities sold under agreements to repurchase. The estimated fair value of demand, savings and interest-bearing transaction accounts is the amount payable on demand at the reporting date. Carrying value is used because there is no stated maturity on these accounts, and the customer has the ability to withdraw the funds immediately. Also excluded from this summary and the following table are those financial instruments recorded at fair value on a recurring basis, as previously described.

The fair value of Investment Securities Held to Maturity was measured using information from the same third-party servicer used for Investment Securities Available for Sale using the same methodologies discussed above. Investment Securities Held to Maturity includes \$4.8 million in short-term municipal bond anticipation notes that are non-rated and do not have an active secondary market or information readily available on standard financial systems. As a result, the securities are classified as Level 3 securities. These are investments in municipalities in the Company's market area, and management performs a credit analysis on the municipality before investing in these securities.

Federal Home Loan Bank of New York (FHLB) stock is an equity interest that can be sold to the issuing FHLB, to other Federal Home Loan Banks, or to other member banks at its par value. Because ownership of these securities is restricted, they do not have a readily determinable fair value. As such, the Company's FHLB Stock is recorded at cost or par value and is evaluated for impairment each reporting period by considering the ultimate recoverability of the investment rather than temporary declines in value. The Company's evaluation primarily includes an evaluation of liquidity, capitalization, operating performance, commitments, and regulatory or legislative events.

The net loan portfolio at June 30, 2015 and December 31, 2014 has been valued using a present value discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The valuation of the Company's loan portfolio is consistent with accounting guidance but does not fully incorporate the exit price approach.

For fixed maturity certificates of deposit, fair value was estimated based on the present value of discounted cash flows using the rates currently offered for deposits of similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

The fair value of long-term debt is based upon the discounted value of contractual cash flows. The Company estimates the discount rate using the rates currently offered for similar borrowing arrangements. The fair value of subordinated debentures is based on bid/ask prices from brokers for similar types of instruments.

The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle

the obligations with the counterparties at the reporting date. The fair value of commitments to extend credit and standby letters of credit are deemed immaterial.

**Table of Contents**

The following table presents the carrying values, fair values and placement in the fair value hierarchy of the Company's financial instruments as of June 30, 2015 and December 31, 2014:

|   | Carrying Value | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|----------------|------------|--|---|---|
| <b>June 30, 2015</b>                                    |                |            |  |   |   |
| Financial Instruments - Assets<br>(in thousands)        |                |            |  |   |   |
| Investment securities held to maturity                  | \$123,133      | \$123,585  | \$ ---   | \$118,762                                     | \$4,823                                   |
| Federal Home Loan Bank and other membership bank stocks | 12,779         | 12,779     | ---  | 12,779  | ---                                       |
| Loans and leases, net                                   | 2,724,343      | 2,721,370  | ---  | ---   | 2,721,370                                 |
| Financial Instruments - Liabilities                     |                |            |  |   |   |
| Certificates of Deposit                                 | 306,431        | 306,263    | ---  | 306,263                                       | ---                                       |
| Other borrowings  | 262,728        | 268,211    | ---  | 268,211                                       | ---                                       |
| Subordinated debentures                                 | 41,238         | 31,753     | ---  | ---   | 31,753                                    |
| <b>December 31, 2014</b>                                |                |            |  |   |   |
| Financial Instruments - Assets                          |                |            |  |   |   |
| Investment securities held to maturity                  | \$107,976      | \$109,030  | \$ ---   | \$103,916                                     | \$5,114                                   |
| Federal Home Loan Bank and other membership bank stocks | 9,846          | 9,846      | ---  | 9,846   | ---                                       |
| Loans and leases, net                                   | 2,623,142      | 2,624,581  | ---  | ---   | 2,624,581                                 |
| Financial Instruments - Liabilities                     |                |            |  |   |   |
| Certificates of Deposit                                 | 279,962        | 279,439    | ---  | 279,439                                       | ---                                       |
| Other borrowings  | 202,498        | 205,343    | ---  | 205,343                                       | ---                                       |
| Subordinated debentures                                 | 41,238         | 30,929     | ---  | ---   | 30,929                                    |

**Note 9. Derivatives**

Lakeland is a party to interest rate derivatives that are not designated as hedging instruments. Under a program, Lakeland executes interest rate swaps with commercial lending customers to facilitate their respective risk management strategies. These interest rate swaps with customers are simultaneously offset by interest rate swaps that Lakeland executes with a third party, such that Lakeland minimizes its net risk exposure resulting from such transactions. Because the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. The changes in the fair value of the swaps offset each other, except for the credit risk of the counterparties, which is determined by taking into consideration the risk rating, probability of default and loss given default for all counterparties. As of June 30, 2015 and December 31, 2014, Lakeland had \$511,000 and \$505,000, respectively, in available for sale securities pledged for collateral on its interest rate swaps with the financial institution.





**Table of Contents**

The following table presents summary information regarding these derivatives for the periods presented (dollars in thousands):

| June 30, 2015                 | Notional Amount | Average Maturity (Years) | Weighted           | Weighted Average Variable Rate | Fair Value |
|-------------------------------|-----------------|--------------------------|--------------------|--------------------------------|------------|
|                               |                 |                          | Average Fixed Rate |                                |            |
| Customer interest rate swaps  | (\$34,033)      | 12.6                     | 4.290%             | 1 Mo Libor + 2.11              | \$517      |
| 3rd Party interest rate swaps | 34,033          | 12.6                     | 4.290%             | 1 Mo Libor + 2.11              | (517)      |

  

| December 31, 2014             | Notional Amount | Average Maturity (Years) | Weighted           | Weighted Average Variable Rate | Fair Value |
|-------------------------------|-----------------|--------------------------|--------------------|--------------------------------|------------|
|                               |                 |                          | Average Fixed Rate |                                |            |
| Customer interest rate swaps  | (\$17,279)      | 5.7                      | 3.840%             | 1 Mo Libor + 2.21              | \$37       |
| 3rd party interest rate swaps | 17,279          | 5.7                      | 3.840%             | 1 Mo Libor + 2.21              | (\$37)     |

**Note 10. Goodwill and Intangible Assets**

The Company has recorded goodwill of \$110.0 million at June 30, 2015 and December 31, 2014 which includes \$22.9 million from the Somerset Hills acquisition in 2013 and \$87.1 million from prior acquisitions. The Company reviews its goodwill and intangible assets annually, on November 30, or more frequently if conditions warrant, for impairment. In testing goodwill for impairment, the Company compares the estimated fair value of its reporting unit to its carrying amount, including goodwill. The Company has determined that it has one reporting unit, Community Banking.

The Company recorded \$2.7 million in core deposit intangible for the Somerset Hills acquisition. Year-to-date, it has amortized \$218,000 in core deposit intangible. The estimated future amortization expense for the remainder of 2015 and for each of the succeeding five years ended December 31 is as follows (dollars in thousands):

| For the year ended: |        |
|---------------------|--------|
| 2015                | \$ 197 |
| 2016                | 366    |
| 2017                | 316    |
| 2018                | 267    |
| 2019                | 218    |
| 2020                | 168    |

**Note 11. Borrowings**

At June 30, 2015, the Company had federal funds purchased and securities sold under agreements to repurchase of \$115.0 million and \$31.2 million respectively. The securities sold under agreements to repurchase are overnight sweep arrangement accounts with our customers. The Company also had \$70.0 million in long-term securities sold under agreements to repurchase included in other borrowings which have maturities ranging from one to five years. All of the Company's agreements to repurchase are accounted for as secured borrowings and are collateralized by

mortgage backed securities. As of June 30, 2015, Company had \$119.1 million in securities pledged for its securities sold under agreements to repurchase.

At times the market values of securities collateralizing our securities sold under agreements to repurchase may decline due to changes in interest rates and may necessitate our lenders to issue a margin call which requires Lakeland to

## **Table of Contents**

pledge additional collateral to meet that margin call.

