

REPUBLIC FIRST BANCORP INC  
Form 10-Q  
November 07, 2018

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2018.

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: 000-17007

Republic First Bancorp, Inc.  
(Exact name of registrant as specified in its charter)

Pennsylvania 23-2486815  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

50 South 16<sup>th</sup> Street, Philadelphia, Pennsylvania 19102  
(Address of principal executive offices) (Zip code)

215-735-4422  
(Registrant's telephone number, including area code)

Not Applicable  
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES  NO

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

Act.

Large accelerated filer  Accelerated filer   
Non-Accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 Registrant's classes of common stock, as of the latest practicable date.

|                                       |   |
|---------------------------------------|---|
| <u>Common Stock, \$0.01 per share</u> | <u>58,788,603</u>                                   |
| Title of Class                        | Number of Shares Outstanding as of November 6, 2018 |

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REPUBLIC FIRST BANCORP, INC. AND SUBSIDIARIES  
TABLE OF CONTENTS

| Part I: Financial Information  | Page |
|--|------|
| Item 1. Financial Statements   |      |
| Consolidated balance sheets as of September 30, 2018 and December 31, 2017 (unaudited)   | 1    |
| Consolidated statements of income for the three and nine months ended September 30, 2018 and 2017 (unaudited)                      | 2    |
| Consolidated statements of comprehensive income (loss) for the three and nine months ended September 30, 2018 and 2017 (unaudited) | 3    |
| Consolidated statements of cash flows for the nine months ended September 30, 2018 and 2017 (unaudited)                            | 4    |
| Consolidated statements of changes in shareholders' equity for the nine months ended September 30, 2018 and 2017 (unaudited)       | 5    |
| Notes to consolidated financial statements (unaudited)   | 6    |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations                                      | 41   |
| Item 3. Quantitative and Qualitative Disclosures about Market Risk   | 61   |
| Item 4. Controls and Procedures  | 61   |
| Part II: Other Information   |      |
| Item 1. Legal Proceedings  | 62   |
| Item 1A. Risk Factors  | 62   |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds  | 62   |
| Item 3. Defaults Upon Senior Securities  | 62   |
| Item 4. Mine Safety Disclosures  | 62   |
| Item 5. Other Information  | 62   |
| Item 6. Exhibits   | 63   |
| Signatures   | 64   |

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Republic First Bancorp, Inc. and Subsidiaries  
 Consolidated Balance Sheets  
 September 30, 2018 and December 31, 2017  
 (Dollars in thousands, except per share data)  
 (unaudited)

|  | September<br>30, 2018 | December 31,<br>2017 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Cash and due from banks  | \$<br>37,303          | \$<br>36,073         |
| Interest bearing deposits with banks   | 108,996               | 25,869               |
| Cash and cash equivalents  | 146,299               | 61,942               |
| Investment securities available for sale, at fair value  | 487,524               | 464,430              |
| Investment securities held to maturity, at amortized cost (fair value of \$461,518 and \$463,799, respectively)  | 485,291               | 472,213              |
| Restricted stock, at cost  | 1,916                 | 1,918                |
| Mortgage loans held for sale, at fair value  | 29,702                | 43,375               |
| Other loans held for sale  | 3,137                 | 2,325                |
| Loans receivable (net of allowance for loan losses of \$8,084 and \$8,599, respectively)   | 1,370,704             | 1,153,679            |
| Premises and equipment, net  | 81,912                | 74,947               |
| Other real estate owned, net   | 6,768                 | 6,966                |
| Accrued interest receivable  | 8,301                 | 7,009                |
| Goodwill   | 5,011                 | 5,011                |
| Other assets   | 30,641                | 28,532               |
| Total Assets   | \$<br>2,657,206       | \$<br>2,322,347      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                       |                      |
| <b>Liabilities</b>   |                       |                      |
| <b>Deposits</b>  |                       |                      |
| Demand – non-interest bearing  | \$<br>509,188         | \$<br>438,500        |
| Demand – interest bearing  | 1,058,670             | 807,736              |
| Money market and savings   | 703,358               | 700,322              |
| Time deposits  | 129,142               | 116,737              |
| Total Deposits   | 2,400,358             | 2,063,295            |
| Accrued interest payable   | 401                   | 293                  |
| Other liabilities  | 9,366                 | 10,618               |
| Subordinated debt  | 11,257                | 21,681               |
| Total Liabilities  | 2,421,382             | 2,095,887            |
| <b>Shareholders' Equity</b>  |                       |                      |
| Preferred stock, par value \$0.01 per share: 10,000,000 shares authorized; no shares issued and outstanding  | -                     | -                    |
| Common stock, par value \$0.01 per share: 100,000,000 shares authorized; shares issued 59,317,448 as of September 30, 2018 and 57,518,609 as of December 31, 2017; shares outstanding 58,788,603 as of September 30, 2018 and 56,989,764 as of December 31, 2017 | 593                   | 575                  |
| Additional paid in capital   | 268,613               | 256,285              |

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|   |              |              |
|---|--------------|--------------|
| Accumulated deficit   | (10,873)     | (18,983)     |
| Treasury stock at cost (503,408 shares as of September 30, 2018 and December 31, 2017)                  | (3,725)      | (3,725)      |
| Stock held by deferred compensation plan (25,437 shares as of September 30, 2018 and December 31, 2017) | (183)        | (183)        |
| Accumulated other comprehensive loss  | (18,601)     | (7,509)      |
| Total Shareholders' Equity  | 235,824      | 226,460      |
| Total Liabilities and Shareholders' Equity  | \$ 2,657,206 | \$ 2,322,347 |

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Income  
For the Three and Nine Months Ended September 30, 2018 and 2017  
(Dollars in thousands, except per share data)  
(unaudited)

|  | Three Months<br>Ended September<br>30, |          | Nine Months<br>Ended September<br>30, |          |
|--|--|----------|---------------------------------------|----------|
|  | 2018                                   | 2017     | 2018                                  | 2017     |
| Interest income:   |  |          |                                       |          |
| Interest and fees on taxable loans                               | \$16,353                               | \$12,717 | \$45,342                              | \$35,727 |
| Interest and fees on tax-exempt loans                            | 411                                    | 272      | 1,148                                 | 791      |
| Interest and dividends on taxable investment securities          | 6,511                                  | 4,653    | 19,536                                | 14,163   |
| Interest and dividends on tax-exempt investment securities       | 130                                    | 99       | 367                                   | 447      |
| Interest on federal funds sold and other interest-earning assets | 153                                    | 181      | 388                                   | 312      |
| Total interest income  | 23,558                                 | 17,922   | 66,781                                | 51,440   |
| Interest expense:  |  |          |                                       |          |
| Demand- interest bearing   | 1,948                                  | 772      | 4,754                                 | 2,075    |
| Money market and savings   | 1,308                                  | 788      | 3,454                                 | 2,218    |
| Time deposits  | 386                                    | 312      | 1,121                                 | 903      |
| Other borrowings   | 770                                    | 338      | 1,528                                 | 1,046    |
| Total interest expense   | 4,412                                  | 2,210    | 10,857                                | 6,242    |
| Net interest income  | 19,146                                 | 15,712   | 55,924                                | 45,198   |
| Provision for loan losses  | 500                                    | -        | 1,700                                 | 500      |
| Net interest income after provision for loan losses              | 18,646                                 | 15,712   | 54,224                                | 44,698   |
| Non-interest income:   |  |          |                                       |          |
| Loan and servicing fees  | 320                                    | 677      | 839                                   | 1,330    |
| Mortgage banking income  | 2,580                                  | 3,159    | 7,948                                 | 8,551    |
| Gain on sales of SBA loans                                       | 816                                    | 831      | 2,654                                 | 2,315    |
| Service fees on deposit accounts                                 | 1,386                                  | 1,067    | 3,887                                 | 2,820    |
| Loss on sale of investment securities                            | -                                      | -        | (1)                                   | (61)     |
| Other non-interest income  | 29                                     | 44       | 107                                   | 130      |
| Total non-interest income  | 5,131                                  | 5,778    | 15,434                                | 15,085   |
| Non-interest expenses:   |  |          |                                       |          |
| Salaries and employee benefits                                   | 11,203                                 | 9,829    | 32,731                                | 27,800   |
| Occupancy  | 1,975                                  | 1,772    | 5,976                                 | 5,239    |
| Depreciation and amortization                                    | 1,285                                  | 1,292    | 4,107                                 | 3,588    |
| Legal  | 276                                    | 156      | 916                                   | 535      |
| Other real estate owned  | 378                                    | 746      | 881                                   | 1,704    |
| Appraisal and other loan expenses                                | 583                                    | 598      | 1,316                                 | 1,421    |
| Advertising  | 290                                    | 394      | 916                                   | 861      |
| Data processing  | 1,009                                  | 785      | 2,773                                 | 2,335    |
| Insurance  | 181                                    | 277      | 690                                   | 750      |
| Professional fees  | 498                                    | 454      | 1,476                                 | 1,389    |
| Regulatory assessments and costs                                 | 396                                    | 355      | 1,258                                 | 1,008    |
| Taxes, other   | 243                                    | 242      | 733                                   | 716      |
| Other operating expenses   | 2,516                                  | 2,265    | 7,891                                 | 6,308    |
| Total non-interest expense                                       | 20,833                                 | 19,165   | 61,664                                | 53,654   |

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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| Income before provision (benefit) for income taxes | 2,944   | 2,325   | 7,994   | 6,129   |
| Provision (benefit) for income taxes               | 622     | 4       | 1,524   | (38)    |
| Net income   | \$2,322 | \$2,321 | \$6,470 | \$6,167 |
| Net income per share:                              |         |         |         |         |
| Basic  | \$0.04  | \$0.04  | \$0.11  | \$0.11  |
| Diluted  | \$0.04  | \$0.04  | \$0.11  | \$0.11  |

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Comprehensive Income (Loss)  
For the Three and Nine Months Ended September 30, 2018 and 2017  
(Dollars in thousands)  
(unaudited)

|   | Three Months<br>Ended<br>September 30,<br>2018 |         | Nine Months<br>Ended<br>September 30,<br>2018 |         |
|---|--|---------|---|---------|
|   | 2018   | 2017    | 2018  | 2017    |
| Net income  | \$2,322  | \$2,321 | \$6,470                                       | \$6,167 |
| Other comprehensive income (loss), net of tax   |  |         |   |         |
| Unrealized (losses) gains on securities (pre-tax (\$3,202) (\$7), (\$12,210), and \$2,615, respectively)                      | (2,500)  | (5)     | (9,536)                                       | 1,676   |
| Reclassification adjustment for securities losses (pre-tax \$-, \$-, \$1, and \$61, respectively)                             | -  | -       | 1   | 39      |
| Net unrealized gains (losses) on securities   | (2,500)  | (5)     | (9,535)                                       | 1,715   |
| Net unrealized holding losses on securities transferred from available-for-sale to held-to-maturity:                          |  |         |   |         |
| Amortization of net unrealized holding losses to income during the period (pre-tax \$37, \$44, \$106, and \$129 respectively) | 29   | 28      | 83  | 83      |
| Total other comprehensive income (loss)   | (2,471)  | 23      | (9,452)                                       | 1,798   |
| Total comprehensive income (loss)   | \$(149)  | \$2,344 | \$(2,982)                                     | \$7,965 |

(See notes to consolidated financial statements)



Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
For the Nine Months Ended September 30, 2018 and 2017  
(Dollars in thousands)  
(unaudited)

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2018                               | 2017      |
| Cash flows from operating activities  |                                    |           |
| Net income  | \$6,470                            | \$6,167   |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                                    |           |
| Provision for loan losses   | 1,700                              | 500       |
| Write down of other real estate owned   | 18                                 | 777       |
| Depreciation and amortization   | 4,107                              | 3,588     |
| Stock based compensation  | 1,584                              | 1,329     |
| Loss on sale of investment securities   | 1                                  | 61        |
| Amortization of premiums on investment securities   | 2,271                              | 1,788     |
| Accretion of discounts on retained SBA loans  | (1,073)                            | (859)     |
| Fair value adjustments on SBA servicing assets  | 1,252                              | 711       |
| Proceeds from sales of SBA loans originated for sale  | 36,811                             | 28,564    |
| SBA loans originated for sale   | (34,969)                           | (22,395)  |
| Gains on sales of SBA loans originated for sale   | (2,654)                            | (2,315)   |
| Proceeds from sales of mortgage loans originated for sale                                   | 355,181                            | 263,689   |
| Mortgage loans originated for sale  | (335,734)                          | (274,133) |
| Fair value adjustment for mortgage loans originated for sale                                | 474                                | (716)     |
| Gains on sales of mortgage loans originated for sale  | (6,400)                            | (6,340)   |
| Amortization of intangible assets   | -                                  | 61        |
| Amortization of debt issuance costs   | 5                                  | 22        |
| Increase in accrued interest receivable and other assets                                    | (1,278)                            | (3,720)   |
| Decrease in accrued interest payable and other liabilities                                  | (1,049)                            | (34)      |
| Net cash provided by (used in) operating activities   | 26,717                             | (3,255)   |
| Cash flows from investing activities  |                                    |           |
| Purchase of investment securities available for sale  | (81,744)                           | (53,052)  |
| Purchase of investment securities held to maturity  | (61,083)                           | (21,958)  |
| Proceeds from the sale of securities available for sale                                     | 5,713                              | 21,167    |
| Proceeds from the maturity or call of securities available for sale                         | 39,409                             | 25,665    |
| Proceeds from the maturity or call of securities held to maturity                           | 46,156                             | 36,629    |
| Redemption (purchase) of restricted stock   | 2                                  | (312)     |
| Net increase in loans   | (217,967)                          | (131,100) |
| Net proceeds from sale of other real estate owned   | 495                                | 357       |
| Premises and equipment expenditures   | (11,072)                           | (18,263)  |
| Net cash used in investing activities   | (280,091)                          | (140,867) |
| Cash flows from financing activities  |                                    |           |
| Net proceeds from exercise of stock options   | 668                                | 615       |
| Net increase in demand, money market and savings deposits                                   | 324,658                            | 197,431   |
| Net increase in time deposits   | 12,405                             | 10,304    |
| Net cash provided by financing activities   | 337,731                            | 208,350   |

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|  |            |           |
|--|------------|-----------|
| Net increase in cash and cash equivalents                | 84,357     | 64,228    |
| Cash and cash equivalents, beginning of year             | 61,942     | 34,554    |
| Cash and cash equivalents, end of period                 | \$ 146,299 | \$ 98,782 |
| Supplemental disclosures                                 |            |           |
| Interest paid  | \$ 10,749  | \$ 6,109  |
| Income taxes paid  | \$ -       | \$ 75     |
| Non-cash transfers from loans to other real estate owned | \$ 315     | \$ 129    |
| Conversion of subordinated debt to common stock          | \$ 10,094  | \$ 240    |

(See notes to consolidated financial statements)

4

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Republic First Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Changes in Shareholders' Equity  
For the Nine Months Ended September 30, 2018 and 2017  
(Dollars in thousands)  
(unaudited)

|  | Common<br>Stock | Additional<br>Paid in<br>Capital | Accumulated<br>Deficit | Treasury<br>Stock | Stock<br>Held by<br>Deferred<br>Compensation<br>Plan | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Shareholders'<br>Equity |
|--|-----------------|----------------------------------|------------------------|-------------------|--|---|----------------------------------|
| Balance January 1, 2018  | \$ 575          | \$ 256,285                       | \$ (18,983 )           | \$ (3,725 )       | \$ (183 )  | \$ (7,509 )                                   | \$ 226,460                       |
| Reclassification due to the adoption of ASU 2018-02                |                 |                                  | 1,640                  |                   |  | (1,640 )                                      | -                                |
| Net income   |                 |                                  | 6,470                  |                   |  |   | 6,470                            |
| Other comprehensive loss, net of tax                               |                 |                                  |                        |                   |  | (9,452 )                                      | (9,452 )                         |
| Stock based compensation   |                 | 1,584                            |                        |                   |  |   | 1,584                            |
| Conversion of subordinated debt to common stock (1,624,614 shares) | 16              | 10,078                           |                        |                   |  |   | 10,094                           |
| Options exercised (174,225 shares)                                 | 2               | 666                              |                        |                   |  |   | 668                              |
| Balance September 30, 2018   | \$ 593          | \$ 268,613                       | \$ (10,873 )           | \$ (3,725 )       | \$ (183 )  | \$ (18,601 )                                  | \$ 235,824                       |
| Balance January 1, 2017  | \$ 573          | \$ 253,570                       | \$ (27,888 )           | \$ (3,725 )       | \$ (183 )  | \$ (7,294 )                                   | \$ 215,053                       |
| Net income   |                 |                                  | 6,167                  |                   |  |   | 6,167                            |
| Other comprehensive income, net of tax                             |                 |                                  |                        |                   |  | 1,798   | 1,798                            |
| Stock based compensation   |                 | 1,329                            |                        |                   |  |   | 1,329                            |
| Conversion of subordinated debt to common stock (36,922 shares)    |                 | 240                              |                        |                   |  |   | 240                              |
| Options exercised (186,850 shares)                                 | 2               | 613                              |                        |                   |  |   | 615                              |
| Balance September 30, 2017   | \$ 575          | \$ 255,752                       | \$ (21,721 )           | \$ (3,725 )       | \$ (183 )  | \$ (5,496 )                                   | \$ 225,202                       |

(See notes to consolidated financial statements)

Republic First Bancorp, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Note 1: Basis of Presentation

Republic First Bancorp, Inc. (the "Company") is a bank holding company organized and incorporated under the laws of the Commonwealth of Pennsylvania. It is comprised of one wholly-owned subsidiary, Republic First Bank, which does business under the name of Republic Bank ("Republic"). Republic is a Pennsylvania state chartered bank that offers a variety of banking services to individuals and businesses through its offices and store locations in Greater Philadelphia and Southern New Jersey. In July 2016, Republic acquired Oak Mortgage Company, LLC ("Oak Mortgage"), a residential mortgage lending organization. Oak Mortgage is headquartered in Marlton, NJ and is licensed to do business in Pennsylvania, Delaware, New Jersey, and Florida. The Company also has two unconsolidated subsidiaries, which are statutory trusts established by the Company in connection with its sponsorship of two separate issuances of trust preferred securities.

The Company and Republic encounter vigorous competition for market share in the geographic areas they serve from bank holding companies, national, regional and other community banks, thrift institutions, credit unions and other non-bank financial organizations, such as mutual fund companies, insurance companies and brokerage companies.

The Company and Republic are subject to federal and state regulations governing virtually all aspects of their activities, including but not limited to, lines of business, liquidity, investments, the payment of dividends and others. Such regulations and the cost of adherence to such regulations can have a significant impact on earnings and financial condition.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Republic. The Company follows accounting standards set by the Financial Accounting Standards Board ("FASB"). The FASB sets accounting principles generally accepted in the United States of America ("US GAAP") that are followed to ensure consistent reporting of financial condition, results of operations, and cash flows. All material inter-company transactions have been eliminated. Events occurring subsequent to the date of the balance sheet have been evaluated for potential recognition or disclosure in the consolidated financial statements.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. GAAP for interim financial information and with the instructions to United States Securities and Exchange Commission ("SEC") Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for financial statements for a complete fiscal year. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

Note 2: Summary of Significant Accounting Policies

Risks and Uncertainties

The earnings of the Company depend primarily on the earnings of Republic. The earnings of Republic are heavily dependent upon the level of net interest income, which is the difference between interest earned on its interest-earning assets, such as loans and investments, and the interest paid on its interest-bearing liabilities, such as deposits and borrowings. Accordingly, the Company's results of operations are subject to risks and uncertainties surrounding Republic's exposure to changes in the interest rate environment. Prepayments on residential real estate mortgage and other fixed rate loans and mortgage-backed securities vary significantly and may cause significant fluctuations in

interest margins.