### **Note 12. Subsequent Events**

On August 3, 2015, The Company acquired and extinguished \$10.0 million of Lakeland Bancorp Capital Trust IV debentures and recorded a \$1.8 million gain on extinguishment of debt. The interest rate on this debenture floated at LIBOR plus 152 basis points and had a rate of 1.80% at the time of extinguishment. There are \$10.0 million in Lakeland Bancorp Capital Trust IV debentures that remain outstanding.

On August 3, 2015, the Company entered into an agreement and Plan of Merger (the Merger Agreement) with Pascack Bancorp, Inc., pursuant to which Pascack Bancorp will merge with and into the Company, and Pascack Bancorp's wholly owned subsidiary, Pascack Community Bank, will merge with and into Lakeland Bank. The Merger Agreement provides that the shareholders of Pascack Bancorp will receive, at their election, for each outstanding share of Pascack Bancorp common stock that they own at the effective time of the merger or would own upon conversion of preferred stock, either 0.9576 shares of Lakeland Bancorp common stock or \$11.35 in cash, subject to proration as described in the Merger Agreement, so that 90% of the aggregate merger consideration will be shares of Lakeland Bancorp common stock and 10% will be cash. Lakeland Bancorp expects to issue an aggregate of 3,314,328 shares of its common stock in the merger, and will also cash out outstanding Pascack Bancorp options. The transaction is valued at approximately \$43.8 million in the aggregate, or \$11.35 per share. As of June 30, 2015, Pascack Bancorp had consolidated total assets, total loans, total deposits and total stockholders' equity of \$402.7 million, \$334.0 million, \$304.8 million and \$33.3 million, respectively. Pascack Bancorp had net income of \$2.4 million for the year ended December 31, 2014.

The transaction has been approved by the board of directors of each of Lakeland Bancorp and Pascack Bancorp. Subject to approval of the shareholders of Pascack Bancorp, regulatory approvals and other customary closing conditions, the Company anticipates completing the merger in the fourth quarter of 2015.

### **Note 13. Recent Accounting Pronouncements**

In May 2015, the Financial Accounting Standards Board (FASB) issued an accounting standards update clarifying how investments valued using the net asset value practical expedient within the fair value hierarchy should be classified. The accounting standards update was issued to address diversity in practice by exempting investments measured using the net asset value expedient from categorization in the fair value hierarchy. This accounting standards update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this update is not expected to have a material impact on the Company's financial statements.

In April 2015, the FASB issued an accounting standards update requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability consistent with the presentation of debt discounts. The purpose of this update is to simplify the presentation of debt issuance costs and to align the US GAAP presentation of debt more closely with international accounting standards. This amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this update is not expected to have a material impact on the Company's financial statements.

In January 2015, the FASB issued an accounting standards update regarding the elimination of the concept of the extraordinary items from the statement of operations. The purpose of this update is to simplify the statement of operations presentation and to align the US GAAP income statement more closely with international accounting

standards. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this update is not expected to have a material impact on the Company's financial statements.

In June 2014, the FASB issued an accounting standards update regarding share-based payments that requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. This update is effective for interim and annual periods beginning after December 15, 2015. The amendments can be applied prospectively to all awards granted or modified after the effective date or retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented and to all new or modified awards thereafter. Early adoption is permitted. The Company has determined that adoption of this update is not expected to have a material impact on its accounting and disclosures.

In June 2014, the FASB issued an accounting standards update that aligns the accounting for repurchase to maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. This update is effective for the first interim or annual period beginning after December 15, 2014. In addition, the disclosure of certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and interim periods after March 15, 2015. The Company adopted this update in 2015. The disclosures required by this update are contained in Note 11. The Company does not engage in repurchase to maturity transactions, and therefore the adoption of this update did not have a material impact on the Company's financial results.

In May 2014, the FASB issued an accounting standards update that clarifies the principles for recognizing revenue. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for these goods or services. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company is still evaluating the potential impact on the Company's financial statements.

In January 2014, the FASB issued an accounting standards update to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan

## **Table of Contents**

should be derecognized and the real estate recognized. These amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure; or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. This update is effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. The Company adopted this update in the first quarter of 2015, and the disclosures required are included in Note 7. The adoption of this update did not have a material impact on the Company's financial statements.

## **PART I -- ITEM 2**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations**

This section should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

### **Statements Regarding Forward Looking Information**

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

In addition to the risk factors disclosed elsewhere in this document, the following factors, among others, could cause the Company's actual results to differ materially and adversely from such forward-looking statements: changes in the financial services industry and the U.S. and global capital markets, changes in economic conditions nationally, regionally and in the Company's markets, the nature and timing of actions of the Federal Reserve Board and other regulators, the nature and timing of legislation affecting the financial services industry including, but not limited to, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, government intervention in the U.S. financial system, changes in levels of market interest rates, pricing pressures on loan and deposit products, credit risks of the Company's lending and leasing activities, customers' acceptance of the Company's products and services and competition.

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

### **Critical Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company, Lakeland, Lakeland NJ Investment Corp., Lakeland Investment Corp., Lakeland Equity, Inc., Lakeland Preferred Equity, Inc., and Sullivan Financial Services, Inc. All intercompany balances and transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. There have been no material changes in the Company's critical accounting policies, judgments and estimates, including assumptions or estimation techniques utilized, as compared to those disclosed in the Company's most recent Annual Report on Form 10-K.

**Table of Contents**

**Management Overview**

The quarter and six months ended June 30, 2015 represented a period of continued growth for the Company. As discussed in this Management's Discussion and Analysis:

Net income at \$16.2 million, or \$0.42 per diluted share in the first half of 2015, increased 8% compared to \$14.9 million, or \$0.39, per diluted share for the same period last year. Annualized return on average assets was 0.92% for the first half of 2015 compared to 0.90% for the first half of 2014. Annualized return on average equity was 8.44% for the first half of 2015 compared to 8.36% for the first half of 2014.

The Company reported growth in both loans and non-interest bearing demand deposits in the first half of 2015. Loans totaling \$2.76 billion at June 30, 2015 increased by \$101.1 million from December 31, 2014, with a \$125.9 million, or 7% increase in commercial loans. Non-interest-bearing demand deposits at \$714.2 million increased by \$68.2 million, or 11%, and represented 25% of total deposits at June 30, 2015.

Non-performing assets totaled \$20.1 million at June 30, 2015 compared to \$21.7 million at December 31, 2014 and \$20.2 million reported at June 30, 2014.

As a result of declining charge-offs and as a result of management's continuing analysis of the adequacy of the allowance for loan and lease losses, the provision for loan and lease losses was reduced from \$3.1 million in the first half of 2014 to \$1.6 million in the first half of 2015.

The Company has opened a new loan production office (LPO) in the first quarter of 2015 serving the Middlesex/Monmouth County New Jersey region, and opened a similar office in the greater Hudson Valley, New York area. The Company also consolidated three branch locations during the quarter.

**Results of Operations**

**(Second Quarter 2015 Compared to Second Quarter 2014)**

**Net Income**

Net income was \$7.9 million in the second quarter of 2015 compared to net income of \$7.8 million for the second quarter of 2014. Diluted earnings per share was \$0.21 for the second quarter of 2015, compared to diluted earnings per share of \$0.20 for the same period last year. Net interest income at \$28.7 million for the second quarter of 2015 increased \$250,000 from the second quarter of 2014 due primarily to a \$759,000 increase in interest income, partially offset by an increase of \$509,000 in interest expense. The increase in interest income reflects an increase in interest earning assets resulting from organic growth.

**Net Interest Income**



Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. The Company's net interest income is determined by: (i) the volume of interest-earning assets that it holds and the yields that it earns on those assets, and (ii) the volume of interest-bearing liabilities that it has assumed and the rates that it pays on those liabilities.