6

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### Mortgage Banking Activities and Mortgage Loans Held for Sale

Mortgage loans held for sale are originated and held until sold to permanent investors. Management elected to adopt the fair value option in accordance with FASB Accounting Standards Codification ("ASC") 820, Fair Value Measurements and Disclosures, and record loans held for sale at fair value.

Mortgage loans held for sale originated on or subsequent to the election of the fair value option, are recorded on the balance sheet at fair value. The fair value is determined on a recurring basis by utilizing quoted prices from dealers in such securities. Changes in fair value are reflected in mortgage banking income in the statements of income. Direct loan origination costs are recognized when incurred and are included in non-interest expense in the statements of income.

### Interest Rate Lock Commitments ("IRLCs")

Mortgage loan commitments known as interest rate locks that relate to the origination of a mortgage that will be held for sale upon funding are considered derivative instruments under the derivatives and hedging accounting guidance FASB ASC 815, Derivatives and Hedging. Loan commitments that are classified as derivatives are recognized at fair value on the balance sheet as other assets and other liabilities with changes in their fair values recorded as mortgage banking income and included in non-interest income in the statements of income. Outstanding IRLCs are subject to interest rate risk and related price risk during the period from the date of issuance through the date of loan funding, cancellation or expiration. Loan commitments generally range between 30 and 90 days; however, the borrower is not obligated to obtain the loan. Republic is subject to fallout risk related to IRLCs, which is realized if approved borrowers choose not to close on the loans within the terms of the IRLCs. Republic uses best efforts commitments to substantially eliminate these risks. The valuation of the IRLCs issued by Republic includes the value of the servicing released premium. Republic sells loans servicing released, and the servicing released premium is included in the market price. See Note 10 Derivatives and Risk Management Activities.

### Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates are made by management in determining the allowance for loan losses, carrying values of other real estate owned, assessment of other than temporary impairment ("OTTI") of investment securities, fair value of financial instruments, (see "Note 7" below), and the realization of deferred income tax assets. Consideration is given to a variety of factors in establishing these estimates.

In estimating the allowance for loan losses, management considers current economic conditions, past loss experience, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews and regulatory examinations, borrowers' perceived financial and managerial strengths, the adequacy of underlying collateral, if collateral dependent, or present value of future cash flows, and other relevant and qualitative risk factors. Subsequent to foreclosure, an estimate for the carrying value of other real estate owned is normally determined through valuations that are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less the cost to sell. Because the allowance for loan losses and carrying value of other real estate owned are dependent, to a great extent, on the general economy and other conditions that may be beyond the Company's and Republic's control, the estimates of the allowance for loan losses and the carrying values of other real estate owned could differ materially in the near term.

In estimating OTTI of investment securities, securities are evaluated on at least a quarterly basis and more frequently when market conditions warrant such an evaluation, to determine whether a decline in their value is other-than-temporary. To determine whether a loss in value is other-than-temporary, management utilizes criteria such as the reasons underlying the decline, the magnitude and duration of the decline, the intent to hold the security and the likelihood of the Company not being required to sell the security prior to an anticipated recovery in the fair value. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of investment. Once a decline in value is determined to be other-than-temporary, the portion of the decline related to credit impairment is charged to earnings.

In evaluating the Company's ability to recover deferred tax assets, management considers all available positive and negative evidence, including the past operating results and forecasts of future taxable income. In determining future taxable income, management makes assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require management to make judgments about the future taxable income and are consistent with the plans and estimates used to manage the business. A material reduction in estimated future taxable income may require management to record a valuation allowance against the deferred tax assets. A valuation allowance would result in additional income tax expense in the period and could have a significant impact on future earnings.

#### Stock-Based Compensation

The Company has a Stock Option and Restricted Stock Plan ("the 2005 Plan"), under which the Company granted options, restricted stock or stock appreciation rights to the Company's employees, directors, and certain consultants. The 2005 Plan became effective on November 14, 1995, and was amended and approved at the Company's 2005 annual meeting of shareholders. Under the terms of the 2005 Plan, 1.5 million shares of common stock, plus an annual increase equal to the number of shares needed to restore the maximum number of shares that could be available for grant under the 2005 Plan to 1.5 million shares, were available for such grants. As of September 30, 2018, the only grants under the 2005 Plan were option grants. The 2005 Plan provided that the exercise price of each option granted equaled the market price of the Company's stock on the date of the grant. Options granted pursuant to the 2005 Plan vest within one to four years and have a maximum term of 10 years. The 2005 Plan terminated on November 14, 2015 in accordance with the terms and conditions specified in the Plan agreement.

On April 29, 2014 the Company's shareholders approved the 2014 Republic First Bancorp, Inc. Equity Incentive Plan (the "2014 Plan"), under which the Company may grant options, restricted stock, stock units, or stock appreciation rights to the Company's employees, directors, independent contractors, and consultants. Under the terms of the 2014 Plan, 2.6 million shares of common stock, plus an annual adjustment to be no less than 10% of the outstanding shares or such lower number as the Board of Directors may determine, are available for such grants. At September 30, 2018, the maximum number of common shares issuable under the 2014 Plan was 6.0 million shares. During the nine months ended September 30, 2018, 1,079,800 options were granted under the 2014 Plan with a fair value of \$2,978,510.



The Company utilizes the Black-Scholes option pricing model to calculate the estimated fair value of each stock option granted on the date of the grant. A summary of the assumptions used in the Black-Scholes option pricing model for 2018 and 2017 are as follows:

|  | 2018           | 2017                     |
|--|----------------|--------------------------|
| Dividend yield <sup>(1)</sup>          | 0.0%           | 0.0%                     |
| Expected volatility                    | 28.22%         | (2) 45.46% to 50.09% (3) |
| Risk-free interest rate <sup>(4)</sup> | 2.35% to 2.96% | 1.89% to 2.26%           |
| Expected life <sup>(5)</sup>           | 6.25 years     | 5.5 to 7.0 years         |
| Assumed forfeiture rate <sup>(6)</sup> | 4.0%           | 6.0%                     |

(1) A dividend yield of 0.0% is utilized because cash dividends have never been paid.

(2) The expected volatility was based on the historical volatility of the Company's common stock price as adjusted for certain historical periods of extraordinary volatility in order to provide a basis for a reasonable estimate of fair value.

(3) Expected volatility is based on Bloomberg's five and one-half to seven year volatility calculation for "FRBK" stock.

(4) The risk-free interest rate is based on the five to seven year Treasury bond.

(5) The expected life reflects a 1 to 4 year vesting period, the maximum ten year term and review of historical behavior.

(6) Forfeiture rate is determined through forfeited and expired options as a percentage of options granted over the current three year period.

During the nine months ended September 30, 2018 and 2017, 753,864 shares and 526,624 shares vested, respectively. Expense is recognized ratably over the period required to vest. At September 30, 2018, the intrinsic value of the 3,841,275 options outstanding was \$6.7 million, while the intrinsic value of the 1,905,112 exercisable (vested) options was \$5.4 million. At September 30, 2017, the intrinsic value of the 3,038,450 options outstanding was \$12,954,271, while the intrinsic value of the 1,379,848 exercisable (vested) options was \$7,764,313. During the nine months ended September 30, 2018, 174,225 options were exercised resulting in cash receipts of \$668,194 and 70,125 options were forfeited with a weighted average grant date fair value of \$215,201. During the nine months ended September 30, 2017, 186,850 options were exercised resulting in cash receipts of \$615,226 and 14,100 options were forfeited with a weighted average grant date fair value of \$53,246.

Information regarding stock based compensation for the nine months ended September 30, 2018 and 2017 is set forth below:

|  | 2018        | 2017        |
|--|-------------|-------------|
| Stock based compensation expense recognized  | \$1,584,000 | \$1,329,000 |
| Number of unvested stock options             | 1,936,163   | 1,658,602   |
| Fair value of unvested stock options         | \$5,499,104 | \$4,553,854 |
| Amount remaining to be recognized as expense | \$3,886,278 | \$2,966,049 |

The remaining unrecognized expense amount of \$3,886,278 will be recognized ratably as expense through August 2022.

#### Earnings per Share

Earnings per share ("EPS") consists of two separate components: basic EPS and diluted EPS. Basic EPS is computed by dividing net income by the weighted average number of common shares outstanding for each period presented. Diluted EPS is calculated by dividing net income by the weighted average number of common shares outstanding plus dilutive common stock equivalents ("CSEs"). CSEs consist of dilutive stock options granted through the Company's stock option plans for the three and nine months ended September 30, 2018. CSEs consisted of dilutive stock options

granted through the Company's stock option plans and convertible securities related to trust preferred securities issued in 2008 for the three and nine months ended September 30, 2017. The convertible securities related to trust preferred securities issued in 2008 fully converted to common stock in 2018. There was no interest expense in 2018 related to the trust preferred securities issuance. In the diluted EPS computation, the after tax interest expense on the trust preferred securities issuance would normally be added back to the net income for the three and nine months ended September 30, 2017. However, the effect of CSEs (convertible securities related to the trust preferred securities only) and the related add back of after tax interest expense was considered anti-dilutive and therefore was not included in the EPS calculations.

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The calculation of EPS for the three and nine months ended September 30, 2018 and 2017 is as follows (in thousands, except per share amounts):

|   | Three Months<br>Ended<br>September 30,<br>2018 |         | Nine Months<br>Ended<br>September 30,<br>2017 |         |
|---|--|---------|---|---------|
| Net income (basic and diluted)                                | \$2,322  | \$2,321 | \$6,470                                       | \$6,167 |
| Weighted average shares outstanding                           | 58,774   | 56,974  | 58,213  | 56,915  |
| Net income per share – basic                                  | \$0.04   | \$0.04  | \$0.11  | \$0.11  |
| Weighted average shares outstanding (including dilutive CSEs) | 59,774   | 58,314  | 59,338  | 58,213  |
| Net income per share – diluted                                | \$0.04   | \$0.04  | \$0.11  | \$0.11  |

The following is a summary of securities that could potentially dilute basic earnings per common share in future periods. These securities were not included in the computation of diluted earnings per common share because the effect would have been anti-dilutive for the periods presented.

| (in thousands)                  | Three Months<br>Ended<br>September<br>30,<br>2018 |       | Nine Months<br>Ended<br>September<br>30,<br>2017 |       |
|---------------------------------|---|-------|--|-------|
| Anti-dilutive securities        |   |       |  |       |
| Share based compensation awards | 2,845   | 1,698 | 2,720  | 1,740 |
| Convertible securities          | -   | 1,625 | -  | 1,625 |
| Total anti-dilutive securities  | 2,845   | 3,323 | 2,720  | 3,365 |

#### Recent Accounting Pronouncements

##### ASU 2014-09

In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 660): Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40)." ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with The Company (Topic 606): Deferral of the Effective Date. The guidance in this ASU is now effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity

expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The Company's revenue is comprised of net interest income and noninterest income. The scope of the guidance explicitly excludes interest income as well as many other revenues for financial assets and liabilities including revenue derived from loans, investment securities, and derivatives. This ASU was effective for the Company on January 1, 2018. The Company adopted this ASU on a modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. The adoption of this ASU did not have a material impact to its financial condition, results of operations, and consolidated financial statements. Refer to Note 11: Revenue Recognition for further disclosure as to the impact of Topic 606.

#### ASU 2016-01

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall. The guidance in this ASU among other things, (1) requires equity investments with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (3) eliminates the requirement for public businesses entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (4) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (5) requires an entity to present separately in other comprehensive income the portion of the change in fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (6) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (7) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. The guidance in this ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The guidance was effective for the Company on January 1, 2018 and was adopted using a modified retrospective approach. The adoption of ASU No. 2016-01 on January 1, 2018 did not have a material impact on the Company's Consolidated Financial Statements. In accordance with (4) above, the Company measured the fair value of its loan portfolio as of September 30, 2018 using an exit price notion (see Note 7 Fair Value of Financial Instruments).

#### ASU 2016-02

In February 2016, the FASB issued ASU No. 2016-02, Leases. From the Company's perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. From the landlord perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact of the ASU on its financial condition and results of operations and expects to recognize right-of-use assets and lease liabilities for substantially all of its operating lease commitments based on the present value of unpaid lease payments as of the date of adoption. The Company does not intend to early adopt this ASU.

#### ASU 2016-09

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 will amend current guidance such that all excess tax benefits and tax deficiencies related to share-based payment awards will be recognized as income tax expense or benefit in the income statement during the period in which they occur. Additionally, excess tax benefits will be classified along with other income tax cash flows as an operating activity rather than a financing activity. ASU 2016-09 also provides that any entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, which is the current requirement, or account for forfeitures when they occur. ASU 2016-09 was effective January 1, 2017. There was no material impact on the consolidated financial statements upon adoption.

#### ASU 2016-13

In June 2016, the FASB issued ASU 2016-13, Financial Instruments–Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The Company is currently evaluating the impact of this ASU, continuing its implementation efforts and reviewing the loss modeling requirements consistent with lifetime expected loss estimates. The Company expects that the new model will include different assumptions used in calculating credit losses, such as estimating losses over the estimated life of a financial asset and will consider expected future changes in macroeconomic conditions. The adoption of this ASU may result in an increase to the Company's allowance for loan losses which will depend upon the nature and characteristics of the Company's loan portfolio at the adoption date, as well as the macroeconomic conditions and forecasts at that date. For the Company, this update will be effective for interim and annual periods beginning after December 15, 2019. The Company currently does not intend to early adopt this new guidance.

#### ASU 2016-15

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230). The ASU addresses classification of certain cash receipts and cash payments in the statement of cash flows. The new guidance was adopted on January 1, 2018, on a retrospective basis. The adoption of 2016-15 did not result any changes in classifications in the Consolidated Statement of Cash Flows.

#### ASU-2017-01

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805). The ASU clarifies the definition of a business in ASC 805. The FASB issued the ASU in response to stakeholder feedback that the definition of a business in ASC 805 is being applied too broadly. In addition, stakeholders said that analyzing transactions under the current definition is difficult and costly. Concerns about the definition of a business were among the primary issues raised in connection with the Financial Accounting Foundation's post-implementation review report on FASB Statement No. 141(R), Business Combinations (codified in ASC 805). The amendments in the ASU are intended to make application of the guidance more consistent and cost-efficient. The ASU is effective for public business entities in annual periods beginning after December 15, 2017, including interim periods therein. For all other entities, the ASU is effective in annual periods beginning after December 15, 2018, and interim periods within annual periods beginning

after December 15, 2019. The ASU must be applied prospectively on or after the effective date, and no disclosures for a change in accounting principle are required at transition. Early adoption is permitted for transactions (i.e., acquisitions or dispositions) that occurred before the issuance date or effective date of the standard if the transactions were not reported in financial statements that have been issued or made available for issuance. Unless the Company enters into a business combination, the impact of the ASU will not have a material impact on the consolidated financial statements.

#### ASU 2017-04

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test For Goodwill Impairment. The ASU simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. Instead, if "the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit." For public business entities that are SEC filers, the ASU is effective for annual and any interim impairment tests for periods beginning after December 15, 2019. The Company early adopted this ASU on July 1, 2018 using the simplified method. The adoption of ASU 2017-04 did not have a material impact on the consolidated financial statements.

#### ASU 2017-08

In March 2017, the FASB issued ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities, which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Earlier application is permitted for all entities, including adoption in an interim period. If an entity early adopts the ASU in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The Company has not yet determined the impact the adoption of ASU 2017-08 will have on the consolidated financial statements.

#### ASU 2018-02

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows for reclassification from accumulated other comprehensive income (loss) to retained earnings for stranded tax effects resulting from the 2017 Tax Cuts and Jobs Act described in the "Income Taxes" section below. The amount of the reclassification should include the effect of the change in the federal corporate income tax rate related to items remaining in accumulated other comprehensive income (loss). The ASU would require an entity to disclose whether it elects to reclassify stranded tax effects from accumulated other comprehensive income (loss) to retained earnings in the period of adoption and, more generally, a description of the accounting policy for releasing income tax effects from accumulated other comprehensive income (loss). The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption of the amendments in this update is permitted for periods for which financial statements have not yet been issued or made available for issuance, including in the period the Act was enacted. The Company adopted this ASU on January 1, 2018, by recording the reclassification adjustment to its beginning retained earnings in the amount of \$1.6 million. The Company utilized the portfolio approach when releasing tax effects from AOCI for its investment securities.

#### ASU 2018-03

In February of 2018, the FASB Issued ASU 2018-03, Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10). The ASU was issued to clarify certain aspects of ASU 2016-01 such as treatment for discontinuations and adjustments for equity securities without a readily determinable market value, forward contracts and purchased options, presentation requirements for certain fair value option liabilities, fair value option liabilities denominated in a foreign currency, and transition guidance for equity securities without a readily determinable fair value. The Company adopted this ASU on January 1, 2018. The adoption of this ASU did not have a significant impact on the Company's financial condition, results of operations and consolidated financial statements.





Note 3: Legal Proceedings

The Company and Republic are from time to time parties (plaintiff or defendant) to lawsuits in the normal course of business. While any litigation involves an element of uncertainty, management is of the opinion that the liability of the Company and Republic, if any, resulting from such actions will not have a material effect on the financial condition or results of operations of the Company and Republic.

Note 4: Segment Reporting

The Company has one reportable segment: community banking. The community bank segment primarily encompasses the commercial loan and deposit activities of Republic, as well as, residential mortgage and consumer loan products in the area surrounding its stores.