Net interest income on a tax equivalent basis for the second quarter of 2015 was \$28.9 million, compared to \$28.7 million for the second quarter of 2014. The net interest margin decreased from 3.69% in the second quarter of 2014 to 3.46% in the second quarter of 2015 primarily as a result of a 19 basis point decrease in the yield on interest earning assets as well as a six basis point increase in the cost of interest bearing liabilities. The decrease in the net interest margin was somewhat mitigated by an increase in interest income earned on free funds (interest earning assets funded by non-interest bearing liabilities) resulting from an increase in average non-interest bearing deposits of \$48.8 million. The components of net interest income will be discussed in greater detail below.

**Table of Contents**

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

|   | For the Three Months Ended,<br>June 30, 2015 |                                |   | For the Three Months Ended,<br>June 30, 2014 |                                |                                     |
|---|--|--------------------------------|---|--|--------------------------------|-------------------------------------|
|   | Average<br>Balance                           | Interest<br>Income/<br>Expense | Average<br>rates<br>earned/<br>paid<br>(dollars in thousands) | Average<br>Balance                           | Interest<br>Income/<br>Expense | Average<br>rates<br>earned/<br>paid |
| <b>Assets</b>                               |  |                                |   |  |                                |                                     |
| Interest-earning assets:                    |  |                                |   |  |                                |                                     |
| Loans and leases (A)                        | \$ 2,720,801                                 | \$ 28,211                      | 4.16%   | \$ 2,552,010                                 | \$ 27,558                      | 4.33%                               |
| Taxable investment securities and other     | 532,150                                      | 2,688                          | 2.02%   | 461,073                                      | 2,515                          | 2.18%                               |
| Tax-exempt securities                       | 68,397                                       | 612                            | 3.58%   | 76,901                                       | 718                            | 3.74%                               |
| Federal funds sold (B)                      | 24,032                                       | 11                             | 0.18%   | 24,555                                       | 9                              | 0.15%                               |
| <b>Total interest-earning assets</b>        | <b>3,345,380</b>                             | <b>31,522</b>                  | <b>3.78%</b>  | <b>3,114,539</b>                             | <b>30,800</b>                  | <b>3.97%</b>                        |
| Noninterest-earning assets:                 |  |                                |   |  |                                |                                     |
| Allowance for loan and lease losses         | (30,996)                                     |                                |   | (29,685)                                     |                                |                                     |
| Other assets                                | 286,032                                      |                                |   | 275,435                                      |                                |                                     |
| <b>TOTAL ASSETS</b>                         | <b>\$ 3,600,416</b>                          |                                |   | <b>\$ 3,360,289</b>                          |                                |                                     |
| <b>Liabilities and Stockholders' Equity</b> |  |                                |   |  |                                |                                     |
| Interest-bearing liabilities:               |  |                                |   |  |                                |                                     |
| Savings accounts                            | \$ 402,142                                   | \$ 53                          | 0.05%   | \$ 387,179                                   | \$ 51                          | 0.05%                               |
| Interest-bearing transaction accounts       | 1,480,866                                    | 853                            | 0.23%   | 1,433,382                                    | 826                            | 0.23%                               |
| Time deposits                               | 295,996                                      | 440                            | 0.59%   | 284,475                                      | 366                            | 0.51%                               |
| Borrowings                                  | 326,859                                      | 1,293                          | 1.58%   | 236,908                                      | 887                            | 1.50%                               |
| <b>Total interest-bearing liabilities</b>   | <b>2,505,863</b>                             | <b>2,639</b>                   | <b>0.42%</b>  | <b>2,341,944</b>                             | <b>2,130</b>                   | <b>0.36%</b>                        |

|  |              |  |              |
|--|--------------|--|--------------|
| Noninterest-bearing liabilities:                 |              |  |              |
| Demand deposits                                  | 688,854      |  | 640,080      |
| Other liabilities                                | 15,548       |  | 14,463       |
| Stockholders equity                              | 390,151      |  | 363,802      |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b> |              |  |              |
|  | \$ 3,600,416 |  | \$ 3,360,289 |

|                                 |        |       |        |       |
|---------------------------------|--------|-------|--------|-------|
| Net interest income/spread      | 28,883 | 3.36% | 28,670 | 3.60% |
| Tax equivalent basis adjustment | 214    |       | 251    |       |

|                            |           |  |           |  |
|----------------------------|-----------|--|-----------|--|
| <b>NET INTEREST INCOME</b> | \$ 28,669 |  | \$ 28,419 |  |
|----------------------------|-----------|--|-----------|--|

Net interest margin (C) 3.46% 3.69%

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

(B) Includes interest-bearing cash accounts.

(C) Net interest income divided by interest-earning assets.

Interest income on a tax equivalent basis increased from \$30.8 million in the second quarter of 2014 to \$31.5 million in the second quarter of 2015, an increase of \$722,000, or 2%. The increase in interest income was primarily a result of a \$230.8 million increase in average interest earning assets partially offset by a 19 basis point decrease in the yield on interest earning assets. The yield on average loans and leases at 4.16% in the second quarter of 2015 was 17 basis points lower than the second quarter of 2014 due primarily to strong growth in new loans and leases originated or refinanced at lower rates. The yield on average taxable and tax exempt investment securities both decreased by 16 basis points compared to the second quarter of 2014 due to investments in new securities at lower rates.

Total interest expense at \$2.6 million in the second quarter of 2015 was \$509,000 greater than the \$2.1 million reported for the same period in 2014. The cost of average interest-bearing liabilities increased from 0.36% in the second quarter of 2014 to 0.42% in 2015. The increase in the cost of funds was due to a change in the mix of total interest-bearing liabilities. Interest-bearing deposits as a percent of total interest-bearing liabilities declined from 90% for the second quarter of 2014 to 87% in the second quarter of 2015. Borrowings as a percent of interest-bearing liabilities increased from 10% in the second quarter of 2014, to 13% in the second quarter of 2015 as borrowings increased \$90.0 million in that time period to help fund loan growth. Borrowings at a rate of 1.58% have a higher cost than interest bearing deposits which had an average cost of 0.25% for the second quarter of 2015.

---

**Table of Contents****Provision for Loan and Lease Losses**

In determining the provision for loan and lease losses, management considers national and local economic conditions; trends in the portfolio including orientation to specific loan types or industries; experience, ability and depth of lending management in relation to the complexity of the portfolio; adequacy and adherence to policies, procedures and practices; levels and trends in delinquencies, impaired loans and net charge-offs; and the results of independent third party loan review.

In the second quarter of 2015, a \$740,000 provision for loan and lease losses was recorded, which was \$853,000, or 54%, lower than the provision for the same period last year. During the second quarter of 2015, the Company charged off loans and leases of \$1.5 million and recovered \$404,000 in previously charged off loans and leases compared to \$1.7 million and \$484,000, respectively, during the same period in 2014. The lower provision resulted primarily from declining trends in net charge-offs and non-performing loans during the quarter. For more information regarding the determination of the provision, see Risk Elements below.

**Noninterest Income**

Noninterest income at \$5.0 million in the second quarter of 2015 increased by \$587,000, or 13%, compared to the second quarter of 2014. Service charges on deposit accounts at \$2.5 million decreased \$213,000, or 8%, primarily due to a decline in overdraft fees. Commissions and fees at \$1.2 million in the second quarter of 2015 increased \$114,000, or 11%, compared to the same period last year, due primarily to an increase in investment commission income and loan fee income. Gains on sales of loans totaled \$464,000 in the second quarter of 2015 compared to \$152,000 during the same period last year, due to increased origination and sales of residential mortgages. Other income totaling \$443,000 in the second quarter of 2015 was \$334,000 higher than the same period in 2014, due primarily to \$305,000 in swap income compared to no swap income in the second quarter of 2014.