## Note 5: Investment Securities

A summary of the amortized cost and market value of securities available for sale and securities held to maturity at September 30, 2018 and December 31, 2017 is as follows:

| (dollars in thousands)              | At September 30, 2018 |                        |                         |            |
|-------------------------------------|-----------------------|------------------------|-------------------------|------------|
|                                     | Amortized Cost        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Collateralized mortgage obligations | \$ 350,237            | \$ -                   | \$ (16,609)             | \$ 333,628 |
| Agency mortgage-backed securities   | 71,100                | -                      | (2,980)                 | 68,120     |
| Municipal securities                | 19,532                | 5                      | (602)                   | 18,935     |
| Corporate bonds                     | 62,605                | 208                    | (3,188)                 | 59,625     |
| Asset-backed securities             | 6,691                 | -                      | (22)                    | 6,669      |
| Trust preferred securities          | 725                   | -                      | (178)                   | 547        |
| Total securities available for sale | \$ 510,890            | \$ 213                 | \$ (23,579)             | \$ 487,524 |
| U.S. Government agencies            | \$ 111,550            | \$ -                   | \$ (6,084)              | \$ 105,466 |
| Collateralized mortgage obligations | 245,967               | 43                     | (10,126)                | 235,884    |
| Agency mortgage-backed securities   | 127,774               | -                      | (7,606)                 | 120,168    |
| Total securities held to maturity   | \$ 485,291            | \$ 43                  | \$ (23,816)             | \$ 461,518 |
| (dollars in thousands)              | At December 31, 2017  |                        |                         |            |
|                                     | Amortized Cost        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Collateralized mortgage obligations | \$ 327,972            | \$ -                   | \$ (7,731)              | \$ 320,241 |
| Agency mortgage-backed securities   | 55,664                | 2                      | (800)                   | 54,866     |
| Municipal securities                | 15,142                | 20                     | (62)                    | 15,100     |
| Corporate bonds                     | 62,670                | 103                    | (2,491)                 | 60,282     |
| Asset-backed securities             | 13,414                | 38                     | -                       | 13,452     |
| Trust preferred securities          | 725                   | -                      | (236)                   | 489        |
| Total securities available for sale | \$ 475,587            | \$ 163                 | \$ (11,320)             | \$ 464,430 |
| U.S. Government agencies            | \$ 112,605            | \$ 50                  | \$ (2,235)              | \$ 110,420 |
| Collateralized mortgage obligations | 215,567               | 314                    | (3,970)                 | 211,911    |
| Agency mortgage-backed securities   | 143,041               | 47                     | (2,620)                 | 140,468    |
| Other securities                    | 1,000                 | -                      | -                       | 1,000      |
| Total securities held to maturity   | \$ 472,213            | \$ 411                 | \$ (8,825)              | \$ 463,799 |

The following table presents investment securities by stated maturity at September 30, 2018. Collateralized mortgage obligations and agency mortgage-backed securities have expected maturities that differ from contractual maturities because borrowers have the right to call or prepay with or without prepayment penalties and, therefore, these securities are classified separately with no specific maturity date.

| (dollars in thousands)              | Available for Sale |            | Held to Maturity |            |
|-------------------------------------|--------------------|------------|------------------|------------|
|                                     | Amortized Cost     | Fair Value | Amortized Cost   | Fair Value |
| Due in 1 year or less               | \$2,047            | \$2,044    | \$-              | \$-        |
| After 1 year to 5 years             | 6,898              | 6,877      | 14,814           | 14,433     |
| After 5 years to 10 years           | 75,375             | 71,569     | 96,736           | 91,033     |
| After 10 years                      | 5,233              | 5,286      | -                | -          |
| Collateralized mortgage obligations | 350,237            | 333,628    | 245,967          | 235,884    |
| Agency mortgage-backed securities   | 71,100             | 68,120     | 127,774          | 120,168    |
| Total                               | \$510,890          | \$487,524  | \$485,291        | \$461,518  |

The Company's investment securities portfolio consists primarily of debt securities issued by U.S. government agencies, U.S. government-sponsored agencies, state governments, local municipalities and certain corporate entities. There were no private label mortgage-backed securities ("MBS") or collateralized mortgage obligations ("CMO") held in the investment securities portfolio as of September 30, 2018 and December 31, 2017. There were also no MBS or CMO securities that were rated "Alt-A" or "sub-prime" as of those dates.

The fair value of investment securities is impacted by interest rates, credit spreads, market volatility and liquidity conditions. Net unrealized gains and losses in the available for sale portfolio are included in shareholders' equity as a component of accumulated other comprehensive income or loss, net of tax. Securities classified as held to maturity are carried at amortized cost. An unrealized loss exists when the current fair value of an individual security is less than the amortized cost basis.

The Company regularly evaluates investment securities that are in an unrealized loss position in order to determine if the decline in fair value is other than temporary. Factors considered in the evaluation include the current economic climate, the length of time and the extent to which the fair value has been below cost, the current interest rate environment and the rating of each security. An OTTI loss must be recognized for a debt security in an unrealized loss position if the Company intends to sell the security or it is more likely than not that it will be required to sell the security prior to recovery of the amortized cost basis. The amount of OTTI loss recognized is equal to the difference between the fair value and the amortized cost basis of the security that is attributed to credit deterioration. Accounting standards require the evaluation of the expected cash flows to be received to determine if a credit loss has occurred. In the event of a credit loss, that amount must be recognized against income in the current period. The portion of the unrealized loss related to other factors, such as liquidity conditions in the market or the current interest rate environment, is recorded in accumulated other comprehensive income (loss) for investment securities classified available for sale.

There were no impairment charges (credit losses) on any security held in the investment portfolio for the three and nine month periods ended September 30, 2018 and 2017.

The following table presents a roll-forward of the balance of credit-related impairment losses on securities held at September 30, 2018 and 2017 for which a portion of OTTI was recognized in other comprehensive income:

(dollars in thousands) 2018 2017

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|  |       |       |
|--|-------|-------|
| Beginning Balance, January 1 <sup>st</sup>   | \$274 | \$937 |
| Additional credit-related impairment loss on securities for which an other-than-temporary impairment was previously recognized | -     | -     |
| Reductions for securities sold during the period   | -     | (483) |
| Ending Balance, September 30 <sup>th</sup>   | \$274 | \$454 |

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The following tables show the fair value and gross unrealized losses associated with the investment portfolio, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position in the available for sale and held to maturity section:

| At September 30, 2018               |                     |                   |                   |                   |            |                   |
|-------------------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
| (dollars in thousands)              | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|                                     | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| Collateralized mortgage obligations | \$ 136,643          | \$ 4,278          | \$ 196,985        | \$ 12,331         | \$ 333,628 | \$ 16,609         |
| Agency mortgage-backed securities   | 41,522              | 1,388             | 26,598            | 1,592             | 68,120     | 2,980             |
| Municipal securities                | 11,906              | 293               | 4,892             | 309               | 16,798     | 602               |
| Corporate bonds                     | 1,604               | 3                 | 51,815            | 3,185             | 53,419     | 3,188             |
| Asset backed securities             | 6,669               | 22                | -                 | -                 | 6,669      | 22                |
| Trust preferred securities          | -                   | -                 | 547               | 178               | 547        | 178               |
| Total Available for Sale            | \$ 198,344          | \$ 5,984          | \$ 280,837        | \$ 17,595         | \$ 479,181 | \$ 23,579         |

  

| At September 30, 2018               |                     |                   |                   |                   |            |                   |
|-------------------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
| (dollars in thousands)              | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|                                     | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government agencies            | \$42,809            | \$1,832           | \$62,657          | \$4,252           | \$105,466  | \$6,084           |
| Collateralized mortgage obligations | 112,206             | 3,679             | 120,449           | 6,447             | 232,655    | 10,126            |
| Agency mortgage-backed securities   | 25,745              | 1,193             | 94,423            | 6,413             | 120,168    | 7,606             |
| Total Held to Maturity              | \$ 180,760          | \$6,704           | \$ 277,529        | \$17,112          | \$ 458,289 | \$23,816          |

  

| At December 31, 2017                |                     |                   |                   |                   |            |                   |
|-------------------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
| (dollars in thousands)              | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|                                     | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| Collateralized mortgage obligations | \$150,075           | \$1,565           | \$170,166         | \$6,166           | \$320,241  | \$7,731           |
| Agency mortgage-backed securities   | 29,967              | 226               | 21,045            | 574               | 51,012     | 800               |
| Municipal securities                | 5,742               | 27                | 2,656             | 35                | 8,398      | 62                |
| Corporate bonds                     | -                   | -                 | 52,509            | 2,491             | 52,509     | 2,491             |
| Asset backed securities             | -                   | -                 | -                 | -                 | -          | -                 |
| Trust preferred securities          | -                   | -                 | 489               | 236               | 489        | 236               |
| Total Available for Sale            | \$185,784           | \$1,818           | \$246,865         | \$9,502           | \$432,649  | \$11,320          |

  

| At December 31, 2017                |                     |                   |                   |                   |            |                   |
|-------------------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
| (dollars in thousands)              | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|                                     | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government agencies            | \$42,045            | \$ 213            | \$ 59,594         | \$ 2,022          | \$101,639  | \$ 2,235          |
| Collateralized mortgage obligations | 56,955              | 767               | 107,986           | 3,203             | 164,941    | 3,970             |
| Agency mortgage-backed securities   | 55,170              | 221               | 82,479            | 2,399             | 137,649    | 2,620             |
| Total Held to Maturity              | \$ 154,170          | \$ 1,201          | \$250,059         | \$ 7,624          | \$404,229  | \$ 8,825          |

Unrealized losses on securities in the investment portfolio amounted to \$47.4 million with a total fair value of \$937.5 million as of September 30, 2018 compared to unrealized losses of \$20.1 million with a total fair value of \$836.9 million as of December 31, 2017. The Company believes the unrealized losses presented in the tables above are temporary in nature and primarily related to market interest rates or limited trading activity in particular type of

security rather than the underlying credit quality of the issuers. The Company does not believe that these losses are other than temporary and does not currently intend to sell or believe it will be required to sell securities in an unrealized loss position prior to maturity or recovery of the amortized cost bases.

The Company held fourteen U.S. Government agency securities, eighty-nine collateralized mortgage obligations and twenty-nine agency mortgage-backed securities that were in an unrealized loss position at September 30, 2018. Principal and interest payments of the underlying collateral for each of these securities carry minimal credit risk. Management found no evidence of OTTI on any of these securities and believes the unrealized losses are due to fluctuations in fair values resulting from changes in market interest rates and are considered temporary as of September 30, 2018.

All municipal securities held in the investment portfolio are reviewed on least a quarterly basis for impairment. Each bond carries an investment grade rating by either Moody's or Standard & Poor's. In addition, the Company periodically conducts its own independent review on each issuer to ensure the financial stability of the municipal entity. The largest geographic concentration was in Pennsylvania and New Jersey and consisted of either general obligation or revenue bonds backed by the taxing power of the issuing municipality. At September 30, 2018, the investment portfolio included twenty-three municipal securities that were in an unrealized loss position. Management believes the unrealized losses were the result of movements in long-term interest rates and are not reflective of credit deterioration.

At September 30, 2018, the investment portfolio included one asset-backed security that was in an unrealized loss position. The asset-backed security held in the investment securities portfolio is a Sallie Mae bond, collateralized by student loans which are guaranteed by the U.S. Department of Education. Management believes the unrealized loss on this security was driven by changes in market interest rates and not a result of credit deterioration. At September 30, 2018, the investment portfolio also included seven corporate bonds that were in an unrealized loss position. Management believes the unrealized losses on these securities were also driven by changes in market interest rates and not a result of credit deterioration.

The unrealized loss on the trust preferred security is primarily the result of the secondary market becoming inactive for this type of security and is also considered temporary at this time. The following table provides additional detail about the trust preferred security held in the portfolio as of September 30, 2018.

| (dollars in thousands) | Class / Tranche | Amortized Cost | Fair Value | Unrealized Losses | Lowest Credit Rating Assigned | Number of Banks Currently Performing | Deferrals / Defaults as % of Current Balance | Conditional Default Rates for 2018 and beyond | Cumulative OTTI to Date | Life |
|------------------------|-----------------|----------------|------------|-------------------|-------------------------------|--------------------------------------|--|---|-------------------------|------|
| TPREF Funding II       | Class B Notes   | \$ 725         | \$ 547     | \$ (178)          | C                             | 18                                   | 29%  | 0.32%   | \$ 274                  |      |

There were no proceeds from the sale of investments securities for the three months ended September 30, 2018. During the nine months ended September 30, 2018, the proceeds from the sale of investment securities were \$5.7 million. A gross loss of \$1,000 was realized on the sale of investment securities for the nine months ended September 30, 2018.

There were no proceeds from the sale of investments securities for the three months ended September 30, 2017. During the nine months ended September 30, 2017, the proceeds from the sale of investment securities were \$21.2 million. Gross gains of \$487,000 were realized on these sales which were offset by gross losses of \$548,000. The tax benefit applicable to the net losses for the three and nine months ended September 30, 2017 was \$22,000. Included in the 2017 sales activity was the sale of one CDO security. Proceeds from the sale of the CDO security totaled \$970,000. A gross loss of \$548,000 was recognized on this sale. Management had previously stated that it did not intend to sell the CDO security prior to its maturity or the recovery of its cost basis, nor would it be forced to sell this security prior to maturity or recovery of the cost basis. This statement was made over a period of several years where there was limited trading activity in the pooled trust preferred CDO market resulting in fair market value estimates



well below the book values. During 2017, management received several inquiries regarding the availability of its remaining CDO securities and noted an increased level of trading in this type of security. As a result of the increased activity and the level of bids received, management elected to sell one CDO resulting in a net loss of \$548,000 during the nine months ended September 30, 2017 which was partially offset by gains on sales of twenty-eight municipal securities, one agency mortgage-backed security and one collateralized mortgage obligation. The Bank continues to demonstrate the ability and intent to hold the remaining CDO until maturity or recovery of the cost basis, but will evaluate future opportunities to sell the remaining CDO if they arise.

## Note 6: Loans Receivable and Allowance for Loan Losses

The following table sets forth the Company's gross loans by major categories as of September 30, 2018 and December 31, 2017:

| (dollars in thousands)            | September<br>30,<br>2018 | December<br>31,<br>2017 |
|-----------------------------------|--------------------------|-------------------------|
| Commercial real estate            | \$495,529                | \$433,304               |
| Construction and land development | 125,512                  | 104,617                 |
| Commercial and industrial         | 195,493                  | 173,343                 |
| Owner occupied real estate        | 358,956                  | 309,838                 |
| Consumer and other                | 86,897                   | 76,183                  |
| Residential mortgage              | 116,376                  | 64,764                  |
| Total loans receivable            | 1,378,763                | 1,162,049               |
| Deferred costs                    | 25                       | 229                     |
| Allowance for loan losses         | (8,084)                  | (8,599)                 |
| Net loans receivable              | \$1,370,704              | \$1,153,679             |

The Company disaggregates its loan portfolio into groups of loans with similar risk characteristics for purposes of estimating the allowance for loan losses. The Company's loan groups include commercial real estate, construction and land development, commercial and industrial, owner occupied real estate, consumer, and residential mortgages. The loan groups are also considered classes for purposes of monitoring and assessing credit quality based on certain risk characteristics.

The following tables provide the activity in and ending balances of the allowance for loan losses by loan portfolio class at and for the three months ended September 30, 2018 and 2017:

| (dollars in thousands)                | Commercial<br>Real Estate | Construction<br>and Land<br>Development | Commercial<br>and<br>Industrial | Owner<br>Occupied<br>Real<br>Estate | Consumer<br>and Other | Residential<br>Mortgage | Unallocated | Total   |
|---------------------------------------|---------------------------|---|---------------------------------|-------------------------------------|-----------------------|-------------------------|-------------|---------|
| Three months ended September 30, 2018 |                           |   |                                 |                                     |                       |                         |             |         |
| Allowance for loan losses:            |                           |   |                                 |                                     |                       |                         |             |         |
| Beginning balance:                    | \$ 2,039                  | \$ 772                                  | \$ 1,449                        | \$ 1,856                            | \$ 509                | \$ 638                  | \$ 303      | \$7,566 |
| Charge-offs                           | -                         | -                                       | -                               | -                                   | (1)                   | -                       | -           | (1)     |
| Recoveries                            | 17                        | -                                       | 1                               | -                                   | 1                     | -                       | -           | 19      |
| Provisions (credits)                  | 202                       | 34                                      | 193                             | 156                                 | 38                    | 103                     | (226)       | 500     |
| Ending balance                        | \$ 2,258                  | \$ 806                                  | \$ 1,643                        | \$ 2,012                            | \$ 547                | \$ 741                  | \$ 77       | \$8,084 |
| Three months ended September 30, 2017 |                           |   |                                 |                                     |                       |                         |             |         |
| Allowance for loan losses:            |                           |   |                                 |                                     |                       |                         |             |         |
| Beginning balance:                    | \$ 3,171                  | \$ 580                                  | \$ 2,496                        | \$ 1,598                            | \$ 544                | \$ 238                  | \$ 827      | \$9,454 |
| Charge-offs                           | -                         | -                                       | (1,195)                         | (49)                                | (4)                   | -                       | -           | (1,248) |
| Recoveries                            | 47                        | -                                       | 5                               | -                                   | -                     | -                       | -           | 52      |
| Provisions (credits)                  | 381                       | 69                                      | (85)                            | 87                                  | 11                    | 85                      | (548)       | -       |
|                                       | \$ 3,599                  | \$ 649                                  | \$ 1,221                        | \$ 1,636                            | \$ 551                | \$ 323                  | \$ 279      | \$8,258 |

Ending balance

19

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The following tables provide the activity in and ending balances of the allowance for loan losses by loan portfolio class at and for the nine months ended September 30, 2018 and 2017:

| (dollars in thousands)               | Commercial Real Estate | Construction and Land Development | Commercial and Industrial | Owner Occupied Real Estate | Consumer and Other | Residential Mortgage | Unallocated | Total   |
|--------------------------------------|------------------------|-----------------------------------|---------------------------|----------------------------|--------------------|----------------------|-------------|---------|
| Nine months ended September 30, 2018 |                        |                                   |                           |                            |                    |                      |             |         |
| Allowance for loan losses:           |                        |                                   |                           |                            |                    |                      |             |         |
| Beginning balance:                   | \$ 3,774               | \$ 725                            | \$ 1,317                  | \$ 1,737                   | \$ 573             | \$ 392               | \$ 81       | \$8,599 |
| Charge-offs                          | (1,535)                | -                                 | (151)                     | (465)                      | (213)              | -                    | -           | (2,364) |
| Recoveries                           | 50                     | -                                 | 77                        | 20                         | 2                  | -                    | -           | 149     |
| Provisions (credits)                 | (31)                   | 81                                | 400                       | 720                        | 185                | 349                  | (4)         | 1,700   |
| Ending balance                       | \$ 2,258               | \$ 806                            | \$ 1,643                  | \$ 2,012                   | \$ 547             | \$ 741               | \$ 77       | \$8,084 |

| (dollars in thousands)               | Commercial Real Estate | Construction and Land Development | Commercial and Industrial | Owner Occupied Real Estate | Consumer and Other | Residential Mortgage | Unallocated | Total   |
|--------------------------------------|------------------------|-----------------------------------|---------------------------|----------------------------|--------------------|----------------------|-------------|---------|
| Nine months ended September 30, 2017 |                        |                                   |                           |                            |                    |                      |             |         |
| Allowance for loan losses:           |                        |                                   |                           |                            |                    |                      |             |         |
| Beginning balance:                   | \$ 3,254               | \$ 557                            | \$ 2,884                  | \$ 1,382                   | \$ 588             | \$ 58                | \$ 432      | \$9,155 |
| Charge-offs                          | -                      | -                                 | (1,347)                   | (157)                      | (12)               | -                    | -           | (1,516) |
| Recoveries                           | 54                     | -                                 | 64                        | -                          | 1                  | -                    | -           | 119     |
| Provisions (credits)                 | 291                    | 92                                | (380)                     | 411                        | (26)               | 265                  | (153)       | 500     |
| Ending balance                       | \$ 3,599               | \$ 649                            | \$ 1,221                  | \$ 1,636                   | \$ 551             | \$ 323               | \$ 279      | \$8,258 |

The following tables provide a summary of the allowance for loan losses and balance of loans receivable by loan class and by impairment method as of September 30, 2018 and December 31, 2017:

| (dollars in thousands)                | Commercial Real Estate | Construction and Land Development | Commercial and Industrial | Owner Occupied Real Estate | Consumer and Other | Residential Mortgage | Unallocated | Total       |
|---------------------------------------|------------------------|-----------------------------------|---------------------------|----------------------------|--------------------|----------------------|-------------|-------------|
| September 30, 2018                    |                        |                                   |                           |                            |                    |                      |             |             |
| Allowance for loan losses:            |                        |                                   |                           |                            |                    |                      |             |             |
| Individually evaluated for impairment | \$ 194                 | \$ -                              | \$ 792                    | \$ 242                     | \$ 85              | \$ -                 | \$ -        | \$1,313     |
| Collectively evaluated for impairment | 2,064                  | 806                               | 851                       | 1,770                      | 462                | 741                  | 77          | 6,771       |
| Total allowance for loan losses       | \$ 2,258               | \$ 806                            | \$ 1,643                  | \$ 2,012                   | \$ 547             | \$ 741               | \$ 77       | \$8,084     |
| Loans receivable:                     |                        |                                   |                           |                            |                    |                      |             |             |
| Loans evaluated individually          | \$ 13,510              | \$ -                              | \$ 3,979                  | \$ 3,035                   | \$ 801             | \$ -                 | \$ -        | \$21,325    |
| Loans evaluated collectively          | 482,019                | 125,512                           | 191,514                   | 355,921                    | 86,096             | 116,376              | -           | 1,357,438   |
| Total loans receivable                | \$ 495,529             | \$ 125,512                        | \$ 195,493                | \$ 358,956                 | \$ 86,897          | \$ 116,376           | \$ -        | \$1,378,763 |

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| (dollars in thousands)                | Commercial<br>Real Estate | Construction<br>and Land<br>Development | Commercial<br>and<br>Industrial | Owner<br>Occupied<br>Real<br>Estate | Consumer<br>and<br>Other | Residential<br>Mortgage | Unallocated | Total        |
|---------------------------------------|---------------------------|---|---------------------------------|-------------------------------------|--------------------------|-------------------------|-------------|--------------|
| December 31, 2017                     |                           |   |                                 |                                     |                          |                         |             |              |
| Allowance for loan losses:            |                           |   |                                 |                                     |                          |                         |             |              |
| Individually evaluated for impairment | \$ 1,964                  | \$ -                                    | \$ 374                          | \$ 235                              | \$ 217                   | \$ -                    | \$ -        | \$ 2,790     |
| Collectively evaluated for impairment | 1,810                     | 725                                     | 943                             | 1,502                               | 356                      | 392                     | 81          | 5,809        |
| Total allowance for loan losses       | \$ 3,774                  | \$ 725                                  | \$ 1,317                        | \$ 1,737                            | \$ 573                   | \$ 392                  | \$ 81       | \$ 8,599     |
| Loans receivable:                     |                           |   |                                 |                                     |                          |                         |             |              |
| Loans evaluated individually          | \$ 15,415                 | \$ -                                    | \$ 4,501                        | \$ 3,798                            | \$ 1,002                 | \$ -                    | \$ -        | \$ 24,716    |
| Loans evaluated collectively          | 417,889                   | 104,617                                 | 168,842                         | 306,040                             | 75,181                   | 64,764                  | -           | 1,137,333    |
| Total loans receivable                | \$ 433,304                | \$ 104,617                              | \$ 173,343                      | \$ 309,838                          | \$ 76,183                | \$ 64,764               | \$ -        | \$ 1,162,049 |

A loan is considered impaired, when based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming loans, but also include internally classified accruing loans. The following table summarizes information with regard to impaired loans by loan portfolio class as of September 30, 2018 and December 31, 2017:

| (dollars in thousands)              | September 30, 2018  |                          |                   | December 31, 2017   |                          |                   |
|-------------------------------------|---------------------|--------------------------|-------------------|---------------------|--------------------------|-------------------|
|                                     | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| With no related allowance recorded: |                     |                          |                   |                     |                          |                   |
| Commercial real estate              | \$8,894             | \$8,899                  | \$ -              | \$9,264             | \$9,268                  | \$ -              |
| Construction and land development   | -                   | -                        | -                 | -                   | -                        | -                 |
| Commercial and industrial           | 1,969               | 5,728                    | -                 | 2,756               | 6,674                    | -                 |
| Owner occupied real estate          | 2,198               | 2,298                    | -                 | 2,595               | 2,743                    | -                 |
| Consumer and other                  | 649                 | 1,008                    | -                 | 655                 | 981                      | -                 |
| Residential mortgage                | -                   | -                        | -                 | -                   | -                        | -                 |
| Total                               | \$13,710            | \$17,933                 | \$ -              | \$15,270            | \$19,666                 | \$ -              |

|                                   |          |         |         |         |         |         |
|-----------------------------------|----------|---------|---------|---------|---------|---------|
| With an allowance recorded:       |          |         |         |         |         |         |
| Commercial real estate            | \$4,616  | \$5,500 | \$194   | \$6,151 | \$6,165 | \$1,964 |
| Construction and land development | -        | -       | -       | -       | -       | -       |
| Commercial and industrial         | 2,010    | 2,198   | 792     | 1,745   | 1,752   | 374     |
| Owner occupied real estate        | 837      | 894     | 242     | 1,203   | 1,206   | 235     |
| Consumer and other                | 152      | 155     | 85      | 347     | 379     | 217     |
| Residential mortgage              | -        | -       | -       | -       | -       | -       |
| Total                             | \$ 7,615 | \$8,747 | \$1,313 | \$9,446 | \$9,502 | \$2,790 |

|                                   |          |          |         |          |          |         |
|-----------------------------------|----------|----------|---------|----------|----------|---------|
| Total:                            |          |          |         |          |          |         |
| Commercial real estate            | \$13,510 | \$14,399 | \$194   | \$15,415 | \$15,433 | \$1,964 |
| Construction and land development | -        | -        | -       | -        | -        | -       |
| Commercial and industrial         | 3,979    | 7,926    | 792     | 4,501    | 8,426    | 374     |
| Owner occupied real estate        | 3,035    | 3,192    | 242     | 3,798    | 3,949    | 235     |
| Consumer and other                | 801      | 1,163    | 85      | 1,002    | 1,360    | 217     |
| Residential mortgage              | -        | -        | -       | -        | -        | -       |
| Total                             | \$21,325 | \$26,680 | \$1,313 | \$24,716 | \$29,168 | \$2,790 |

The following table presents additional information regarding the Company's impaired loans for the three months ended September 30, 2018 and September 30, 2017:

| (dollars in thousands)              | Three Months Ended September 30,  |                                  |                                   |                                  |
|-------------------------------------|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|                                     | 2018                              |                                  | 2017                              |                                  |
|                                     | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded: |                                   |                                  |                                   |                                  |
| Commercial real estate              | \$9,748                           | \$ 72                            | \$7,024                           | \$ 106                           |
| Construction and land development   | -                                 | -                                | -                                 | -                                |
| Commercial and industrial           | 2,566                             | 12                               | 2,366                             | 8                                |
| Owner occupied real estate          | 2,255                             | 15                               | 2,313                             | 17                               |
| Consumer and other                  | 647                               | 10                               | 923                               | 9                                |
| Residential mortgage                | -                                 | -                                | -                                 | -                                |
| Total                               | \$15,216                          | \$ 109                           | \$12,626                          | \$ 140                           |
| With an allowance recorded:         |                                   |                                  |                                   |                                  |
| Commercial real estate              |                                   | \$3,976                          | \$ -                              | \$6,391                          |
| Construction and land development   |                                   | -                                | -                                 | -                                |
| Commercial and industrial           |                                   | 1,948                            | 1                                 | 2,118                            |
| Owner occupied real estate          |                                   | 905                              | 6                                 | 1,100                            |
| Consumer and other                  |                                   | 169                              | -                                 | 346                              |
| Residential mortgage                |                                   | -                                | -                                 | -                                |
| Total                               |                                   | \$6,998                          | \$7                               | \$9,955                          |
| Total:                              |                                   |                                  |                                   |                                  |
| Commercial real estate              | \$13,724                          | \$72                             | \$13,415                          | \$110                            |
| Construction and land development   | -                                 | -                                | -                                 | -                                |
| Commercial and industrial           | 4,514                             | 13                               | 4,484                             | 24                               |
| Owner occupied real estate          | 3,160                             | 21                               | 3,413                             | 25                               |
| Consumer and other                  | 816                               | 10                               | 1,269                             | 11                               |
| Residential mortgage                | -                                 | -                                | -                                 | -                                |
| Total                               | \$22,214                          | \$116                            | \$22,581                          | \$170                            |

The following table presents additional information regarding the Company's impaired loans for the nine months ended September 30, 2018 and September 30, 2017:

| (dollars in thousands)              | Nine Months Ended September 30, |                            |                             |                            |
|-------------------------------------|---------------------------------|----------------------------|-----------------------------|----------------------------|
|                                     | 2018                            |                            | 2017                        |                            |
|                                     | Average Recorded Investment     | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded: |                                 |                            |                             |                            |
| Commercial real estate              | \$11,454                        | \$ 216                     | \$9,657                     | \$ 271                     |
| Construction and land development   | -                               | -                          | -                           | -                          |
| Commercial and industrial           | 3,762                           | 45                         | 2,149                       | 26                         |
| Owner occupied real estate          | 2,367                           | 43                         | 1,719                       | 46                         |
| Consumer and other                  | 645                             | 12                         | 837                         | 17                         |
| Residential mortgage                | -                               | -                          | 33                          | 1                          |
| Total                               | \$18,228                        | \$ 316                     | \$14,395                    | \$ 361                     |
| With an allowance recorded:         |                                 |                            |                             |                            |
| Commercial real estate              | \$2,692                         | \$-                        | \$6,575                     | \$13                       |
| Construction and land development   | -                               | -                          | -                           | -                          |
| Commercial and industrial           | 1,826                           | 4                          | 2,710                       | 50                         |
| Owner occupied real estate          | 1,047                           | 18                         | 1,437                       | 22                         |
| Consumer and other                  | 201                             | 1                          | 438                         | 8                          |
| Residential mortgage                | -                               | -                          | -                           | -                          |
| Total                               | \$5,766                         | \$23                       | \$11,160                    | \$93                       |
| Total:                              |                                 |                            |                             |                            |
| Commercial real estate              | \$14,146                        | \$216                      | \$16,232                    | \$284                      |
| Construction and land development   | -                               | -                          | -                           | -                          |
| Commercial and industrial           | 5,588                           | 49                         | 4,859                       | 76                         |
| Owner occupied real estate          | 3,414                           | 61                         | 3,156                       | 68                         |
| Consumer and other                  | 846                             | 13                         | 1,275                       | 25                         |
| Residential mortgage                | -                               | -                          | 33                          | 1                          |
| Total                               | \$23,994                        | \$339                      | \$25,555                    | \$454                      |



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The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of September 30, 2018 and December 31, 2017:

| (dollars in thousands)            | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days | Total<br>Past<br>Due | Current     | Total<br>Loans<br>Receivable | Loans<br>Receivable<br>><br>90<br>Days and<br>Accruing |
|-----------------------------------|------------------------------|------------------------------|----------------------------|----------------------|-------------|------------------------------|--|
| At September 30, 2018             |                              |                              |                            |                      |             |                              |  |
| Commercial real estate            | \$1,148                      | \$128                        | \$7,159                    | \$8,435              | \$487,094   | \$495,529                    | \$ -   |
| Construction and land development | -                            | -                            | -                          | -                    | 125,512     | 125,512                      | -  |
| Commercial and industrial         | -                            | 108                          | 3,868                      | 3,976                | 191,517     | 195,493                      | -  |
| Owner occupied real estate        | -                            | -                            | 1,651                      | 1,651                | 357,305     | 358,956                      | -  |
| Consumer and other                | 221                          | -                            | 801                        | 1,022                | 85,875      | 86,897                       | -  |
| Residential mortgage              | 125                          | -                            | -                          | 125                  | 116,251     | 116,376                      | -  |
| Total                             | \$1,494                      | \$236                        | \$13,479                   | \$15,209             | \$1,363,554 | \$1,378,763                  | \$ -   |

| (dollars in thousands)            | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days | Total<br>Past<br>Due | Current     | Total<br>Loans<br>Receivable | Loans<br>Receivable<br>><br>90 Days<br>and<br>Accruing |
|-----------------------------------|------------------------------|------------------------------|----------------------------|----------------------|-------------|------------------------------|--|
| At December 31, 2017              |                              |                              |                            |                      |             |                              |  |
| Commercial real estate            | \$-                          | \$-                          | \$8,963                    | \$8,963              | \$424,341   | \$433,304                    | \$ -   |
| Construction and land development | -                            | -                            | -                          | -                    | 104,617     | 104,617                      | -  |
| Commercial and industrial         | 969                          | -                            | 2,895                      | 3,864                | 169,479     | 173,343                      | -  |
| Owner occupied real estate        | -                            | -                            | 2,136                      | 2,136                | 307,702     | 309,838                      | -  |
| Consumer and other                | 144                          | -                            | 851                        | 995                  | 75,188      | 76,183                       | -  |
| Residential mortgage              | -                            | -                            | -                          | -                    | 64,764      | 64,764                       | -  |
| Total                             | \$1,113                      | \$-                          | \$14,845                   | \$15,958             | \$1,146,091 | \$1,162,049                  | \$ -   |

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of September 30, 2018 and December 31, 2017:

| (dollars in thousands)            | Pass      | Special<br>Mention | Substandard | Doubtful | Total     |
|-----------------------------------|-----------|--------------------|-------------|----------|-----------|
| At September 30, 2018:            |           |                    |             |          |           |
| Commercial real estate            | \$487,438 | \$932              | \$7,159     | \$ -     | \$495,529 |
| Construction and land development | 125,512   | -                  | -           | -        | 125,512   |
| Commercial and industrial         | 191,499   | 15                 | 3,699       | 280      | 195,493   |
| Owner occupied real estate        | 354,595   | 1,326              | 3,035       | -        | 358,956   |
| Consumer and other                | 86,096    | -                  | 801         | -        | 86,897    |
| Residential mortgage              | 116,251   | 125                | -           | -        | 116,376   |

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Total \$1,361,391 \$ 2,398 \$ 14,694 \$ 280 \$1,378,763

| (dollars in thousands)            | Pass        | Special<br>Mention | Substandard | Doubtful | Total       |
|-----------------------------------|-------------|--------------------|-------------|----------|-------------|
| At December 31, 2017:             |             |                    |             |          |             |
| Commercial real estate            | \$423,382   | \$ 959             | \$ 8,963    | \$ -     | \$433,304   |
| Construction and land development | 104,617     | -                  | -           | -        | 104,617     |
| Commercial and industrial         | 168,702     | 140                | 4,221       | 280      | 173,343     |
| Owner occupied real estate        | 306,040     | -                  | 3,798       | -        | 309,838     |
| Consumer and other                | 75,181      | -                  | 1,002       | -        | 76,183      |
| Residential mortgage              | 64,637      | 127                | -           | -        | 64,764      |
| Total                             | \$1,142,559 | \$ 1,226           | \$ 17,984   | \$ 280   | \$1,162,049 |

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The following table shows non-accrual loans by class as of September 30, 2018 and December 31, 2017:

| (dollars in thousands)            | September<br>30,<br>2018 | December<br>31,<br>2017 |
|-----------------------------------|--------------------------|-------------------------|
| Commercial real estate            | \$ 7,159                 | \$ 8,963                |
| Construction and land development | -                        | -                       |
| Commercial and industrial         | 3,868                    | 2,895                   |
| Owner occupied real estate        | 1,651                    | 2,136                   |
| Consumer and other                | 801                      | 851                     |
| Residential mortgage              | -                        | -                       |
| Total                             | \$ 13,479                | \$ 14,845               |

If these loans were performing under their original contractual rate, interest income on such loans would have increased approximately \$156,000 and \$519,000 for the three and nine months ended September 30, 2018, respectively, and \$127,000 and \$372,000 for the three and nine months ended September 30, 2017, respectively.

#### Troubled Debt Restructurings

A modification to the contractual terms of a loan which results in a concession to a borrower that is experiencing financial difficulty is classified as a troubled debt restructuring ("TDR"). The concessions made in a TDR are those that would not otherwise be considered for a borrower or collateral with similar risk characteristics. A TDR is typically the result of efforts to minimize potential losses that may be incurred during loan workouts, foreclosure, or repossession of collateral at a time when collateral values are declining. Concessions include a reduction in interest rate below current market rates, a material extension of time to the loan term or amortization period, partial forgiveness of the outstanding principal balance, acceptance of interest only payments for a period of time, or a combination of any of these conditions.

The following table summarizes information with regard to outstanding troubled debt restructurings at September 30, 2018 and December 31, 2017:

| (dollars in thousands)            | Number<br>of Loans | Accrual<br>Status | Non-<br>Accrual<br>Status | Total<br>TDRs |
|-----------------------------------|--------------------|-------------------|---------------------------|---------------|
| September 30, 2018                |                    |                   |                           |               |
| Commercial real estate            | 1                  | \$ 6,351          | \$-                       | \$ 6,351      |
| Construction and land development | -                  | -                 | -                         | -             |
| Commercial and industrial         | 3                  | -                 | 1,524                     | 1,524         |
| Owner occupied real estate        | 1                  | -                 | 242                       | 242           |
| Consumer and other                | -                  | -                 | -                         | -             |
| Residential mortgage              | -                  | -                 | -                         | -             |
| Total                             | 5                  | \$ 6,351          | \$ 1,766                  | \$ 8,117      |
| December 31, 2017                 |                    |                   |                           |               |
| Commercial real estate            | 1                  | \$ 6,452          | \$-                       | \$ 6,452      |
| Construction and land development | -                  | -                 | -                         | -             |
| Commercial and industrial         | 3                  | 1,175             | 349                       | 1,524         |
| Owner occupied real estate        | 1                  | 242               | -                         | 242           |
| Consumer and other                | -                  | -                 | -                         | -             |
| Residential mortgage              | -                  | -                 | -                         | -             |

|       |   |         |       |         |
|-------|---|---------|-------|---------|
| Total | 5 | \$7,869 | \$349 | \$8,218 |
|-------|---|---------|-------|---------|

All TDRs are considered impaired and are therefore individually evaluated for impairment in the calculation of the allowance for loan losses. Some TDRs may not ultimately result in the full collection of principal and interest as restructured and could lead to potential incremental losses. These potential incremental losses would be factored into our estimate of the allowance for loan losses. The level of any subsequent defaults will likely be affected by future economic conditions.

There were no loan modifications made during the three and nine months ended September 30, 2018 that met the criteria of a TDR.

The Company modified one commercial and industrial loan during the twelve month period ended December 31, 2017. In accordance with the modified terms of the commercial and industrial loan, the principal balance of \$975,000 was converted from a line of credit to a term loan with a five year maturity.

The Company modified one owner occupied real estate loan during the twelve month period ended December 31, 2017. In accordance with the modified terms of the owner occupied loan of \$245,000, certain concessions have been granted, including a reduction in the interest rate and an extension of the maturity date of the loan.

The Company modified one commercial real estate loan in the amount of \$6.5 million during the twelve month period ended December 31, 2017 that met the criteria of a TDR. This loan was transferred to non-accrual status during the second quarter of 2015 as a result of delinquency caused by tenant vacancies. The Company restructured the loan based on new leases obtained by the borrower. In accordance with the modified terms of the loan, certain concessions have been granted, including a reduction in the interest rate. In addition, the principal was increased by \$421,000. As a result of current payments for six consecutive months, the loan was returned to accrual status in the third quarter of 2017.