**Noninterest Expense**

Noninterest expense totaling \$21.2 million increased \$1.7 million in the second quarter of 2015 compared to the second quarter of 2014. Salaries and employee benefits expense at \$12.1 million, increased \$944,000 from the same period last year, primarily due to costs associated with the addition of the new LPOs, increased medical benefit costs, and year-over-year incremental salary and benefit increases. Net occupancy expense at \$2.3 million increased \$232,000 compared to the second quarter of 2014, primarily as a result of a \$205,000 write down to the fair market value for one of the closed branches. Stationary, supplies and postage increased \$43,000 compared to the second quarter of 2014 due primarily to mailings of compliance disclosures in the second quarter of 2015. Marketing expense at \$416,000 in the second quarter of 2015 decreased \$60,000 compared to the second quarter of 2014 due primarily to the timing of marketing campaigns. Legal expense at \$325,000 increased \$106,000 compared to the same period last year primarily due to legal costs incurred to file a registration statement in the second quarter. Other real estate owned and other repossessed assets expense decreased by \$73,000 compared to the second quarter of 2014 due primarily to write downs on OREO properties recorded during the second quarter of 2014. Other expenses at \$3.4 million increased \$496,000 due primarily to an increase in loan origination costs and data processing fees. The Company's efficiency ratio, a non-GAAP financial measure, was 62.1% in the second quarter of 2015, compared to 58.7% for the same period last year. The increase was primarily due to an increase in noninterest expenses. The Company uses this ratio because it believes that the ratio provides a good comparison of period-to-period performance and because the ratio is widely accepted in the banking industry. The following table shows the calculation of the efficiency ratio for the periods presented:



**Table of Contents**

|   | <b>For the Three Months Ended June 30,</b> |           |
|---|--|-----------|
|   | 2015                                       | 2014      |
|   | (dollars in thousands)                     |           |
| <b>Calculation of efficiency ratio:</b>                     |  |           |
| Total noninterest expense                                   | \$ 21,195                                  | \$ 19,530 |
| Amortization of core deposit intangibles                    | (107)                                      | (119)     |
| Other real estate owned and other repossessed asset expense | (27)                                       | (100)     |
| Provision for unfunded lending commitments                  | (60)                                       | 93        |
| Noninterest expense, as adjusted                            | \$ 21,001                                  | \$ 19,404 |
| Net interest income   | \$ 28,669                                  | \$ 28,419 |
| Noninterest income  | 4,958                                      | 4,371     |
| Total revenue   | 33,627                                     | 32,790    |
| Tax-equivalent adjustment on municipal securities           | 214  | 251       |
| Gains on sales of investment securities                     | (17)                                       | -         |
| Total revenue, as adjusted                                  | \$ 33,824                                  | \$ 33,041 |
| Efficiency ratio  | 62.1%                                      | 58.7%     |

**Income Tax Expense**

The effective tax rate decreased from 33.3% in the second quarter of 2014 to 32.8% in the second quarter of 2015 primarily as a result of an increase in tax advantaged items as a percent of pretax income. Tax advantaged items include tax-exempt security interest and income on bank owned life insurance policies.

**(Year to Date 2015 Compared to Year to Date 2014)****Net Income**

Net income was \$16.2 million in the first half of 2015 compared to net income of \$14.9 million for the first half of 2014. Diluted earnings per share was \$0.42 for the first half of 2015, compared to diluted earnings per share of \$0.39 for the same period last year. Net interest income at \$57.2 million for the first half of 2015 increased \$923,000 compared to the first half of 2014 due to a \$1.8 million increase in interest income partially offset by a \$898,000 increase in interest expense. The increase in net interest income reflects an increase in interest earning assets resulting from organic growth.

**Net Interest Income**

Net interest income on a tax equivalent basis for the first half of 2015 was \$57.6 million, compared to \$56.8 million for the first half of 2014 resulting primarily from growth in average earning assets of \$220.3 million. The net interest margin decreased from 3.71% in the first half of 2014 to 3.51% in the first half of 2015 primarily as a result of a 16 basis point decrease in the yield on interest earning assets as well as a five basis point increase in the cost of interest bearing liabilities. Net interest income in the first half of 2015 included \$690,000 in net interest received resulting from the change in status of non-performing loans and prepayment fee income compared to \$142,000 of such income in the same period in 2014. The net interest margin excluding the impact of these items would be 3.47% and 3.70% for the first half of 2015 and 2014, respectively. The decrease in the net interest margin was somewhat mitigated by an increase in interest income earned on free funds (interest earning assets funded by non-interest bearing liabilities) resulting from an increase in average non-interest bearing deposits of \$45.2 million. The components of net interest

income will be discussed in greater detail below.

**Table of Contents**

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

**CONSOLIDATED STATISTICS ON A TAX EQUIVALENT BASIS**

|   | For the Six Months Ended,<br>June 30, 2015 |                                |   | For the Six Months Ended,<br>June 30, 2014 |                                |                                     |
|---|--|--------------------------------|---|--|--------------------------------|-------------------------------------|
|   | Average<br>Balance                         | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid<br><br>(dollars in thousands) | Average<br>Balance                         | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid |
| <b>Assets</b>                               |  |                                |   |  |                                |                                     |
| <b>Interest-earning assets:</b>             |  |                                |   |  |                                |                                     |
| Loans (A)                                   | \$ 2,690,823                               | \$ 56,107                      | 4.20%   | \$ 2,519,679                               | \$ 54,456                      | 4.36%                               |
| Taxable investment securities and other     | 523,179                                    | 5,362                          | 2.05%   | 463,105                                    | 5,061                          | 2.19%                               |
| Tax-exempt securities                       | 68,599                                     | 1,243                          | 3.62%   | 76,732                                     | 1,446                          | 3.77%                               |
| Federal funds sold (B)                      | 25,849                                     | 23                             | 0.18%   | 28,677                                     | 22                             | 0.15%                               |
| Total interest-earning assets               | 3,308,450                                  | 62,735                         | 3.82%   | 3,088,193                                  | 60,985                         | 3.98%                               |
| <b>Noninterest-earning assets:</b>          |  |                                |   |  |                                |                                     |
| Allowance for loan and lease losses         | (30,994)                                   |                                |   | (29,986)                                   |                                |                                     |
| Other assets                                | 286,404                                    |                                |   | 278,423                                    |                                |                                     |
| <b>TOTAL ASSETS</b>                         | <b>\$ 3,563,860</b>                        |                                |   | <b>\$ 3,336,630</b>                        |                                |                                     |
| <b>Liabilities and Stockholders' Equity</b> |  |                                |   |  |                                |                                     |
| <b>Interest-bearing liabilities:</b>        |  |                                |   |  |                                |                                     |
| Savings accounts                            | \$ 398,667                                 | \$ 104                         | 0.05%   | \$ 386,099                                 | \$ 102                         | 0.05%                               |
| Interest-bearing transaction accounts       | 1,488,028                                  | 1,692                          | 0.23%   | 1,437,055                                  | 1,628                          | 0.23%                               |
| Time deposits                               | 288,459                                    | 833                            | 0.58%   | 288,826                                    | 776                            | 0.54%                               |
| Borrowings                                  | 311,089                                    | 2,484                          | 1.60%   | 219,641                                    | 1,709                          | 1.56%                               |
| Total interest-bearing liabilities          | 2,486,243                                  | 5,113                          | 0.41%   | 2,331,621                                  | 4,215                          | 0.36%                               |
| <b>Noninterest-bearing liabilities:</b>     |  |                                |   |  |                                |                                     |
| Demand deposits                             | 674,780                                    |                                |   | 629,570                                    |                                |                                     |
| Other liabilities                           | 15,950                                     |                                |   | 15,044                                     |                                |                                     |
| Stockholders' equity                        | 386,887                                    |                                |   | 360,395                                    |                                |                                     |
|   | <b>\$ 3,563,860</b>                        |                                |   | <b>\$ 3,336,630</b>                        |                                |                                     |



TOTAL LIABILITIES  
AND STOCKHOLDERS  
EQUITY

|                                    |                  |       |                  |       |
|------------------------------------|------------------|-------|------------------|-------|
| Net interest income/spread         | 57,622           | 3.41% | 56,770           | 3.62% |
| Tax equivalent basis<br>adjustment | 435              |       | 506              |       |
| <b>NET INTEREST INCOME</b>         | <b>\$ 57,187</b> |       | <b>\$ 56,264</b> |       |
| Net interest margin (C)            |                  | 3.51% |                  | 3.71% |

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

(B) Includes interest-bearing cash accounts.