After a loan is determined to be a TDR, the Company continues to track its performance under the most recent restructured terms. There were no TDRs that subsequently defaulted during the three months ended September 30, 2018 and during the year ended December 31, 2017. There were three TDRs that subsequently defaulted during the nine months ended September 30, 2018.

There were no residential mortgages in the process of foreclosure as of September 30, 2018 and December 31, 2017. Other real estate owned relating to residential real estate was \$0 at September 30, 2018 and \$42,000 at December 31, 2017.

#### Note 7: Fair Value of Financial Instruments

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

The Company follows the guidance issued under ASC 820, Fair Value Measurement, which defines fair value, establishes a framework for measuring fair value under GAAP, and identifies required disclosures on fair value measurements.

ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or

liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are as follows:

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

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2018 and December 31, 2017 were as follows:

| (dollars in thousands)                      | Total     | (Level 1)<br>Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets | (Level 2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
|---|-----------|--|---|--|
| <b>September 30, 2018</b>                   |           |  |   |  |
| <b>Assets:</b>                              |           |  |   |  |
| Collateralized mortgage obligations         | \$333,628 | -  | \$333,628   | -  |
| Agency mortgage-backed securities           | 68,120    | -  | 68,120  | -  |
| Municipal securities                        | 18,935    | -  | 18,935  | -  |
| Corporate bonds                             | 59,625    | -  | 56,440  | 3,185  |
| Asset-backed securities                     | 6,669     | -  | 6,669   | -  |
| Trust Preferred Securities                  | 547       | -  | -   | 547  |
| Securities Available for Sale               | \$487,524 | -  | \$483,792   | \$3,732  |
| <br>  |           |  |   |  |
| Mortgage Loans Held for Sale                | \$29,702  | -  | \$29,702  | -  |
| SBA Servicing Assets                        | 4,855     | -  | -   | 4,855  |
| Interest Rate Lock Commitments              | 417       | -  | 417   | -  |
| Best Efforts Forward Loan Sales Commitments | 8         | -  | 8   | -  |
| Mandatory Forward Loan Sales Commitments    | 19        | -  | 19  | -  |
| <br>  |           |  |   |  |
| <b>Liabilities:</b>                         |           |  |   |  |
| Interest Rate Lock Commitments              | -         | -  | -   | -  |
| Best Efforts Forward Loan Sales Commitments | 90        | -  | 90  | -  |
| Mandatory Forward Loan Sales Commitments    | 103       | -  | 103   | -  |
| <br>  |           |  |   |  |
| <b>December 31, 2017</b>                    |           |  |   |  |
| <b>Assets:</b>                              |           |  |   |  |
| Collateralized mortgage obligations         | \$320,241 | -  | \$320,241   | -  |
| Agency mortgage-backed securities           | 54,866    | -  | 54,866  | -  |
| Municipal securities                        | 15,100    | -  | 15,100  | -  |
| Corporate bonds                             | 60,282    | -  | 57,196  | 3,086  |
| Asset-backed securities                     | 13,452    | -  | 13,452  | -  |
| Trust Preferred Securities                  | 489       | -  | -   | 489  |
| Securities Available for Sale               | \$464,430 | -  | \$460,855   | \$3,575  |
| <br>  |           |  |   |  |
| Mortgage Loans Held for Sale                | \$43,375  | -  | \$43,375  | -  |



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|   |       |   |     |       |
|---|-------|---|-----|-------|
| SBA Servicing Assets                        | 5,243 | - | -   | 5,243 |
| Interest Rate Lock Commitments              | 363   | - | 363 | -     |
| Best Efforts Forward Loan Sales Commitments | 5     | - | 5   | -     |
| Mandatory Forward Loan Sales Commitments    | 19    | - | 19  | -     |

Liabilities:

|   |     |   |     |   |
|---|-----|---|-----|---|
| Interest Rate Lock Commitments              | 1   | - | 1   | - |
| Best Efforts Forward Loan Sales Commitments | 93  | - | 93  | - |
| Mandatory Forward Loan Sales Commitments    | 195 | - | 195 | - |

The following tables present an analysis of the activity in the SBA servicing assets for the three and nine months ended September 30, 2018 and 2017:

| (dollars in thousands)                     | Three Months<br>Ended<br>September 30, |         |
|--|--|---------|
|  | 2018                                   | 2017    |
| Beginning balance, July 1 <sup>st</sup>    | \$4,977                                | \$5,194 |
| Additions                                  | 297                                    | 268     |
| Fair value adjustments                     | (419)                                  | (75)    |
| Ending balance, September 30 <sup>th</sup> | \$4,855                                | \$5,387 |

| (dollars in thousands)                     | Nine Months<br>Ended<br>September 30, |         |
|--|---------------------------------------|---------|
|  | 2018                                  | 2017    |
| Beginning balance, January 1 <sup>st</sup> | \$5,243                               | \$5,352 |
| Additions                                  | 864                                   | 746     |
| Fair value adjustments                     | (1,252)                               | (711)   |
| Ending balance, September 30 <sup>th</sup> | \$4,855                               | \$5,387 |

Fair value adjustments are recorded as loan and servicing fees on the statement of income. Servicing fee income, not including fair value adjustments, totaled \$486,000 and \$468,000 for the three months ended September 30, 2018 and 2017, respectively. Servicing fee income, not including fair value adjustments, totaled \$1.5 million and \$1.4 million for the nine months ended September 30, 2018 and 2017, respectively. Total loans in the amount of \$204.9 million at September 30, 2018 and December 31, 2017 were serviced for others.

The following table presents a reconciliation of the securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2018 and 2017:

| Level 3 Investments Only<br>(dollars in thousands) | Three Months<br>Ended<br>September 30,<br>2018 |                    | Three Months<br>Ended<br>September 30,<br>2017 |                    |
|--|--|--------------------|--|--------------------|
|  | Trust<br>Preferred<br>Securities               | Corporate<br>Bonds | Trust<br>Preferred<br>Securities               | Corporate<br>Bonds |
| Balance, July 1 <sup>st</sup>                      | \$547  | \$ 3,083           | \$968  | \$ 3,079           |
| Unrealized gains (losses)                          | -  | 102                | 140  | (54)               |
| Proceeds from sales                                | -  | -                  | -  | -                  |
| Realized losses                                    | -  | -                  | -  | -                  |
| Balance, September 30 <sup>th</sup>                | \$547  | \$ 3,185           | \$1,108  | \$ 3,025           |

  

| Level 3 Investments Only | Nine Months<br>Ended<br>September 30,<br>2018 |           | Nine Months<br>Ended<br>September 30,<br>2017 |           |
|--------------------------|---|-----------|---|-----------|
|                          | Trust   | Corporate | Trust   | Corporate |

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| (dollars in thousands)              | Preferred<br>Securities | Bonds    | Preferred<br>Securities | Bonds    |
|-------------------------------------|-------------------------|----------|-------------------------|----------|
| Balance, January 1 <sup>st</sup>    | \$489                   | \$ 3,086 | \$1,820                 | \$ 2,971 |
| Unrealized gains (losses)           | 58                      | 99       | 806                     | 54       |
| Proceeds from sales                 | -                       | -        | (970)                   | -        |
| Realized losses                     | -                       | -        | (548)                   | -        |
| Balance, September 30 <sup>th</sup> | \$547                   | \$ 3,185 | \$1,108                 | \$ 3,025 |

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For assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2018 and December 31, 2017 were as follows:

| (dollars in thousands)  | Total   | (Level 1)<br>Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets | (Level 2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
|-------------------------|---------|---|---|--|
| September 30, 2018      |         |   |   |  |
| Impaired loans          | \$6,302 | \$ -  | \$ -  | \$ 6,302   |
| Other real estate owned | 463     | -   | -   | 463  |
| December 31, 2017       |         |   |   |  |
| Impaired loans          | \$7,322 | \$ -  | \$ -  | \$ 7,322   |
| Other real estate owned | 5,727   | -   | -   | 5,727  |

The table below presents additional quantitative information about level 3 assets measured at fair value on a nonrecurring basis (dollars in thousands):

| Asset Description          | Quantitative Information about Level 3 Fair Value Measurements |                                   |                             | Range (Weighted Average) |
|----------------------------|--|-----------------------------------|-----------------------------|--------------------------|
|                            | Fair Value   | Valuation Technique               | Unobservable Input          |                          |
| September 30, 2018         |  |                                   |                             |                          |
| Corporate bonds            | \$3,185  | Discounted Cash Flows             | Discount Rate               | (7.32%)                  |
| Trust preferred securities | \$ 547   | Discounted Cash Flows             | Discount Rate               | (8.23%)                  |
| SBA servicing assets       | \$4,855  | Discounted Cash Flows             | Conditional Prepayment Rate | (10.19%)                 |
|                            |  |                                   | Discount Rate               | (11.25%)                 |
| Impaired loans             | \$6,302  | Appraised Value of Collateral (1) | Liquidation expenses (2)    | 11% - 23% (13%) (3)      |
| Other real estate owned    | \$463  | Appraised Value of Collateral (1) | Liquidation expenses (2)    | (7%) (3)                 |
| December 31, 2017          |  |                                   |                             |                          |
| Corporate bonds            | \$3,086  | Discounted Cash Flows             | Discount Rate               | (5.99%)                  |
| Trust preferred securities | \$ 489   | Discounted Cash Flows             | Discount Rate               | (8.33%)                  |

|                         |         |                                   |                                |                     |
|-------------------------|---------|-----------------------------------|--------------------------------|---------------------|
| SBA servicing assets    | \$5,243 | Discounted<br>Cash Flows          | Conditional<br>Prepayment Rate | (7.85%)             |
|                         |         |                                   | Discount Rate                  | (10.50%)            |
| Impaired loans          | \$7,322 | Appraised Value of Collateral (1) | Liquidation expenses (2)       | 10% - 21% (14%) (3) |
| Other real estate owned | \$5,727 | Appraised Value of Collateral (1) | Liquidation expenses (2)       | (22%) (3)           |
|                         |         | Sales Price                       | Liquidation expenses (2)       | 4% - 7% (7%) (3)    |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include Level 3 inputs that are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.

(3) The range and weighted average of qualitative factors such as economic conditions and estimated liquidation expenses are presented as a percent of the appraised value.

The significant unobservable inputs for impaired loans and other real estate owned are the appraised value or an agreed upon sales price. These values are adjusted for estimated costs to sell which are incremental direct costs to transact a sale such as broker commissions, legal fees, closing costs and title transfer fees. The costs must be considered essential to the sale and would not have been incurred if the decision to sell had not been made. The costs to sell are based on costs associated with the Company's actual sales of other real estate owned which are assessed annually.

## Fair Value Assumptions

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at September 30, 2018 and December 31, 2017.

### Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair values.

### Investment Securities

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level 3 investments.

The types of instruments valued based on matrix pricing in active markets include all of the Company's U.S. government and agency securities, corporate bonds, asset backed securities, and municipal obligations. Such instruments are generally classified within Level 2 of the fair value hierarchy. As required by ASC 820-10, the Company does not adjust the matrix pricing for such instruments.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, and may be adjusted to reflect illiquidity and/or non-transferability, with such adjustment generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes Level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows. The Level 3 investment securities classified as available for sale are comprised of a single trust preferred security and a single corporate bond.

The trust preferred security is a pool of similar securities that are grouped into an asset structure commonly referred to as collateralized debt obligations ("CDOs") which consist of the debt instruments of various banks, diversified by the number of participants in the security as well as geographically. The secondary market for this security has become inactive, and therefore this security is classified as a Level 3 security. The fair value analysis does not reflect or represent the actual terms or prices at which any party could purchase the security. There is currently a limited secondary market for the security and there can be no assurance that any secondary market for the security will expand.

An independent, third party pricing service is used to estimate the current fair market value of the CDO held in the investment securities portfolio. The calculations used to determine fair value are based on the attributes of the trust preferred security, the financial condition of the issuers of the trust preferred security, and market based assumptions. The INTEX CDO Deal Model Library was utilized to obtain information regarding the attributes of the security and its specific collateral as of September 30, 2018 and December 31, 2017. Financial information on the issuers was also obtained from Bloomberg, the FDIC, and SNL Financial. Both published and unpublished industry sources were utilized in estimating fair value. Such information includes prepayment speed assumptions, discount rates, default rates, and loss severity percentages.

The fair market valuation for the CDO was determined based on discounted cash flow analyses. The cash flows are primarily dependent on the estimated speeds at which the underlying trust preferred securities are expected to prepay, the estimated rates at which the trust preferred securities are expected to defer payments, the estimated rates at which the trust preferred securities are expected to default, and the severity of the losses on the securities that default.

Increases (decreases) in actual or expected issuer defaults tend to decrease (increase) the fair value of senior and mezzanine tranches of CDOs. The value of the Company's mezzanine tranches of the CDO is also affected by expected future interest rates. However, due to the structure of the security, timing of cash flows, and secondary effects on the financial performance of the underlying issuers, the effects of changes in future interest rates on the fair value of the Company's holdings are not quantifiably estimable.

Also included in Level 3 investment securities classified as available for sale is a corporate bond that is not actively traded. Impairment would depend on the repayment ability of the underlying issuer, which is assessed through a detailed quarterly review of the issuer's financial statements. The issuer is a "well capitalized" financial institution as defined by federal banking regulations and has demonstrated the ability to raise additional capital, when necessary, through the public capital markets. The fair value of this corporate bond is estimated by obtaining a price of a comparable floating rate debt instrument through Bloomberg.

#### Mortgage Loans Held for Sale (Carried at Fair Value)

The fair value of mortgage loans held for sale is determined by obtaining prices at which they could be sold in the principal market at the measurement date and are classified within Level 2 of the fair value hierarchy. Republic elected to adopt the fair value option for its mortgage loans held for sale portfolio in order to more accurately reflect their economic value. Interest income on loans held for sale, which totaled \$389,000 and \$914,000 for three and nine months ended September 30, 2018, respectively, and \$277,000 and \$577,000 for the three and nine months ended September 30, 2017, respectively, are included in interest and fees in the statements of income.

The following table reflects the difference between the carrying amount of mortgage loans held for sale, measured at fair value and the aggregate unpaid principal amount that Republic is contractually entitled to receive at maturity as of September 30, 2018 and December 31, 2017 (dollars in thousands):

|                    | Carrying<br>Amount | Aggregate<br>Unpaid<br>Principal<br>Balance | Excess<br>Carrying<br>Amount<br>Over<br>Aggregate<br>Unpaid<br>Principal<br>Balance |
|--------------------|--------------------|---|---|
| September 30, 2018 | \$29,702           | \$ 28,847                                   | \$ 855  |
| December 31, 2017  | \$43,375           | \$ 42,046                                   | \$ 1,329  |





Changes in the excess carrying amount over aggregate unpaid principal balance are recorded in the statement of income in mortgage banking income. Republic did not have any mortgage loans held for sale recorded at fair value that were 90 or more days past due and on non-accrual at September 30, 2018 and December 31, 2017.

#### Interest Rate Lock Commitments ("IRLC")

The fair value of Republic's IRLC instruments are based upon the underlying loans measured at fair value on a recurring basis and the probability of such commitments being exercised. Due to observable market data inputs used by Republic, IRLCs are classified within Level 2 of the valuation hierarchy.

#### Best Efforts Forward Loan Sales Commitments

Best efforts forward loan sales commitments are classified within Level 2 of the valuation hierarchy. Best efforts forward loan sales commitments fix the forward sales price that will be realized upon the sale of mortgage loans into the secondary market. Best efforts forward loan sales commitments are entered into for loans at the time the borrower commitment is made. These best efforts forward loan sales commitments are valued using the committed price to the counterparty against the current market price of the interest rate lock commitment or mortgage loan held for sale.

#### Mandatory Forward Loan Sales Commitments

Fair values for mandatory forward loan sales commitments are based on fair values of the underlying mortgage loans and the probability of such commitments being exercised. Due to the observable inputs used by Republic, best efforts mandatory loan sales commitments are classified within Level 2 of the valuation hierarchy.

#### Impaired Loans (Carried at Lower of Cost or Fair Value)

Impaired loans are those that the Company has measured impairment based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less any valuation allowance. The valuation allowance amount is calculated as the difference between the recorded investment in a loan and the present value of expected future cash flows or it is calculated based on discounted collateral values if the loans are collateral dependent.

#### Other Real Estate Owned (Carried at Lower of Cost or Fair Value)

These assets are carried at the lower of cost or fair value. At September 30, 2018 and December 31, 2017, these assets are carried at current fair value and classified within Level 3 of the fair value hierarchy.

#### SBA Servicing Asset (Carried at Fair Value)

The SBA servicing asset is initially recorded when loans are sold and the servicing rights are retained and recorded on the balance sheet. An updated fair value is obtained from an independent third party on a quarterly basis and adjustments are presented as loan and servicing fees on the statement of income. The valuation begins with the projection of future cash flows for each asset based on their unique characteristics, the Company's market-based assumptions for prepayment speeds and estimated losses and recoveries. The present value of the future cash flows are then calculated utilizing the Company's market-based discount ratio assumptions. In all cases, the Company's models expected payments for every loan for each quarterly period in order to create the most detailed cash flow stream possible.



The Company uses assumptions and estimates in determining the impairment of the SBA servicing asset. These assumptions include prepayment speeds and discount rates commensurate with the risks involved and comparable to assumptions used by participants to value and bid serving rights available for sale in the market. At September 30, 2018 and December 31, 2017, the sensitivity of the current fair value of the SBA loan servicing rights to immediate 10% and 20% adverse changes in key assumptions are included in the accompanying table.

| (dollars in thousands)                       | September<br>30, 2018 | December<br>31, 2017 |
|--|-----------------------|----------------------|
| SBA Servicing Asset                          |                       |                      |
| Fair Value of SBA Servicing Asset            | \$4,855               | \$5,243              |
| Composition of SBA Loans Serviced for Others |                       |                      |
| Fixed-rate SBA loans                         | 2%                    | 2%                   |
| Adjustable-rate SBA loans                    | 98%                   | 98%                  |
| Total  | 100%                  | 100%                 |
| Weighted Average Remaining Term              | 20.5 years            | 20.5 years           |
| Prepayment Speed                             | 10.19%                | 7.85%                |
| Effect on fair value of a 10% increase       | \$(171)               | \$(171)              |
| Effect on fair value of a 20% increase       | (333)                 | (333)                |
| Weighted Average Discount Rate               | 11.25%                | 10.50%               |
| Effect on fair value of a 10% increase       | \$(187)               | \$(211)              |
| Effect on fair value of a 20% increase       | (362)                 | (407)                |

The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. As indicated, changes in value based on adverse changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in value may not be linear. Also in this table, the effect of an adverse variation in a particular assumption on the value of the SBA servicing rights is calculated without changing any other assumption. While in reality, changes in one factor may magnify or counteract the effect of the change.