(C) Net interest income divided by interest-earning assets.

Interest income on a tax equivalent basis increased from \$61.0 million in the first half of 2014 to \$62.7 million in the first half of 2015, an increase of \$1.8 million, or 3%. The increase in interest income was primarily a result of a \$171.1 million increase in average loans and leases partially offset by a 16 basis point decrease in the yield on interest earning assets. The yield on average loans and leases at 4.20% in the first half of 2015 was 16 basis points lower than the first half of 2014. The yield on average taxable and tax exempt investment securities decreased by 14 basis points and 15 basis points, respectively, compared to the first half of 2014. The decline in yields in interest earning assets were due to the same reasons discussed in the quarterly comparison.

Total interest expense increased from \$4.2 million in the first half of 2014 to \$5.1 million in the first half of 2015, an increase of \$898,000, or 21%. The cost of average interest-bearing liabilities increased from 0.36% in the first half of 2014 to 0.41% in 2015. The increase in the cost of interest-bearing liabilities was due to the same reasons discussed in the quarterly comparison.

**Table of Contents****Provision for Loan and Lease Losses**

In the first half of 2015, a \$1.6 million provision for loan and lease losses was recorded, which was \$1.5 million lower than the provision for the same period last year. During the first half of 2015, the Company charged off loans and leases of \$2.8 million and recovered \$636,000 in previously charged off loans and leases compared to \$4.2 million and \$1.1 million, respectively, during the same period in 2014. The lower provision primarily resulted from lower net charge-offs during the six months ended June 30, 2015. For more information regarding the determination of the provision, see Risk Elements below.

**Noninterest Income**

Noninterest income at \$9.7 million in the first half of 2015 increased by \$1.3 million, or 15%, compared to the first half of 2014. Service charges on deposit accounts at \$4.8 million decreased \$432,000, or 8%, primarily due to a decline in overdraft fees. Commissions and fees at \$2.5 million in the first half of 2015 increased \$408,000 compared to the same period last year due primarily to the same reason discussed in the quarterly analysis. Gains on sales of loans at \$729,000 in the first half of 2015 increased \$494,000 compared to the same period last year. In the first half of 2015, a \$332,000 death benefit was received on a bank owned life insurance policy, accounting for the 50% increase in that category. Other income totaling \$570,000 in the first half of 2015 was \$405,000 higher than the same period in 2014. Within other income, the Company recorded \$305,000 in swap income compared to no swap income in the first half of 2014 and \$103,000 in gains on sale of other real estate compared to \$28,000 during the same period last year.

**Noninterest Expense**

Noninterest expense totaling \$41.2 million increased \$2.0 million in the first half of 2015 from the first half of 2014. Salary and employee benefits at \$23.9 million increased by \$1.9 million, or 9%, primarily due to the same reasons discussed in the quarterly analysis. Net occupancy expense increased from \$4.7 million in the first half of 2014, to \$4.8 million in the first half of 2015 for the same reason discussed in the quarterly analysis. Stationary, supplies and postage increased \$54,000 compared to the first half of 2014 primarily due to the same reason discussed in the quarterly comparison. Marketing expense at \$656,000 in the first half of 2015 decreased \$206,000 compared to the first half of 2014 due primarily to the timing of marketing campaigns. In the first half of 2015, legal expense at \$441,000 and other real estate owned and other repossessed assets at \$19,000 decreased \$51,000 and \$96,000, respectively, compared to the same period last year, resulting primarily from the continuing reduction in delinquencies and the recovery of expenses related to non-performing loans. Other expenses at \$6.1 million increased \$275,000 compared to the first half of 2014, due to an increase in loan origination costs and data processing costs offset by a decline in professional fees. The Company's efficiency ratio, a non-GAAP financial measure, was 60.6% in the first half of 2015, compared to 59.8% for the same period last year. The Company uses this ratio because it believes that the ratio provides a good comparison of period-to-period performance and because the ratio is widely accepted in the banking industry. The following table shows the calculation of the efficiency ratio for the periods presented:

**Table of Contents**

|   | For the Six Months Ended June 30, |           |
|---|-----------------------------------|-----------|
|   | 2015                              | 2014      |
|   | (dollars in thousands)            |           |
| <b>Calculation of efficiency ratio:</b>                     |                                   |           |
| Total noninterest expense                                   | \$ 41,237                         | \$ 39,272 |
| Amortization of core deposit intangibles                    | (218)                             | (242)     |
| Other real estate owned and other repossessed asset expense | (19)                              | (115)     |
| Provision for unfunded lending commitments                  | (190)                             | 82        |
| Noninterest expense, as adjusted                            | \$ 40,810                         | \$ 38,997 |
| Net interest income   | \$ 57,187                         | \$ 56,264 |
| Noninterest income  | 9,696                             | 8,444     |
| Total revenue   | 66,883                            | 64,708    |
| Tax-equivalent adjustment on municipal securities           | 435                               | 506       |
| Gains on sales of investment securities                     | (17)                              | (2)       |
| Total revenue, as adjusted                                  | \$ 67,301                         | \$ 65,212 |
| Efficiency ratio  | 60.6%                             | 59.8%     |

**Income Tax Expense**

The effective tax rate decreased from 33.1% in the first half of 2014 to 32.6% in the first half of 2015 primarily as a result of an increase in tax advantaged items as a percent of pre-tax income. Tax advantaged income items include interest income on tax-exempt securities and income on bank owned life insurance.

**Financial Condition**

The Company's total assets increased \$160.8 million from \$3.54 billion at December 31, 2014, to \$3.70 billion at June 30, 2015. Total loans were \$2.76 billion, an increase of \$101.1 million from \$2.66 billion at December 31, 2014. Total deposits were \$2.84 billion, an increase of \$52.1 million from December 31, 2014.

**Loans and Leases**

Gross loans and leases of \$2.76 billion at June 30, 2015 increased by \$101.1 million from December 31, 2014 primarily in the commercial loans secured by real estate category. Commercial loans secured by real estate and commercial, industrial and other increased \$83.3 million, or 5%, and \$24.4 million, or 10%, respectively, from December 31, 2014 to June 30, 2015. Real estate construction loans at \$82.3 million increased \$18.2 million, while residential mortgages and home equity and consumer loans decreased \$16.9 million and \$7.0 million, respectively. For more information on the loan portfolio, see Note 7 in Notes to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

**Risk Elements**

Non-performing assets decreased from \$21.7 million, or 0.61% of total assets, on December 31, 2014 to \$20.1 million, or 0.54% of total assets, on June 30, 2015. Non-performing assets decreased primarily in the commercial secured by real estate category, which decreased by \$2.1 million partially offset by a \$1.0 million increase in non-performing assets in commercial, industrial and other loans. Non-accrual loans at June 30, 2015 included two loan relationships with a balance



**Table of Contents**

of \$1.0 million or over, totaling \$3.5 million, and four loan relationships between \$500,000 and \$1.0 million, totaling \$2.6 million.

There were \$102,000 in loans and leases past due ninety days or more and still accruing at June 30, 2015 compared to \$66,000 at December 31, 2014. These loans primarily consisted of consumer loans which are generally placed on non-accrual and reviewed for charge-off when principal and interest payments are four months in arrears unless the obligations are well-secured and in the process of collection.

On June 30, 2015, the Company had \$12.4 million in loans that were troubled debt restructurings and still accruing interest income compared to \$10.6 million at December 31, 2014. Troubled debt restructurings are those loans where the Company has granted concessions to the borrower in payment terms, either in rate or in term, as a result of the financial condition of the borrower.

On June 30, 2015, the Company had \$26.0 million in impaired loans (consisting primarily of non-accrual and restructured loans and leases) compared to \$25.7 million at year-end 2014. For more information on impaired loans and leases see Note 7 in Notes to the Consolidated Financial Statements of this Quarterly Report on Form 10-Q. The valuation allowance for impaired loans is based primarily on the fair value of the underlying collateral. Based on such evaluation, \$1.3 million has been allocated as a portion of the allowance for loan and lease losses for impairment at June 30, 2015. At June 30, 2015, the Company also had \$48.2 million in loans and leases that were rated substandard that were not classified as non-performing or impaired compared to \$46.3 million at December 31, 2014.