#### Off-Balance Sheet Financial Instruments (Disclosed at notional amounts)

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

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The estimated fair values of the Company's financial instruments were as follows at September 30, 2018:

| (dollars in thousands)                      | Fair Value Measurements at September 30, 2018 |              |  |   |   |
|---|---|--------------|--|---|---|
|   | Carrying Amount                               | Fair Value   | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Balance Sheet Data</b>                   |   |              |  |   |   |
| <b>Financial assets:</b>                    |   |              |  |   |   |
| Cash and cash equivalents                   | \$ 146,299                                    | \$ 146,299   | \$ 146,299   | \$ -  | \$ -                                      |
| Investment securities available for sale    | 487,524                                       | 487,524      | -  | 483,792                                       | 3,732                                     |
| Investment securities held to maturity      | 485,291                                       | 461,518      | -  | 461,518                                       | -   |
| Restricted stock                            | 1,916   | 1,916        | -  | 1,916   | -   |
| Loans held for sale                         | 32,839  | 32,879       | -  | 29,702  | 3,177                                     |
| Loans receivable, net                       | 1,370,704                                     | 1,349,046    | -  | -   | 1,349,046                                 |
| SBA servicing assets                        | 4,855   | 4,855        | -  | -   | 4,855                                     |
| Accrued interest receivable                 | 8,301   | 8,301        | -  | 8,301   | -   |
| Interest rate lock commitments              | 417   | 417          | -  | 417   | -   |
| Best efforts forward loan sales commitments | 8   | 8            | -  | 8   | -   |
| Mandatory forward loan sales commitments    | 19  | 19           | -  | 19  | -   |
| <b>Financial liabilities:</b>               |   |              |  |   |   |
| <b>Deposits</b>                             |   |              |  |   |   |
| Demand, savings and money market            | \$ 2,271,216                                  | \$ 2,271,216 | \$ -   | \$ 2,271,216                                  | \$ -                                      |
| Time  | 129,142                                       | 127,589      | -  | 127,589                                       | -   |
| Subordinated debt                           | 11,257  | 8,509        | -  | -   | 8,509                                     |
| Accrued interest payable                    | 401   | 401          | -  | 401   | -   |
| Interest rate lock commitments              | -   | -            | -  | -   | -   |
| Best efforts forward loan sales commitments | 90  | 90           | -  | 90  | -   |
| Mandatory forward loan sales commitments    | 103   | 103          | -  | 103   | -   |
| <b>Off-Balance Sheet Data</b>               |   |              |  |   |   |
| Commitments to extend credit                | -   | -            | -  | -   | -   |
| Standby letters-of-credit                   | -   | -            | -  | -   | -   |

The estimated fair values of the Company's financial instruments were as follows at December 31, 2017.

| (dollars in thousands)                      | Fair Value Measurements at December 31, 2017 |             |  |   |   |
|---|--|-------------|--|---|---|
|   | Carrying Amount                              | Fair Value  | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Balance Sheet Data</b>                   |  |             |  |   |   |
| <b>Financial assets:</b>                    |  |             |  |   |   |
| Cash and cash equivalents                   | \$61,942                                     | \$61,942    | \$61,942   | \$-   | \$-                                       |
| Investment securities available for sale    | 464,430                                      | 464,430     | -  | 460,855                                       | 3,575                                     |
| Investment securities held to maturity      | 472,213                                      | 463,799     | -  | 463,799                                       | -   |
| Restricted stock                            | 1,918  | 1,918       | -  | 1,918   | -   |
| Loans held for sale                         | 45,700                                       | 45,714      | -  | 43,375  | 2,339                                     |
| Loans receivable, net                       | 1,153,679                                    | 1,120,305   | -  | -   | 1,120,305                                 |
| SBA servicing assets                        | 5,243  | 5,243       | -  | -   | 5,243                                     |
| Accrued interest receivable                 | 7,009  | 7,009       | -  | 7,009   | -   |
| Interest rate lock commitments              | 363  | 363         | -  | 363   | -   |
| Best efforts forward loan sales commitments | 5  | 5           | -  | 5   | -   |
| Mandatory forward loan sales commitments    | 19   | 19          | -  | 19  | -   |
| <b>Financial liabilities:</b>               |  |             |  |   |   |
| <b>Deposits</b>                             |  |             |  |   |   |
| Demand, savings and money market            | \$1,946,558                                  | \$1,946,558 | \$-  | \$1,946,558                                   | \$-                                       |
| Time  | 116,737                                      | 115,673     | -  | 115,673                                       | -   |
| Subordinated debt                           | 21,681                                       | 18,458      | -  | -   | 18,458                                    |
| Accrued interest payable                    | 293  | 293         | -  | 293   | -   |
| Interest rate lock commitments              | 1  | 1           | -  | 1   | -   |
| Best efforts forward loan sales commitments | 93   | 93          | -  | 93  | -   |
| Mandatory forward loan sales commitments    | 195  | 195         | -  | 195   | -   |
| <b>Off-Balance Sheet Data</b>               |  |             |  |   |   |
| Commitments to extend credit                | -  | -           | -  | -   | -   |
| Standby letters-of-credit                   | -  | -           | -  | -   | -   |

## Note 8: Changes in Accumulated Other Comprehensive Income (Loss) By Component (1)

The following table presents the changes in accumulated other comprehensive loss by component for the nine months ended September 30, 2018 and 2017, and the year ended December 31, 2017.

|  | Unrealized Gains<br>(Losses) on<br>Available-For-Sale<br>Securities | Unrealized<br>Holding<br>Losses on<br>Securities<br>Transferred<br>From<br>Available-For-Sale<br>To<br>Held-To-Maturity | Total       |
|--|---|---|-------------|
| (dollars in thousands)   |   |   |             |
| Balance January 1, 2018  | \$ (7,150)  | \$ (359)  | \$ (7,509)  |
| Reclassification due to the adoption of ASU 2018-02                                | (1,562)   | (78)  | (1,640)     |
| Unrealized loss on securities  | (9,536)   | -   | (9,536)     |
| Amounts reclassified from accumulated other comprehensive income to net income (2) | 1   | 83  | 84          |
| Net current-period other comprehensive income (loss)                               | (9,535)   | 83  | (9,452)     |
| Balance September 30, 2018   | \$ (18,247)   | \$ (354)  | \$ (18,601) |
| Balance January 1, 2017  | \$ (6,831)  | \$ (463)  | \$ (7,294)  |
| Unrealized gain on securities  | 1,676   | -   | 1,676       |
| Amounts reclassified from accumulated other comprehensive income to net income (2) | 39  | 83  | 122         |
| Net current-period other comprehensive income                                      | 1,715   | 83  | 1,798       |
| Balance September 30, 2017   | \$ (5,116)  | \$ (380)  | \$ (5,496)  |
| Balance January 1, 2017  | \$ (6,831)  | \$ (463)  | \$ (7,294)  |
| Unrealized loss on securities  | (413)   | -   | (413)       |
| Amounts reclassified from accumulated other comprehensive income to net income (2) | 94  | 104   | 198         |
| Net current-period other comprehensive income (loss)                               | (319)   | 104   | (215)       |
| Balance December 31, 2017  | \$ (7,150)  | \$ (359)  | \$ (7,509)  |

(1) All amounts are net of tax. Amounts in parentheses indicate reductions to other comprehensive income.

(2) Reclassification amounts are reported as gains on sales of investment securities, impairment losses, and amortization of net unrealized losses on the Consolidated Statement of Operations.

## Note 9: Goodwill and Other Intangibles

The Company completed an annual impairment test for goodwill as of July 31, 2018 and 2017. Future impairment testing will be conducted as of July 31 on an annual basis, unless a triggering event occurs in the interim that would suggest impairment, in which case it would be tested as of the date of the triggering event. During the nine months ended September 30, 2018 and 2017, there was no goodwill impairment recorded. There can be no assurance that future impairment assessments or tests will not result in a charge to earnings.



The Company's goodwill and intangible assets related to the acquisition of Oak Mortgage in July 2016 is detailed below:

| (dollars in thousands) | Balance<br>December<br>31,<br>2017 | Additions/<br>Adjustments | Amortization | Balance<br>September<br>30,<br>2018 | Amortization<br>Period (in years) |
|------------------------|------------------------------------|---------------------------|--------------|-------------------------------------|-----------------------------------|
| Goodwill               | \$ 5,011                           | \$ -                      | \$ -         | \$ 5,011                            | Indefinite                        |

  

| (dollars in thousands) | Balance<br>December<br>31,<br>2016 | Additions/<br>Adjustments | Amortization | Balance<br>September<br>30,<br>2017 | Amortization<br>Period (in years) |
|------------------------|------------------------------------|---------------------------|--------------|-------------------------------------|-----------------------------------|
| Goodwill               | \$ 5,011                           | \$ -                      | \$ -         | \$ 5,011                            | Indefinite                        |
| Non-compete agreements | 61                                 | -                         | (61)         | -                                   | 1                                 |
| Total                  | \$ 5,072                           | \$ -                      | \$ (61)      | \$ 5,011                            |                                   |

Note 10: Derivatives and Risk Management Activities

Republic did not have any derivative instruments designated as hedging instruments, or subject to master netting and collateral agreements for the nine months ended September 30, 2018 and 2017. The following table summarizes the amounts recorded in Republic's statement of financial condition for derivatives not designated as hedging instruments as of September 30, 2018 and December 31, 2017 (in thousands):

| September 30, 2018                          | Balance Sheet<br>Presentation | Fair<br>Value | Notional<br>Amount |
|---|-------------------------------|---------------|--------------------|
| Asset derivatives:                          |                               |               |                    |
| IRLC's                                      | Other Assets                  | \$417         | \$19,367           |
| Best efforts forward loan sales commitments | Other Assets                  | 8             | 2,775              |
| Mandatory forward loan sales commitments    | Other Assets                  | 19            | 6,481              |
| Liability derivatives:                      |                               |               |                    |
| IRLC's                                      | Other Liabilities             | \$-           | \$-                |
| Best efforts forward loan sales commitments | Other Liabilities             | 90            | 16,592             |
| Mandatory forward loan sales commitments    | Other Liabilities             | 103           | 21,731             |
| December 31, 2017                           | Balance Sheet<br>Presentation | Fair<br>Value | Notional<br>Amount |
| Asset derivatives:                          |                               |               |                    |
| IRLCs                                       | Other Assets                  | \$363         | \$16,366           |
| Best efforts forward loan sales commitments | Other Assets                  | 5             | 1,807              |
| Mandatory forward loan sales commitments    | Other Assets                  | 19            | 4,566              |



Liability derivatives:

|   |                   |     |        |
|---|-------------------|-----|--------|
| IRLCs                                       | Other Liabilities | \$1 | \$424  |
| Best efforts forward loan sales commitments | Other Liabilities | 93  | 14,983 |
| Mandatory forward loan sales commitments    | Other Liabilities | 195 | 36,223 |

The following tables summarize the amounts recorded in Republic's statement of income for derivative instruments not designated as hedging instruments for the three and nine months ended September 30, 2018 and 2017 (in thousands):

|                    |                                  | Three<br>Months<br>Ended<br>September<br>30, 2018 | Nine<br>Months<br>Ended<br>September<br>30, 2018 |
|--------------------|----------------------------------|---|--|
|                    | Income Statement<br>Presentation | Gain/(Loss)                                       | Gain/(Loss)                                      |
| Asset derivatives: |                                  |   |  |

|   |                         |          |       |
|---|-------------------------|----------|-------|
| IRLC's                                      | Mortgage banking income | \$ (297) | \$ 54 |
| Best efforts forward loan sales commitments | Mortgage banking income | 7        | 3     |
| Mandatory forward loan sales commitments    | Mortgage banking income | 13       | -     |

Liability derivatives:

|   |                         |      |      |
|---|-------------------------|------|------|
| IRLC's                                      | Mortgage banking income | \$ 3 | \$ 1 |
| Best efforts forward loan sales commitments | Mortgage banking income | 120  | 3    |
| Mandatory forward loan sales commitments    | Mortgage banking income | 198  | 92   |

|                    |                                  | Three<br>Months<br>Ended<br>September<br>30, 2017 | Nine<br>Months<br>Ended<br>September<br>30, 2017 |
|--------------------|----------------------------------|---|--|
|                    | Income Statement<br>Presentation | Gain/(Loss)                                       | Gain/(Loss)                                      |
| Asset derivatives: |                                  |   |  |

|   |                         |          |        |
|---|-------------------------|----------|--------|
| IRLC's                                      | Mortgage banking income | \$ (126) | \$ 196 |
| Best efforts forward loan sales commitments | Mortgage banking income | (8)      | (90)   |
| Mandatory forward loan sales commitments    | Mortgage banking income | 47       | (178)  |

Liability derivatives:

|   |                         |      |       |
|---|-------------------------|------|-------|
| IRLC's                                      | Mortgage banking income | \$ - | \$ 54 |
| Best efforts forward loan sales commitments | Mortgage banking income | 38   | -     |
| Mandatory forward loan sales commitments    | Mortgage banking income | 12   | (99)  |

The fair value of Republic's IRLCs, best efforts forward loan sales commitments, and mandatory forward loan sales commitments are based upon the estimated value of the underlying mortgage loan (determined consistent with "Loans Held for Sale"), adjusted for (1) estimated costs to complete and originate the loan, and (2) the estimated percentage of IRLCs that will result in a closed mortgage loan. The valuation of the IRLCs issued by Republic includes the value of the servicing released premium. Republic sells loans servicing released, and the servicing released premium is

included in the market price.

Note 11: Revenue Recognition

On January 1, 2018, the Company adopted ASU 2014-09 "Revenue from Contracts with Customers" (Topic 606) and all subsequent ASUs that modified Topic 606. As stated in Note 2 Summary of Significant Accounting Policies, the implementation of the new standard did not have a material impact on the measurement of recognition of revenue. Management determined that a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and investments. In addition, certain non-interest income streams such as gains on sales of residential mortgage and SBA loans, income associated with servicing assets, and loan fees, including residential mortgage originations to be sold and prepayment and late fees charged across all loan categories are also not in scope of the new guidance. Topic 606 is applicable to non-interest revenue streams such as service charges on deposit accounts. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Non-interest revenue streams in-scope of Topic 606 are discussed below.

#### Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), ATM fees, NSF fees, and other deposit related fees.

The Company's performance obligation for account analysis fees and monthly services fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided, which is typically one month. Revenue is recognized at month end after the completion of the service period and payment for these service charges on deposit accounts is primarily received through a direct charge to customers' accounts.

ATM fees, NSF fees, and other deposit related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and the related revenue recognized, at a point in time. Payment for these service charges are received immediately through a direct charge to customers' accounts.

For the Company, there are no other material revenue streams within the scope of Topic 606.

The following tables present non-interest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine months ended September 30, 2018 and 2017.

|   | Three Months<br>Ended<br>September 30,<br>2018 2017 |         |
|---|---|---------|
| (dollars in thousands)                          |   |         |
| Non-interest income                             |   |         |
| In-scope of Topic 606                           |   |         |
| Service charges on deposit accounts             | \$1,386   | \$1,067 |
| Other non-interest income                       | 29  | 44      |
| Non-interest income (in-scope of Topic 606)     | 1,415   | 1,111   |
| Non-interest income (out-of-scope of Topic 606) | 3,716   | 4,667   |
| Total non-interest income                       | \$5,131   | \$5,778 |
|   |   |         |
|   | Nine Months<br>Ended<br>September 30,<br>2018 2017  |         |
| (dollars in thousands)                          |   |         |
| Non-interest income                             |   |         |
| In-scope of Topic 606                           |   |         |
| Service charges on deposit accounts             | \$3,887   | \$2,820 |
| Other non-interest income                       | 107   | 130     |
| Non-interest income (in-scope of Topic 606)     | 3,994   | 2,950   |
| Non-interest income (out-of-scope of Topic 606) | 11,440  | 12,135  |

|                           |          |          |
|---------------------------|----------|----------|
| Total non-interest income | \$15,434 | \$15,085 |
|---------------------------|----------|----------|

## Contract Balances

A contract assets balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's non-interest revenue streams are largely based on transaction activity, or standard month-end revenue accruals. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term contracts with customers, and therefore, does not experience significant contract balances. As of September 30, 2018 and December 31, 2017, the Company did not have any significant contract balances.

## Contract Acquisition Costs

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize as an expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the assets that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition cost.

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

The following is management's discussion and analysis of our financial condition, changes in financial condition, and results of operations in the accompanying consolidated financial statements. This discussion should be read in conjunction with the accompanying notes to the consolidated financial statements.

We may from time to time make written or oral "forward-looking statements", including statements contained in this quarterly report. The forward-looking statements contained herein are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. For example, risks and uncertainties can arise with changes in: general economic conditions, including turmoil in the financial markets and related efforts of government agencies to stabilize the financial system; the adequacy of our allowance for loan losses and our methodology for determining such allowance; adverse changes in our loan portfolio and credit risk-related losses and expenses; concentrations within our loan portfolio, including our exposure to commercial real estate loans, and to our primary service area; changes in interest rates; our ability to identify, negotiate, secure and develop new store locations and renew, modify, or terminate leases or dispose of properties for existing store locations effectively; business conditions in the financial services industry, including competitive pressure among financial services companies, new service and product offerings by competitors, price pressures and similar items; deposit flows; loan demand; the regulatory environment, including evolving banking industry standards, changes in legislation or regulation; our securities portfolio and the valuation of our securities; accounting principles, policies and guidelines as well as estimates and assumptions used in the preparation of our financial statements; rapidly changing technology; litigation liabilities, including costs, expenses, settlements and judgments; and other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services. You should carefully review the risk factors described in the Annual Report on Form 10-K for the year ended December 31, 2017 and other documents we file from time to time with the Securities and Exchange Commission. The words "would be," "could be," "should be," "probability," "risk," "target," "objective," "may," "will," "estimate," "project," "believe," "intend," "anticipate," "plan," "seek," "expect" and similar expressions or variations on such expressions are intended to identify forward-looking statements. All such statements are made in good faith by us pursuant to the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. We do not undertake to update any

forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of us, except as may be required by applicable law or regulations.

## Recent Regulatory Reform Legislation

On May 24, 2018, President Trump signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Act"), which was designed to ease certain restrictions imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Most of the changes made by the new Act can be grouped into five general areas: mortgage lending; certain regulatory relief for "community" banks; enhanced consumer protections in specific areas, including subjecting credit reporting agencies to additional requirements; certain regulatory relief for large financial institutions, including increasing the threshold at which institutions are classified a systemically important financial institutions (from \$50 billion to \$250 billion) and therefore subject to stricter oversight, and revising the rules for larger institution stress testing; and certain changes to federal securities regulations designed to promote capital formation. Some of the key provisions of the Act as it relates to community banks and bank holding companies include, but are not limited to: (i) designating mortgages held in portfolio as "qualified mortgages" for banks with less than \$10 billion in assets, subject to certain documentation and product limitations; (ii) exempting banks with less than \$10 billion in assets (and total trading assets and trading liabilities of 5% or less of total assets) from Volcker Rule requirements relating to proprietary trading; (iii) simplifying capital calculations for banks with less than \$10 billion in assets by requiring federal banking agencies to establish a community bank leverage ratio of tangible equity to average consolidated assets of not less than 8% or more than 10%, and provide that banks that maintain tangible equity in excess of such ratio will be deemed to be in compliance with risk-based capital and leverage requirements; (iv) assisting smaller banks with obtaining stable funding by providing an exception for reciprocal deposits from FDIC restrictions on acceptance of brokered deposits; (v) raising the eligibility for use of short-form Call Reports from \$1 billion to \$5 billion in assets; (vi) clarifying definitions pertaining to high volatility commercial real estate loans (HVCRE), which require higher capital allocations, so that only loans with increased risk are subject to higher risk weightings; and (vii) changing the eligibility for use of the small bank holding company policy statement from institutions with under \$1 billion in assets to institutions with under \$3 billion in assets. We continue to analyze the changes implemented by the Act, but do not believe that such changes will materially impact our business, operations, or financial results.