There were no loans and leases at June 30, 2015, other than those designated non-performing, impaired or substandard, where the Company was aware of any credit conditions of any borrowers or obligors that would indicate a strong possibility of the borrowers not complying with present terms and conditions of repayment and which may result in such loans and leases being included as non-accrual, past due or renegotiated at a future date.

The following table sets forth for the periods presented, the historical relationships among the allowance for loan and lease losses, the provision for loan and lease losses, the amount of loans and leases charged-off and the amount of loan and lease recoveries:

**Table of Contents**

|   | Six Months<br>Ended<br>June 30,<br>2015 | Six Months<br>Ended<br>June 30,<br>2014 | Year<br>Ended<br>December 31,<br>2014 |
|---|---|---|---------------------------------------|
| (dollars in thousands)  |   |   |                                       |
| Balance of the allowance at the beginning of the year                       | \$30,684                                | \$29,821                                | \$29,821                              |
| Loans and leases charged off:   |   |   |                                       |
| Commercial, secured by real estate  | 1,351                                   | 1,791                                   | 2,282                                 |
| Commercial, industrial and other  | 74                                      | 612                                     | 999                                   |
| Leases  | 529                                     | 165                                     | 597                                   |
| Real estate-mortgage  | 106                                     | 509                                     | 827                                   |
| Real estate-construction  | 20                                      | 25                                      | 25                                    |
| Home equity and consumer  | 676                                     | 1,084                                   | 2,697                                 |
| Total loans charged off   | 2,756                                   | 4,186                                   | 7,427                                 |
| Recoveries:   |   |   |                                       |
| Commercial, secured by real estate  | 364                                     | 354                                     | 999                                   |
| Commercial, industrial and other  | 84                                      | 679                                     | 1,039                                 |
| Leases  | 20                                      | --                                      | 19                                    |
| Real estate-mortgage  | 3                                       | 9                                       | 42                                    |
| Real estate-construction  | 106                                     | 1                                       | 106                                   |
| Home equity and consumer  | 59                                      | 106                                     | 220                                   |
| Total Recoveries  | 636                                     | 1,149                                   | 2,425                                 |
| Net charge-offs:  | 2,120                                   | 3,037                                   | 5,002                                 |
| Provision for loan and lease losses   | 1,610                                   | 3,082                                   | 5,865                                 |
| Ending balance  | \$30,174                                | \$29,866                                | \$30,684                              |
| Ratio of annualized net charge-offs to average loans and leases outstanding | 0.16%                                   | 0.24%                                   | 0.19%                                 |

Ratio of allowance at end of period as a percentage of period end total loans and leases

1.09%                      1.14%                      1.16%

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

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

The establishment of specific reserve amounts for all specifically identified classified loans and leases that have been designated as requiring attention by Lakeland.

The establishment of reserves for pools of homogeneous types of loans and leases not subject to specific review, including impaired loans under \$500,000, leases, 1-4 family residential mortgages, and consumer loans.

The establishment of reserve amounts for the non-classified loans and leases in each portfolio based upon the historical average loss experience as modified by management's assessment of the loss emergence period for these portfolios and management's evaluation of key environmental factors.

Lakeland also maintains an unallocated component in its allowance for loan and lease losses. Management believes that the unallocated component is warranted for inherent factors that cannot be practically assigned to individual loss categories, such as the periodic updating of appraisals on impaired loans, as well as periodic updating of commercial loan credit risk ratings by loan officers and Lakeland's internal credit review process.

## **Table of Contents**

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

While the overall balance of the allowance for loan and lease losses at \$30.2 million at June 30, 2015 only decreased \$510,000, or 2%, from December 31, 2014, the distribution of the allowance changed between segments of the loan portfolio reflecting changes in the non-performing loan and charge-off statistics within each portfolio. Loan reserves are based on a combination of historical charge-off experience (analyzing gross charge-offs over a twelve quarter period for commercial loans, and an eight quarter period for all other portfolios), estimating the appropriate loss emergence period and assigning qualitative factors based on general economic conditions and specific bank portfolio characteristics.

Based on the above analysis, the allowance for commercial, industrial and other loans has declined as a result of a significant reduction in charge-offs over a three year look-back period. The allowance for commercial loans secured by real estate increased due to the analysis of specific bank portfolio characteristics including the growth of the portfolio and the change in risk characteristics in the portfolio due to the increasing volume of loans exceeding \$5 million. The allowance for lease losses has increased due to an increase in charge-offs over its lookback period. Allowances for losses in the residential mortgages and home equity and consumer portfolios have declined due to declines in charge-offs over their lookback periods.

Non-performing loans and leases decreased from \$20.7 million on December 31, 2014 to \$19.0 million on June 30, 2015. The allowance for loan and lease losses as a percent of total loans was 1.09% of total loans on June 30, 2015 compared to 1.16% as of December 31, 2014. The reduction in the percentage of the allowance for loan and lease losses as a percent of total loans and leases results from a declining trend in charge-offs and non-performing loans. Management believes, based on appraisals and estimated selling costs, that the majority of its non-performing loans and leases are adequately secured and reserves on its non-performing loans and leases are adequate. Based upon the process employed and giving recognition to all accompanying factors related to the loan and lease portfolio, management considers the allowance for loan and lease losses to be adequate at June 30, 2015.

## **Investment Securities**

For detailed information on the composition and maturity distribution of the Company's investment securities portfolio, see Note 6 in Notes to Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q. Total investment securities increased from \$565.4 million on December 31, 2014 to \$584.8 million on June 30, 2015, an increase of \$19.4 million, or 3%.

## **Deposits**

Total deposits increased from \$2.79 billion on December 31, 2014 to \$2.84 billion on June 30, 2015, an increase of \$52.1 million, or 2%. Noninterest bearing deposits increased \$68.2 million while savings and interest bearing deposits decreased \$42.5 million. The decline in interest bearing deposits is primarily due to a cyclical decrease in public funds. Additionally, time deposits increased \$26.5 million, or 9%, resulting primarily from an increase in public CDs.

## **Liquidity**



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

**Table of Contents**

Lakeland funds loan demand and operation expenses from several sources:

Net income. Cash provided by operating activities was \$16.1 million for the first six months of 2015 compared to \$20.6 million for the same period in 2014.

Deposits. Lakeland can offer new products or change its rate structure in order to increase deposits. In the first six months of 2015, Lakeland's deposits increased \$52.1 million.

Sales of securities. At June 30, 2015 the Company had \$461.7 million in securities designated available for sale. Of these securities, \$300.2 million were pledged to secure public deposits and for other purposes required by applicable laws and regulations.

Repayments on loans and leases can also be a source of liquidity to fund further loan growth.

Overnight credit lines. As a member of the Federal Home Loan Bank of New York (FHLB), Lakeland has the ability to borrow overnight based on the market value of collateral pledged. Lakeland had no overnight borrowings from the FHLB on June 30, 2015. Lakeland also has overnight federal funds lines available for it to borrow up to \$162.0 million. Lakeland had borrowings against these lines of \$115.0 million at June 30, 2015. Lakeland may also borrow from the discount window of the Federal Reserve Bank of New York based on the market value of collateral pledged. Lakeland had no borrowings with the Federal Reserve Bank of New York as of June 30, 2015.

Other borrowings. Lakeland can also generate funds by utilizing long-term debt or securities sold under agreements to repurchase that would be collateralized by security or mortgage collateral. At times the market values of securities collateralizing our securities sold under agreements to repurchase may decline due to changes in interest rates and may necessitate our lenders to issue a margin call which requires Lakeland to pledge additional collateral to meet that margin call.

Management and the Board monitor the Company's liquidity through the asset/liability committee, which monitors the Company's compliance with certain regulatory ratios and other various liquidity guidelines.

The cash flow statements for the periods presented provide an indication of the Company's sources and uses of cash, as well as an indication of the ability of the Company to maintain an adequate level of liquidity. A discussion of the cash flow statement for the six months ended June 30, 2015 follows.

Cash and cash equivalents totaling \$137.6 million on June 30, 2015 increased \$28.3 million from December 31, 2014. Operating activities provided \$16.1 million in net cash. Investing activities used \$131.4 million in net cash, primarily reflecting an increase in loans and leases and investment securities. Financing activities provided \$143.6 million in net cash primarily reflecting the increase in deposits and other borrowings of \$52.2 million and \$60.2 million, respectively. The Company anticipates that it will have sufficient funds available to meet its current loan commitments and deposit maturities. This constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of June 30, 2015. Interest on subordinated debentures and long-term borrowed funds is calculated based on current contractual interest rates.

**Table of Contents**

| (dollars in thousands)                                    | Total              | Within one year  | After one but within three years | After three but within five years | After five years |
|---|--------------------|------------------|----------------------------------|-----------------------------------|------------------|
| Minimum annual rentals on noncancellable operating leases | \$25,262           | \$2,584          | \$4,335                          | \$3,406                           | \$14,937         |
| Benefit plan commitments                                  | 6,508              | 198              | 690                              | 793                               | 4,827            |
| Remaining contractual maturities of time deposits         | 306,431            | 196,781          | 102,847                          | 6,668                             | 135              |
| Subordinated debentures                                   | 41,238             | ---              | ---                              | ---                               | 41,238           |
| Loan commitments  | 707,789            | 562,746          | 95,765                           | 239                               | 49,039           |
| Other borrowings  | 262,728            | 45,000           | 187,728                          | 20,000                            | 10,000           |
| Interest on other borrowings*                             | 31,346             | 5,318            | 7,741                            | 2,882                             | 15,405           |
| Standby letters of credit                                 | 10,885             | 9,067            | 1,738                            | ---                               | 80               |
| <b>Total</b>  | <b>\$1,392,187</b> | <b>\$821,694</b> | <b>\$400,844</b>                 | <b>\$33,988</b>                   | <b>\$135,661</b> |

\*Includes interest on other borrowings and subordinated debentures at a weighted rate of 1.78%.

**Capital Resources**

Total stockholders' equity increased from \$379.4 million on December 31, 2014 to \$390.9 million on June 30, 2015, an increase of \$11.4 million, or 3%. Book value per common share increased to \$10.31 on June 30, 2015 from \$10.01 on December 31, 2014. The increase in stockholders' equity from December 31, 2014 to June 30, 2015 was primarily due to \$16.2 million in net income, partially offset by the payment of dividends on common stock of \$6.1 million.

The Company and Lakeland are subject to various regulatory capital requirements that are monitored by federal banking agencies. Failure to meet minimum capital requirements can lead to certain supervisory actions by regulators; any supervisory action could have a direct material adverse effect on the Company or Lakeland's financial statements. Management believes, as of June 30, 2015, that the Company and Lakeland meet all capital adequacy requirements to which they are subject.

The final rules implementing the Basel Committee on Banking Supervision's (BCBS) capital guidelines for U.S. banks became effective for the Company on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of June 30, 2015, the Company's capital levels remained characterized as well-capitalized under the new rules. For further discussion, see Basel III below.

The capital ratios for the Company and Lakeland at June 30, 2015 are as follows:

|                        | Common Equity                                |                                      |  |   |
|------------------------|--|--------------------------------------|--|---|
|                        | Tier 1 Capital to Total Average Assets Ratio | Tier 1 to Risk-Weighted Assets Ratio | Tier 1 Capital to Risk-Weighted Assets Ratio | Total Capital to Risk-Weighted Assets Ratio |
|                        | June 30, 2015                                | June 30, 2015                        | June 30, 2015                                | June 30, 2015                               |
| <b>Capital Ratios:</b> |  |                                      |  |   |
| The Company            | 9.12%  | 9.66%                                | 11.05%                                       | 12.15%                                      |
| Lakeland Bank          | 8.41%  | 10.20%                               | 10.20%                                       | 11.29%                                      |

|   |       |       |       |        |
|---|-------|-------|-------|--------|
| Well capitalized institution under FDIC Regulations | 5.00% | 6.50% | 8.00% | 10.00% |
|---|-------|-------|-------|--------|

**Table of Contents***Basel III*

On July 2, 2013, the FRB approved the final rules implementing the Basel Committee on Banking Supervision's (BCBS) capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Company. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The final rules also implement strict eligibility criteria for regulatory capital instruments. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. The FDIC's rule is identical in substance to the final rules issued by the FRB. The phase-in period for the final rules began for the Company on January 1, 2015, with full compliance with all of the final rules requirements to be phased in over a multi-year schedule through January 1, 2019. As of June 30, 2015, the Company and Lakeland met all of the requirements under the new rules on a fully phased-in basis, if such requirements were in effect.

**Non-GAAP Financial Measures**

Reported amounts are presented in accordance with U.S. GAAP. The Company's management believes that the supplemental non-GAAP information, which consists of measurements and ratios based on tangible equity and tangible assets, is utilized by regulators and market analysts to evaluate a company's financial condition and therefore, such information is useful to investors. These disclosures should not be viewed as a substitute for financial results determined in accordance with U.S. GAAP, nor are they necessarily comparable to non-GAAP performance measures which may be presented by other companies.

| (dollars in thousands, except per share amounts)                       | June 30,<br>2015 | December 31,<br>2014 |
|--|------------------|----------------------|
| <b>Calculation of tangible book value per common share</b>             |                  |                      |
| Total common stockholders' equity at end of period - GAAP              | \$ 390,860       | \$ 379,438           |
| Less:  |                  |                      |
| Goodwill   | 109,974          | 109,974              |
| Other identifiable intangible assets, net                              | 1,742            | 1,960                |
| Total tangible common stockholders' equity at end of period - Non-GAAP | \$ 279,144       | \$ 267,504           |
| Shares outstanding at end of period                                    | 37,903           | 37,911               |
| Book value per share - GAAP  | \$10.31          | \$10.01              |
| Tangible book value per share - Non-GAAP                               | \$7.36           | \$7.06               |

**Calculation of tangible common equity to tangible assets**

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|   |              |              |
|---|--------------|--------------|
| Total tangible common stockholders equity at end of period - Non-GAAP | \$ 279,144   | \$ 267,504   |
| Total assets at end of period   | \$ 3,699,127 | \$ 3,538,325 |
| Less:   |              |              |
| Goodwill  | 109,974      | 109,974      |
| Other identifiable intangible assets, net                             | 1,742        | 1,960        |
| Total tangible assets at end of period - Non-GAAP                     | \$ 3,587,411 | \$ 3,426,391 |
| Common equity to assets - GAAP  | 10.57%       | 10.72%       |
| Tangible common equity to tangible assets - Non-GAAP                  | 7.78%        | 7.81%        |

**Table of Contents**

| (dollars in thousands)   | For the three months ended, |                  | For the six months ended, |                  |
|--|-----------------------------|------------------|---------------------------|------------------|
|  | June 30,<br>2015            | June 30,<br>2014 | June 30,<br>2015          | June 30,<br>2014 |
| <b>Calculation of return on average tangible common equity</b>   |                             |                  |                           |                  |
| Net income - GAAP  | \$7,862                     | \$7,781          | \$16,192                  | \$14,944         |
| Total average common stockholders equity                         | \$ 390,151                  | \$ 363,802       | \$ 386,887                | \$ 360,395       |
| Less:  |                             |                  |                           |                  |
| Average goodwill   | 109,974                     | 109,974          | 109,974                   | 109,974          |
| Average other identifiable intangible assets, net                | 1,807                       | 2,256            | 1,863                     | 2,317            |
| Total average tangible common stockholders equity - Non-GAAP     | \$ 278,370                  | \$ 251,572       | \$ 275,050                | \$ 248,104       |
| Return on average common stockholders equity - GAAP              | 8.08%                       | 8.58%            | 8.44%                     | 8.36%            |
| Return on average tangible common stockholders equity - Non-GAAP | 11.33%                      | 12.41%           | 11.87%                    | 12.15%           |

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

The Company manages interest rate risk and market risk by identifying and quantifying interest rate risk exposures using simulation analysis and economic value at risk models. Net interest income simulation considers the relative sensitivities of the balance sheet including the effects of interest rate caps on adjustable rate mortgages and the relatively stable aspects of core deposits. As such, net interest income simulation is designed to address the probability of interest rate changes and the behavioral response of the balance sheet to those changes. Market Value of Portfolio Equity represents the fair value of the net present value of assets, liabilities and off-balance-sheet items. Changes in estimates and assumptions made for interest rate sensitivity modeling could have a significant impact on projected results and conclusions. These assumptions could include prepayment rates, sensitivity of non-maturity deposits and other similar assumptions. Therefore, if our assumptions should change, this technique may not accurately reflect the impact of general interest rate movements on the Company's net interest income or net portfolio value.