## Financial Condition

### Assets

Total assets increased by \$334.9 million to \$2.7 billion at September 30, 2018, compared to \$2.3 billion at December 31, 2017.

### Cash and Cash Equivalents

Cash and due from banks and interest bearing deposits comprise this category, which consists of our most liquid assets. The aggregate amount of these two categories increased by \$84.4 million to \$146.3 million at September 30, 2018, from \$61.9 million at December 31, 2017.

### Loans Held for Sale

Loans held for sale are comprised of loans guaranteed by the U.S. Small Business Administration ("SBA") which we usually originate with the intention of selling in the future and residential mortgage loans originated which we also intend to sell in the future. Total SBA loans held for sale were \$3.1 million at September 30, 2018 as compared to \$2.3 million at December 31, 2017. Residential mortgage loans held for sale were \$29.7 million at September 30, 2018 compared to \$43.4 million at December 31, 2017. The decrease in residential mortgage loans held for sale was the result of the timing of sales related to loans originated during the nine months ended September 30, 2018. Loans held for sale, as a percentage of total Company assets, were less than 2% at September 30, 2018.





## Loans Receivable

The loan portfolio represents our largest asset category and is our most significant source of interest income. Our lending strategy is focused on small and medium sized businesses and professionals that seek highly personalized banking services. The loan portfolio consists of secured and unsecured commercial loans including commercial real estate, construction loans, residential mortgages, home improvement loans, home equity loans and lines of credit, overdraft lines of credit, and others. Commercial loans typically range between \$250,000 and \$5,000,000 but customers may borrow significantly larger amounts up to our legal lending limit to a customer, which was approximately \$28.5 million at September 30, 2018. Loans made to one individual customer, even if secured by different collateral, are aggregated for purposes of the lending limit.

Loans increased \$217.0 million, or 19%, to \$1.37 billion at September 30, 2018, versus \$1.15 billion at December 31, 2017. This growth was the result of an increase in loan demand across all categories driven by the successful execution of our relationship banking strategy which focuses on customer service.

## Investment Securities

Investment securities considered available-for-sale are investments that may be sold in response to changing market and interest rate conditions, and for liquidity and other purposes. Our investment securities classified as available-for-sale consist primarily of U.S. Government agency collateralized mortgage obligations ("CMO"), agency mortgage-backed securities ("MBS"), municipal securities, corporate bonds, an asset-backed security ("ABS"), and a pooled trust preferred security ("CDO"). Available-for-sale securities totaled \$487.5 million at September 30, 2018, compared to \$464.4 million at December 31, 2017. The increase was primarily due to the purchase of securities totaling \$81.7 million, partially offset by sales and paydowns of securities totaling \$45.1 million during the first nine months of 2018. At September 30, 2018, the portfolio had a net unrealized loss of \$23.4 million compared to a net unrealized loss of \$11.2 million at December 31, 2017. The change in value of the investment portfolio was driven by an increase in market interest rates which drove a decrease in value of the securities held in our portfolio during the first nine months of 2018.

Investment securities held-to-maturity are investments for which there is the intent and ability to hold the investment to maturity. These investments are carried at amortized cost. The held-to-maturity portfolio consists primarily of U.S. Government agency Small Business Investment Company bonds ("SBIC") and Small Business Administration ("SBA") bonds, CMOs and MBSs. The fair value of securities held-to-maturity totaled \$461.5 million and \$463.8 million at September 30, 2018 and December 31, 2017, respectively. The decrease was primarily due to paydowns of securities held in the portfolio totaling \$46.2 million and an increase in market interest rates which drove a \$15.4 million decrease in the value of the securities in our portfolio partially offset by the purchase of securities totaling \$61.1 million during the first nine months of 2018.

## Restricted Stock

Restricted stock, which represents a required investment in the capital stock of correspondent banks related to available credit facilities, is carried at cost as of September 30, 2018 and December 31, 2017. As of those dates, restricted stock consisted of investments in the capital stock of the Federal Home Loan Bank of Pittsburgh ("FHLB") and Atlantic Community Bankers Bank ("ACBB").

At both September 30, 2018 and December 31, 2017, the investment in FHLB of Pittsburgh capital stock totaled \$1.8 million. At both September 30, 2018 and December 31, 2017, ACBB capital stock totaled \$143,000. Both the FHLB and ACBB issued dividend payments during the first nine months of 2018.



### Other Real Estate Owned

The balance of other real estate owned decreased to \$6.8 million at September 30, 2018 from \$7.0 million at December 31, 2017, primarily due to sales totaling \$495,000 on existing foreclosed properties partially offset by additions totaling \$315,000 during the nine months ended September 30, 2018.

### Goodwill

Goodwill is reviewed for impairment annually as of July 31 and between annual tests when events and circumstances indicate that impairment may have occurred. Impairment is a condition that exists when the carrying amount of goodwill exceeds its implied fair value.

We early adopted Accounting Standards Update ("ASU") 2017-04, Simplifying the Test for Goodwill Impairment during our annual goodwill impairment review in July 2018. The new rules under this guidance provide that the goodwill impairment charge will be the amount by which the reporting unit's carrying amount exceeds its fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. We applied a qualitative assessment for the reporting unit to determine if the one-step quantitative impairment test is necessary.

As part of our qualitative assessment, we reviewed regional and national trends in current and expected economic conditions, examining indicators such as GDP growth, interest rates and unemployment rates. We also considered our own historical performance, expectations of future performance and other trends specific to the banking industry as well as an initial valuation of the Oak Mortgage business performed by an independent third party. Based on our qualitative assessment, we determined that there was no evidence of impairment on the balance of goodwill. As of September 30, 2018 and December 31, 2017, goodwill totaled \$5.0 million.

### Premises and Equipment

The balance of premises and equipment increased to \$81.9 million at September 30, 2018 from \$74.9 million at December 31, 2017. The increase was primarily due to premises and equipment expenditures of \$11.1 million less depreciation and amortization expenses of \$4.1 million during the first nine months of 2018. Two new stores were opened in Fairless Hills, PA and Gloucester Township in 2018 bringing the total store count to twenty-three. Ground has been broken on four more sites in Evesboro, Lumberton, and Somers Point, NJ and Feasterville, PA. Evesboro and Somers Point are expected to be completed by year end. There are also several additional sites in various stages of development for future store locations.

### Deposits

Deposits, which include non-interest and interest-bearing demand deposits, money market, savings and time deposits, are Republic's major source of funding. Deposits are generally solicited from our market area through the offering of a variety of products to attract and retain customers, with a primary focus on multi-product relationships.

Total deposits increased by \$337.1 million to \$2.40 billion at September 30, 2018 from \$2.06 billion at December 31, 2017. The increase was the result of significant growth in interest bearing and non-interest bearing demand deposits. We constantly focus our efforts on the growth of deposit balances through the successful execution of our relationship banking model which is based upon a high level of customer service and satisfaction. We are also in the midst of an aggressive expansion and relocation plan which we refer to as "The Power of Red is Back". Over the last four years, we have opened thirteen new store locations and have several more in various stages of construction and development. This strategy has also allowed us to build a stable core-deposit base and nearly eliminate our dependence upon the

more volatile sources of funding found in brokered and internet based certificates of deposit.

## Shareholders' Equity

Total shareholders' equity increased \$9.4 million to \$235.8 million at September 30, 2018 compared to \$226.5 million at December 31, 2017. The increase was primarily due to the conversion of outstanding trust preferred securities in the first quarter of 2018. \$10.1 million of trust preferred securities were converted into 1.6 million shares of common stock. The change in shareholders' equity was also driven by net income of \$6.5 million recognized during the first nine months of 2018 and stock option exercises of \$668,000, partially offset by a \$9.5 million increase in accumulated other comprehensive losses associated with a decrease in the market value of the investment securities portfolio. The shift in market value of the securities portfolio was primarily driven by an increase in market interest rates which drove a decrease in value of the securities held in our portfolio.

## Results of Operations

### Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

We reported net income of \$2.3 million, or \$0.04 per diluted share, for both three month periods ended September 30, 2018 and September 30, 2017. Income before the provision for income taxes increased by \$619 thousand, or 27%, to \$2.9 million for the three month period ended September 30, 2018 compared to \$2.3 million for the three month period ended September 30, 2017. Profitability improved despite the additional expenses incurred to open new store locations as we execute our growth and expansion strategy. Net income after tax for the three month period ended September 30, 2018 reflects an increased provision for federal and state income taxes which did not have the same impact on 2017 results due to an adjustment to the deferred tax asset valuation allowance.

Net interest income was \$19.1 million for the three month period ended September 30, 2018 compared to \$15.7 million for the three months ended September 30, 2017. Interest income increased \$5.6 million, or 31.4%, due to an increase in average loans receivable and investment securities balances. Interest expense increased \$2.2 million, or 99.6%, primarily due to an increase in average deposit balances and average overnight borrowings combined with a 34 basis point increase in the cost of interest-bearing deposits. The increase in the cost of interest-bearing deposits has been driven by recent increases in the Fed Funds rate which impacts certain deposit balances which are tied to the Fed Funds index.

We recorded a provision for loan losses in the amount of \$500,000 for the three months ended September 30, 2018. We did not record a provision for loan losses for the three months ended September 30, 2017. This increase was primarily due to growth in the allowance required for loans collectively evaluated for impairment driven by an increase in loans receivable.

Non-interest income decreased by \$647,000 to \$5.1 million during the three months ended September 30, 2018 compared to \$5.8 million during the three months ended September 30, 2017. The decrease during the three months ended September 30, 2018 was primarily due to decreases in mortgage banking income and loan and servicing fees partially offset by an increase in service fees on deposit accounts.

Non-interest expenses increased \$1.7 million to \$20.8 million during the three months ended September 30, 2018 compared to \$19.2 million during the three months ended September 30, 2017. This increase was primarily driven by higher salaries, employee benefits, data processing, and occupancy expenses associated with the addition of new stores related to our expansion strategy which we refer to as "The Power of Red is Back". We expect to continue with our expansion strategy as ground has recently been broken on four new store locations and we have also announced our intention to begin opening stores in New York City starting in 2019. Annual merit increases also contributed to the increase in salaries and employee benefit costs.

We recorded a provision for income taxes in the amount of \$622,000 during the three months ended September 30, 2018 compared to a \$4,000 provision for income taxes during the three months ended September 30, 2017. We began recognizing an increased provision for federal and state income taxes during the first quarter of 2018 after reversing our deferred tax asset valuation allowance during the fourth quarter of 2017.

Return on average assets and average equity from continuing operations was 0.36% and 3.90%, respectively, during the three months ended September 30, 2018 compared to 0.45% and 4.11%, respectively, for the three months ended September 30, 2017.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

We reported net income of \$6.5 million, or \$0.11 per diluted share, for the nine months ended September 30, 2018 compared to net income of \$6.2 million, or \$0.11 per diluted share, for the nine months ended September 30, 2017. Income before the provision for income taxes increased by \$1.9 million, or 30%, to \$8.0 million for the nine month period ended September 30, 2018 compared to \$6.1 million for the nine month period ended September 30, 2017. Profitability improved despite the additional expenses incurred to open new store locations as we execute our growth and expansion strategy. Net income after tax for the nine month period ended September 30, 2018 reflects an increased provision for federal and state income taxes which did not have the same impact on 2017 results due to an adjustment to the deferred tax asset valuation allowance.

Net interest income for the nine months ended September 30, 2018 was \$55.9 million as compared to \$45.2 million for the nine months ended September 30, 2017. Interest income increased \$15.3 million, or 29.8%, due to an increase in average loan receivable and investment securities balances. Interest expense increased \$4.6 million, or 73.9%, primarily due to an increase in average deposit balances and average overnight borrowings combined with a 23 basis point increase in the cost of interest-bearing deposits. The increase in the cost of interest-bearing deposits has been driven by recent increases in the Fed Funds rate which impacts certain deposit balances which are tied to the Fed Funds index.

We recorded a provision for loan losses of \$1.7 million for the nine months ended September 30, 2018 compared to a provision for loan losses of \$500,000 for the nine months ended September 30, 2017. This increase was primarily due to growth in the allowance required for loans collectively evaluated for impairment driven by an increase in loans receivable.

Non-interest income increased \$349,000 to \$15.4 million during the nine months ended September 30, 2018 compared to \$15.1 million during the nine months ended September 30, 2017. The increase during the nine months ended September 30, 2018 was primarily due to increases in service fees on deposit accounts and gains on the sales of SBA loans.

Non-interest expenses increased \$8.0 million to \$61.7 million during the nine months ended September 30, 2018 as compared to \$53.7 million during the nine months ended September 30, 2017. This increase was primarily driven by higher salaries, employee benefits, occupancy, and equipment expenses associated with the addition of new stores related to our expansion strategy which we refer to as "The Power of Red is Back". We expect to continue with our expansion strategy as ground has recently been broken on four new store locations and we have also announced our intention to begin opening stores in New York City starting in 2019. Annual merit increases also contributed to the increase in salaries and employee benefit costs.

We recorded a provision for income taxes in the amount of \$1.5 million during the nine months ended September 30, 2018 compared to a \$38,000 benefit for income taxes during the nine months ended September 30, 2017. We began recognizing an increased provision for federal and state income taxes during the nine months ended September 30, 2018 after reversing our deferred tax asset valuation allowance during the fourth quarter of 2017.

Return on average assets and average equity from continuing operations were 0.35% and 3.73%, respectively, during the nine months ended September 30, 2018 compared to 0.41% and 3.74%, respectively, for the nine months ended September 30, 2017.



## Analysis of Net Interest Income

Historically, our earnings have depended primarily upon Republic's net interest income, which is the difference between interest earned on interest earning assets and interest paid on interest bearing liabilities. Net interest income is affected by changes in the mix of the volume and rates of interest earning assets and interest bearing liabilities. The following table provides an analysis of net interest income on an annualized basis, setting forth for the periods average assets, liabilities, and shareholders' equity, interest income earned on interest-earning assets and interest expense on interest-bearing liabilities, average yields earned on interest-earning assets and average rates on interest-bearing liabilities, and Republic's net interest margin (net interest income as a percentage of average total interest-earning assets). Averages are computed based on daily balances. Non-accrual loans are included in average loans receivable. Yields are adjusted for tax equivalency, a non-GAAP measure, using a rate of 21% in 2018 and 35% in 2017.

## Average Balances and Net Interest Income

| (dollars in thousands)                                    | For the three months ended<br>September 30, 2018 |          |                               | For the three months ended<br>September 30, 2017 |          |                               |
|---|--|----------|-------------------------------|--|----------|-------------------------------|
|   | Average<br>Balance                               | Interest | Yield/<br>Rate <sup>(1)</sup> | Average<br>Balance                               | Interest | Yield/<br>Rate <sup>(1)</sup> |
| <b>Interest-earning assets:</b>                           |  |          |                               |  |          |                               |
| Federal funds sold and other interest-earning assets      | \$29,163   | \$153    | 2.08%                         | \$56,316   | \$181    | 1.28%                         |
| Investment securities and restricted stock <sup>(2)</sup> | 1,018,910  | 6,676    | 2.62%                         | 765,678  | 4,805    | 2.51%                         |
| Loans receivable <sup>(2)</sup>                           | 1,390,894  | 16,873   | 4.81%                         | 1,115,920  | 13,136   | 4.67%                         |
| Total interest-earning assets                             | 2,438,967  | 23,702   | 3.86%                         | 1,937,914  | 18,122   | 3.71%                         |
| Other assets  | 135,139  |          |                               | 122,513  |          |                               |
| Total assets  | \$2,574,106                                      |          |                               | \$2,060,427                                      |          |                               |
| <b>Interest-earning liabilities:</b>                      |  |          |                               |  |          |                               |
| Demand – non-interest bearing                             | \$513,292  |          |                               | \$381,380  |          |                               |
| Demand – interest bearing                                 | 861,607  | 1,948    | 0.90%                         | 692,423  | 772      | 0.44%                         |
| Money market & savings                                    | 699,081  | 1,308    | 0.74%                         | 613,506  | 788      | 0.51%                         |
| Time deposits   | 126,378  | 386      | 1.21%                         | 109,878  | 312      | 1.13%                         |
| Total deposits  | 2,200,358  | 3,642    | 0.66%                         | 1,797,187  | 1,872    | 0.41%                         |
| Total interest-bearing deposits                           | 1,684,066  | 3,642    | 0.86%                         | 1,415,807  | 1,872    | 0.52%                         |
| Other borrowings  | 127,150  | 770      | 2.40%                         | 30,220   | 338      | 4.44%                         |
| Total interest-bearing liabilities                        | 1,811,216  | 4,412    | 0.96%                         | 1,446,027  | 2,210    | 0.61%                         |
| Total deposits and other borrowings                       | 2,327,508  | 4,412    | 0.75%                         | 1,827,407  | 2,210    | 0.48%                         |
| Non-interest bearing other liabilities                    | 10,363   |          |                               | 9,179  |          |                               |
| Shareholders' equity                                      | 236,235  |          |                               | 223,841  |          |                               |
| Total liabilities and shareholders' equity                | \$2,574,106                                      |          |                               | \$2,060,427                                      |          |                               |
| Net interest income <sup>(2)</sup>                        |  | \$19,290 |                               | \$15,912   |          |                               |
| Net interest spread                                       |  |          | 2.90%                         |  |          | 3.10%                         |
| Net interest margin <sup>(2)</sup>                        |  |          | 3.14%                         |  |          | 3.26%                         |

<sup>(1)</sup>Yields on investments are calculated based on amortized cost.

<sup>(2)</sup>Net interest income and net interest margin are presented on a tax equivalent basis, a Non-GAAP measure. Net interest income has been increased over the financial statement amount by \$144 and \$200 for the three months ended September 30, 2018 and 2017, respectively, to adjust for tax equivalency. The tax equivalent net interest margin is calculated by dividing tax equivalent net interest income by average total interest earning assets.