The starting point (or base case) for the following table is an estimate of the following year's net interest income assuming that both interest rates and the Company's interest-sensitive assets and liabilities remain at period-end levels. The net interest income estimated for the next twelve months (the base case) is \$114.4 million. The information provided for net interest income assumes that changes in interest rates of plus 200 basis points and minus 200 basis points change gradually in equal increments (rate ramp) over the twelve month period.



## Changes in interest rates

|           |         |         |
|-----------|---------|---------|
| Rate Ramp | +200 bp | -200 bp |
|-----------|---------|---------|

|                              |       |       |
|------------------------------|-------|-------|
| Asset/Liability Policy Limit | -5.0% | -5.0% |
|------------------------------|-------|-------|

|               |       |       |
|---------------|-------|-------|
| June 30, 2015 | -3.3% | -1.9% |
|---------------|-------|-------|

|                   |       |       |
|-------------------|-------|-------|
| December 31, 2014 | -3.6% | -1.9% |
|-------------------|-------|-------|

The Company's review of interest rate risk also includes policy limits for net interest income changes in various rate shock scenarios. Rate shocks assume that current interest rates change immediately. The information provided for net interest income assumes fluctuations or rate shocks for changes in interest rates as shown in the table below.

## Changes in interest rates

|                              |         |         |         |         |
|------------------------------|---------|---------|---------|---------|
| Rate Shock                   | +300 bp | +200 bp | +100 bp | -100 bp |
| Asset/Liability Policy Limit | -15.0%  | -10.0%  | -5.0%   | -5.0%   |

|               |       |       |       |       |
|---------------|-------|-------|-------|-------|
| June 30, 2015 | -3.9% | -2.5% | -1.1% | -4.6% |
|---------------|-------|-------|-------|-------|

|                   |       |       |       |       |
|-------------------|-------|-------|-------|-------|
| December 31, 2014 | -5.2% | -3.2% | -1.3% | -4.5% |
|-------------------|-------|-------|-------|-------|

**Table of Contents**

The base case for the following table is an estimate of the Company's net portfolio value for the periods presented using current discount rates, and assuming the Company's interest-sensitive assets and liabilities remain at period-end levels. The net portfolio value at June 30, 2015 (the base case) was \$498.4 million. The information provided for the net portfolio value assumes fluctuations or rate shocks for changes in interest rates as shown in the table below. Rate shocks assume that current interest rates change immediately.

| Rate Shock                   | Changes in interest rates |         |         |         |
|------------------------------|---------------------------|---------|---------|---------|
|                              | +300 bp                   | +200 bp | +100 bp | -100 bp |
| Asset/Liability Policy Limit | -35.0%                    | -25.0%  | -15.0%  | -15.0%  |
| June 30, 2015                | -12.8%                    | -8.4%   | -3.8%   | 1.1%    |
| December 31, 2014            | -13.0%                    | -8.2%   | -3.5%   | 0.7%    |

The information set forth in the above tables is based on significant estimates and assumptions, and constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995. For more information regarding the Company's market risk and assumptions used in the Company's simulation models, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

Certain shortcomings are inherent in the methodologies used in the above interest rate risk measurements. Modeling changes in net interest income requires the making of certain assumptions regarding prepayment and deposit decay rates, which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. While management believes such assumptions are reasonable, there can be no assurance that assumed prepayment rates and decay rates will approximate actual future loan prepayment and deposit withdrawal activity. Moreover, the net interest income table presented assumes that the composition of interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the net interest income table provides an indication of the Company's interest rate risk exposure at a particular point in time, such measurement is not intended to and does not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual results.

**ITEM 4. Controls and Procedures**

(a) **Disclosure controls and procedures.** As of the end of the Company's most recently completed fiscal quarter covered by this report, the Company carried out an evaluation, with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and are operating in an effective manner and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) **Changes in internal controls over financial reporting.** There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2015 that have materially affected, or

are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION**

## Item 1. Legal Proceedings

There are no pending legal proceedings involving the Company or Lakeland other than those arising in the normal course of business. Management does not anticipate that the potential liability, if any, arising out of such legal proceedings will have a material effect on the financial condition or results of operations of the Company and Lakeland on a consolidated basis.

## Item 1A. Risk Factors

There have been no material changes in risk factors from those disclosed under Item 1A, Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds      Not Applicable

Item 3. Defaults Upon Senior Securities      Not Applicable

Item 4. Mine Safety Disclosures      Not Applicable

Item 5. Other Information      Not Applicable

Item 6. Exhibits

- 10.1      Amendment, dated August 7, 2015, to Employment Agreement, dated May 22, 2008, among Lakeland Bancorp, Inc., Lakeland Bank and Thomas J. Shara, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on August 7, 2015.
- 10.2      Amendment, dated August 7, 2015, to Change in Control Agreement, dated March 1, 2001, as amended by agreements dated March 10, 2003 and December 31, 2008, among Lakeland Bancorp, Inc., Lakeland Bank and Joseph F. Hurley, is incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on August 7, 2015.
- 10.3      Amendment, dated August 7, 2015, to Change in Control Agreement, dated March 1, 2001, as amended by agreements dated March 10, 2003 and December 31, 2008, among Lakeland Bancorp, Inc., Lakeland Bank and Robert A. Vandenberg, is incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on August 7, 2015.
- 10.4      Amendment, dated August 7, 2015, to Change in Control Agreement, dated June 12, 2009, among Lakeland Bancorp, Inc., Lakeland Bank and Ronald E. Schwarz, is incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the SEC on August 7, 2015.
- 10.5      Amendment, dated August 7, 2015, to Change in Control Agreement, dated November 24, 2008, as amended, among Lakeland Bancorp, Inc., Lakeland Bank and David S.

Yanagisawa.

- 10.6 Amendment, dated August 7, 2015, to Change in Control Agreement, dated March 7, 2001, as amended, among Lakeland Bancorp, Inc., Lakeland Bank and Jeffrey J. Buonforte.
- 10.7 Amendment, dated August 7, 2015, to Change in Control Agreement, dated April 7, 2004, as amended, among Lakeland Bancorp, Inc., Lakeland Bank and James R. Noonan.
- 10.8 Amendment, dated August 7, 2015, to Change in Control Agreement, dated October 31, 2013, as amended, among Lakeland Bancorp, Inc., Lakeland Bank and Timothy J. Matteson.
- 31.1 Certification by Thomas J. Shara pursuant to Section 302 of the Sarbanes Oxley Act.
- 31.2 Certification by Joseph F. Hurley pursuant to Section 302 of the Sarbanes Oxley Act.
- 32.1 Certification by Thomas J. Shara and Joseph F. Hurley pursuant to Section 906 of the Sarbanes Oxley Act.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

**Table of Contents**

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.

Lakeland Bancorp, Inc.

(Registrant)

/s/ Thomas J. Shara

Thomas J. Shara  
President and Chief Executive Officer

/s/ Joseph F. Hurley

Joseph F. Hurley  
Executive Vice President and  
Chief Financial Officer

Date: August 7, 2015