## Average Balances and Net Interest Income

| (dollars in thousands)                                    | For the nine months ended<br>September 30, 2018 |          |                               | For the nine months ended<br>September 30, 2017 |          |                               |
|---|---|----------|-------------------------------|---|----------|-------------------------------|
|   | Average<br>Balance                              | Interest | Yield/<br>Rate <sup>(1)</sup> | Average<br>Balance                              | Interest | Yield/<br>Rate <sup>(1)</sup> |
| Interest-earning assets:                                  |   |          |                               |   |          |                               |
| Federal funds sold and other interest-earning assets      | \$27,625  | \$388    | 1.88%                         | \$36,431  | \$312    | 1.15%                         |
| Investment securities and restricted stock <sup>(2)</sup> | 1,027,614                                       | 20,001   | 2.60%                         | 785,121   | 14,850   | 2.52%                         |
| Loans receivable <sup>(2)</sup>                           | 1,310,750                                       | 46,795   | 4.77%                         | 1,063,581                                       | 36,944   | 4.64%                         |
| Total interest-earning assets                             | 2,365,989                                       | 67,184   | 3.80%                         | 1,885,133                                       | 52,106   | 3.70%                         |
| Other assets  | 130,344   |          |                               | 112,018   |          |                               |
| Total assets  | \$2,496,333                                     |          |                               | \$1,997,151                                     |          |                               |
| Interest-earning liabilities:                             |   |          |                               |   |          |                               |
| Demand – non-interest bearing                             | \$475,659                                       |          |                               | \$355,432                                       |          |                               |
| Demand – interest bearing                                 | 866,397   | 4,754    | 0.73%                         | 657,722   | 2,075    | 0.42%                         |
| Money market & savings                                    | 695,386   | 3,454    | 0.66%                         | 607,822   | 2,218    | 0.49%                         |
| Time deposits   | 127,281   | 1,121    | 1.18%                         | 107,881   | 903      | 1.12%                         |
| Total deposits  | 2,164,723                                       | 9,329    | 0.58%                         | 1,728,857                                       | 5,196    | 0.40%                         |
| Total interest-bearing deposits                           | 1,689,064                                       | 9,329    | 0.74%                         | 1,373,425                                       | 5,196    | 0.51%                         |
| Other borrowings  | 90,160  | 1,528    | 2.27%                         | 39,408  | 1,046    | 3.55%                         |
| Total interest-bearing liabilities                        | 1,779,224                                       | 10,857   | 0.82%                         | 1,412,833                                       | 6,242    | 0.59%                         |
| Total deposits and other borrowings                       | 2,254,883                                       | 10,857   | 0.64%                         | 1,768,265                                       | 6,242    | 0.47%                         |
| Non-interest bearing other liabilities                    | 9,534   |          |                               | 8,628   |          |                               |
| Shareholders' equity                                      | 231,916   |          |                               | 220,258   |          |                               |
| Total liabilities and shareholders' equity                | \$2,496,333                                     |          |                               | \$1,997,151                                     |          |                               |
| Net interest income <sup>(2)</sup>                        |   | \$56,327 |                               |   | \$45,864 |                               |
| Net interest spread                                       |   |          | 2.98%                         |   |          | 3.11%                         |
| Net interest margin <sup>(2)</sup>                        |   |          | 3.18%                         |   |          | 3.25%                         |

<sup>(1)</sup>Yields on investments are calculated based on amortized cost.

<sup>(2)</sup>Net interest income and net interest margin are presented on a tax equivalent basis, a Non-GAAP measure. Net interest income has been increased over the financial statement amount by \$403 and \$666 for the nine months ended September 30, 2018 and 2017, respectively, to adjust for tax equivalency. The tax equivalent net interest margin is calculated by dividing tax equivalent net interest income by average total interest earning assets.

## Rate/Volume Analysis of Changes in Net Interest Income

Net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following table sets forth an analysis of volume and rate changes in net interest income for the three and nine months ended September 30, 2018, as compared to the three and nine months ended September 30, 2017. For purposes of this table, changes in interest income and expense are allocated to volume and rate categories based upon the respective changes in average balances and average rates.

| (dollars in thousands)                               | For the three months ended September 30, 2018 vs. 2017 |              |              | For the nine months ended September 30, 2018 vs. 2017 |              |              |
|--|--|--------------|--------------|---|--------------|--------------|
|  | Average Volume   | Average Rate | Total Change | Average Volume  | Average Rate | Total Change |
| Interest earned:                                     |  |              |              |   |              |              |
| Federal funds sold and other interest-earning assets | \$(128)  | \$ 100       | \$(28)       | \$(123)   | \$ 199       | \$76         |
| Securities   | 1,660  | 211          | 1,871        | 4,720   | 431          | 5,151        |
| Loans  | 3,249  | 488          | 3,737        | 8,549   | 1,302        | 9,851        |
| Total interest-earning assets                        | 4,781  | 799          | 5,580        | 13,146  | 1,932        | 15,078       |
| Interest expense:                                    |  |              |              |   |              |              |
| Deposits   |  |              |              |   |              |              |
| Interest-bearing demand deposits                     | 406  | 770          | 1,176        | 1,145   | 1,534        | 2,679        |
| Money market and savings                             | 179  | 341          | 520          | 466   | 770          | 1,236        |
| Time deposits  | 51   | 23           | 74           | 171   | 47           | 218          |
| Total deposit interest expense                       | 636  | 1,134        | 1,770        | 1,782   | 2,351        | 4,133        |
| Other borrowings                                     | 507  | (75)         | 432          | 766   | (284)        | 482          |
| Total interest expense                               | 1,143  | 1,059        | 2,202        | 2,548   | 2,067        | 4,615        |
| Net interest income                                  | \$3,638  | \$(260)      | \$3,378      | \$10,598  | \$(135)      | \$10,463     |

## Net Interest Income and Net Interest Margin

Net interest income, on a fully tax-equivalent basis, a non-GAAP measure, for the three months ended September 30, 2018 increased \$3.4 million, or 21.2%, over the same period in 2017. Interest income on interest-earning assets totaled \$23.7 million and \$18.1 million for the three months ended September 30, 2018 and 2017, respectively. The increase in interest income earned was primarily the result of an increase in the average balances of loans receivable and investment securities. Total interest expense for the three months ended September 30, 2018 increased by \$2.2 million, or 99.6%, to \$4.4 million from \$2.2 million for the same period in 2017. Interest expense on deposits increased by \$1.8 million, or 94.6%, for the three months ended September 30, 2018 versus the same period in 2017 due to increases in average deposit balances and higher rates. Interest expense on other borrowings increased by \$432,000 for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 due primarily to a \$107.3 million increase in average overnight borrowings balances.

Net interest income, on a fully tax-equivalent basis, a non-GAAP measure, for the nine months ended September 30, 2018 increased \$10.5 million, or 22.8%, over the same period in 2017. Interest income on interest-earning assets totaled \$67.2 million and \$52.1 million for the nine months ended September 30, 2018 and 2017, respectively. The increase in interest income earned was primarily the result of an increase in the average balances of loans receivable and investment securities. Total interest expense for the nine months ended September 30, 2018 increased by \$4.6

million, or 73.9%, to \$10.9 million from \$6.2 million for the same period in 2017. Interest expense on deposits increased by \$4.1 million, or 79.5%, for the nine months ended September 30, 2018 versus the same period in 2017 due to both increases in average deposit balances and higher rates. Interest expense on other borrowings increased by \$482,000 for the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017 due to an increase of \$57.9 million in average overnight borrowings.

Changes in net interest income are frequently measured by two statistics: net interest rate spread and net interest margin. Net interest rate spread is the difference between the average rate earned on interest-earning assets and the average rate incurred on interest-bearing liabilities. Our net interest rate spread on a fully tax-equivalent basis was 2.90% during the three months ended September 30, 2018 compared to 3.10% during the three months ended September 30, 2017 and was 2.98% during the nine months ended September 30, 2018 compared to 3.11% during nine months ended September 30, 2017. Net interest margin represents the difference between interest income, including net loan fees earned, and interest expense, reflected as a percentage of average interest-earning assets. For the three months ended September 30, 2018 and September 30, 2017, the fully tax-equivalent net interest margin was 3.14% and 3.26%, respectively. The net interest margin for the three months ended September 30, 2018 decreased primarily due to a rate increase of 27 basis points in total deposits and other borrowings compared to an increase of 15 basis points in the yield on total interest earning assets. For the nine months ended September 30, 2018 and September 30, 2017, the fully tax-equivalent net interest margin was 3.18% and 3.25%, respectively. The net interest margin for the nine months ended September 30, 2018 decreased primarily due to a rate increase of 17 basis points in total deposits and other borrowings offset by an increase of 10 basis points in the yield on total interest earning assets.

#### Provision for Loan Losses

We recorded a \$500,000 provision for loan losses for the three months ended September 30, 2018 as compared to no provision for the three months ended September 30, 2017. We recorded a \$1.7 million provision for loan losses for the nine months ended September 30, 2018 as compared to \$500,000 for the nine months ended September 30, 2017. During the three and nine months ended September 30, 2018, there was an increase in the allowance required for loans collectively evaluated for impairment driven by an increase in loans receivable.

#### Non Interest Income

Total non-interest income for the three months ended September 30, 2018 decreased \$647,000, or 11.2%, compared to the three months ended September 30, 2017. Mortgage banking income totaled \$2.6 million during the three months ended September 30, 2018 which represents a decrease of \$579,000 from the same period in 2017. Loan advisory and servicing fees totaled \$320,000 for the three months ended September 30, 2018 which represents a decrease of \$357,000 from the same period in 2017. The decrease was primarily due to a decrease in SBA servicing fee income in the three months ended September 30, 2018 as a result of fair value adjustments. Gains on the sale of SBA loans totaled \$816,000 for the three months ended September 30, 2018 versus \$831,000 for the same period in 2017. Service fees on deposit accounts totaled \$1.4 million for the three months ended September 30, 2018 which represents an increase of \$319,000 over the same period in 2017. This increase was due to the growth in the number of customer accounts and transaction volume. No gains or losses were recognized on the sale of investment securities during the three months ended September 30, 2018 and 2017.

Total non-interest income for the nine months ended September 30, 2018 increased \$349,000, or 2.3%, compared to the nine months ended September 30, 2017. Service fees on deposit accounts totaled \$3.9 million for the nine months ended September 30, 2018 which represents an increase of \$1.1 million over the same period in 2017. This increase was due to the growth in the number of customer accounts and transaction volume. Gains on the sale of SBA loans totaled \$2.7 million for the nine months ended September 30, 2018 versus \$2.3 million for the same period in 2017. The increase of \$339,000 in gains on the sale of SBA loans was driven by an increase in SBA loans sold during the nine months ended September 30, 2018. We recognized losses of \$1,000 on the sale of investment securities during the nine months ended September 30, 2018 compared to losses of \$61,000 during the same period in 2017. Mortgage banking income totaled \$7.9 million for the nine months ended September 30, 2018, a decrease of \$603,000, compared to \$8.6 million during the nine months ended September 30, 2017. The decrease is primarily driven by fair value adjustments on loans held for sale and IRLCs. Loan and servicing fees totaled \$839,000 for the nine months ended September 30, 2018 which represents a decrease of \$491,000 from the same period in 2017. The decrease was primarily due to a decrease in SBA servicing fee income in the nine months ended September 30, 2018 as a result of

fair value adjustments.

50

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## Non Interest Expenses

### Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

Non-interest expenses increased \$1.7 million, or 8.7%, for the three months ended September 30, 2018 compared to the same period in 2017. An explanation of changes in non-interest expenses for certain categories is presented in the following paragraphs.

Salaries and employee benefits increased by \$1.4 million, or 14.0%, for the three months ended September 30, 2018 compared to the same period in 2017 which was primarily driven by annual merit increases along with increased staffing levels related to our growth strategy of adding and relocating stores, which we refer to as "The Power of Red is Back". There were twenty-three stores open as of September 30, 2018 compared to twenty-two stores at September 30, 2017.

Occupancy expense, including depreciation and amortization expense, increased by \$196,000, or 6.4%, for the three months ended September 30, 2018 compared to the same period last year, also as a result of our continuing growth and expansion strategy.

Other real estate expenses totaled \$378,000 during the three months ended September 30, 2018, a decrease of \$368,000, or 49.3%, compared to the same period in 2017. This decrease was a result of higher costs to carry foreclosed properties and higher writedowns on foreclosed assets in the prior period.

All other non-interest expenses increased by \$466,000, or 8.4%, for the three months ended September 30, 2018 compared to the same period last year. Increases in data processing, legal, professional fees, regulatory assessments and costs, and other expenses resulting from our expansion strategy also contributed to the growth in other operating expenses.

### Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Non-interest expenses increased \$8.0 million, or 14.9%, for the nine months ended September 30, 2018 compared to the same period in 2017. An explanation of changes in non-interest expenses for certain categories is presented in the following paragraphs.

Salaries and employee benefits increased by \$4.9 million, or 17.7%, for the nine months ended September 30, 2018 compared to the same period in 2017 which was primarily driven by annual merit increases along with increased staffing levels related to our growth strategy of adding and relocating stores, which we refer to as "The Power of Red is Back". There were twenty-three stores open as of September 30, 2018 compared to twenty-two stores at September 30, 2017.

Occupancy expense increased by \$737,000, or 14.1%, and depreciation and amortization expenses increased by \$519,000, or 14.5%, for the nine months ended September 30, 2018 compared to the same period last year, also as a result of our continuing growth and expansion strategy.

Other real estate expenses totaled \$881,000 during the nine months ended September 30, 2018, a decrease of \$823,000, or 48.3%, compared to the same period in 2017. This decrease was a result of higher costs to carry foreclosed properties and higher writedowns on foreclosed assets in the prior period.



All other non-interest expenses increased by \$2.6 million, or 17.3%, for the nine months ended September 30, 2018 compared to the same period last year. Increases in data processing, legal, regulatory assessments and costs, professional fees, advertising, and other expenses resulting from our expansion strategy also contributed to the growth in other operating expenses.

One key measure that management utilizes to monitor progress in controlling overhead expenses is the ratio of annualized net non-interest expenses to average assets, a non-GAAP measure. For the purposes of this calculation, net non-interest expenses equal non-interest expenses less non-interest income. For the three months ended September 30, 2018, this ratio was 2.42% compared to 2.58% for the three months ended September 30, 2017. For the nine months ended September 30, 2018, the ratio was 2.48% compared to 2.58% for the nine months ended September 30, 2017, respectively. The decrease in this ratio was mainly due to an increase in average assets.

Another productivity measure utilized by management is the operating efficiency ratio, a non-GAAP measure. This ratio expresses the relationship of non-interest expenses to net interest income plus non-interest income. For the three months ended September 30, 2018, the operating efficiency ratio was 85.8% compared to 89.2% for the three months ended September 30, 2017. The efficiency ratio was 86.4% for the nine months ended September 30, 2018 compared to 89.1% for the nine months ended September 30, 2017. The decrease in this ratio was due to net interest income and non-interest income increasing at a faster rate than non-interest expenses.

#### Provision (Benefit) for Income Taxes

We recorded a provision for income taxes in the amount of \$622,000 for the three months ended September 30, 2018, compared to a \$4,000 provision for the three months ended September 30, 2017. For the nine months ended September 30, 2018, we recorded a provision for income taxes of \$1.5 million compared to a \$38,000 benefit for the nine months ended September 30, 2017. We began recognizing an increased provision for federal and state income taxes during the first quarter of 2018 after reversing our deferred tax asset valuation allowance during the fourth quarter of 2017. We initially recorded a deferred tax asset valuation allowance in 2011 and continued to carry this allowance after determining that some portion of the deferred tax asset balance may not be realized within its life cycle based on the weight of available evidence. Adjustments to the valuation allowance resulted in the recognition of a minimal provision for income taxes in each period until its reversal in 2017. The effective tax rates for the three months ended September 30, 2018 and 2017 were 21% and 30%, respectively. For the nine months ended September 30, 2018 and 2017, the effective tax rates were 19% and 29%, respectively. The effective tax rates for the three and nine months ended September 30, 2017 excluded the adjustment to the deferred tax asset valuation allowance.

We evaluate the carrying amount of our deferred tax assets on a quarterly basis or more frequently, if necessary, in accordance with the guidance provided in FASB Accounting Standards Codification Topic 740 (ASC 740), in particular, applying the criteria set forth therein to determine whether it is more likely than not (i.e. a likelihood of more than 50%) that some portion, or all, of the deferred tax asset will not be realized within its life cycle, based on the weight of available evidence. If management makes a determination based on the available evidence that it is more likely than not that some portion or all of the deferred tax assets will not be realized in future periods, a valuation allowance is calculated and recorded. These determinations are inherently subjective and dependent upon estimates and judgments concerning management's evaluation of both positive and negative evidence.

In conducting the deferred tax asset analysis, we believe it is important to consider the unique characteristics of an industry or business. In particular, characteristics such as business model, level of capital and reserves held by a financial institution and the ability to absorb potential losses are important distinctions to be considered for bank holding companies like us. In addition, it is also important to consider that net operating loss carryforwards ("NOLs") calculated for federal income tax purposes can generally be carried back two years and carried forward for a period of twenty years. In order to realize our deferred tax assets, we must generate sufficient taxable income in such future

years.

In assessing the need for a valuation allowance, we carefully weighed both positive and negative evidence currently available. Judgment is required when considering the relative impact of such evidence. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which it can be objectively verified.

52

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The ongoing success of our growth and expansion strategy, along with the successful integration of the mortgage company and the limited exposure remaining with current asset quality issues, put us in a position to rely on projections of future taxable income when evaluating the need for a valuation allowance against deferred tax assets. Based on the guidance provided in ASC 740, we believed that the positive evidence considered at September 30, 2018 and December 31, 2017 outweighed the negative evidence and that it was more likely than not that all of our deferred tax assets would be realized within their life cycle. Therefore, a valuation allowance is not required.

The net deferred tax asset balance was \$13.8 million as of September 30, 2018 and \$12.7 million as of December 31, 2017. The deferred tax asset will continue to be analyzed on a quarterly basis for changes affecting realizability.

#### Net Income and Net Income per Common Share

Net income for the three months ended September 30, 2018 was \$2.3 million, an increase of \$1,000, compared to \$2.3 million recorded for the three months ended September 30, 2017. The increase in net income in the three months ended September 30, 2018 was due to an increase in pre-tax income of \$619,000 which was partially offset by the provision for income taxes of \$618,000.

Net income for the nine months ended September 30, 2018 was \$6.5 million, an increase of \$303,000, compared to \$6.2 million recorded for the nine months ended September 30, 2017. The increase in net income in the nine months ended September 30, 2018 was due to an increase in pre-tax income of \$1.9 million which was partially offset by the provision for income taxes of \$1.6 million.

For the three month periods ended September 30, 2018 and September 30, 2017, basic and fully-diluted net income per common share was \$0.04. For the nine month periods ended September 30, 2018 and September 30, 2017, basic and fully-diluted net income per common share was \$0.11.

#### Return on Average Assets and Average Equity

Return on average assets (ROA) measures our net income in relation to our total average assets. The ROA for the three months ended September 30, 2018 was 0.36%, compared to 0.45% for the three months ended September 30, 2017. The ROA for the nine months ended September 30, 2018 and 2017 was 0.35% and 0.41%, respectively. Return on average equity (ROE) indicates how effectively we can generate net income on the capital invested by our shareholders. ROE is calculated by dividing annualized net income by average stockholders' equity. The ROE was 3.90% for the three months September 30, 2018, compared to 4.11% for the three months ended September 30, 2017. The ROE for the nine months ended September 30, 2018 and 2017 was 3.73% and 3.74%, respectively.

#### Commitments, Contingencies and Concentrations

Financial instruments with contract amounts representing potential credit risk were commitments to extend credit of approximately \$270.3 million and \$264.3 million, and standby letters of credit of approximately \$13.4 million and \$12.6 million, at September 30, 2018 and December 31, 2017, respectively. These financial instruments constitute off-balance sheet arrangements. Commitments often expire without being drawn upon. Substantially all of the \$270.3 million of commitments to extend credit at September 30, 2018 were committed as variable rate credit facilities.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and many require the payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the customer. Collateral held varies but may include real estate, marketable

securities, pledged deposits, equipment and accounts receivable.

Standby letters of credit are conditional commitments issued that guarantee the performance of a customer to a third party. The credit risk and collateral policy involved in issuing letters of credit is essentially the same as that involved in extending loan commitments. The amount of collateral obtained is based on management's credit evaluation of the customer. Collateral held varies but may include real estate, marketable securities, pledged deposits, equipment and accounts receivable. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of liability as of September 30, 2018 and December 31, 2017 for guarantees under standby letters of credit issued is not material.

#### Regulatory Matters

We are required to comply with certain "risk-based" capital adequacy guidelines issued by the Federal Reserve and the FDIC. The risk-based capital guidelines assign varying risk weights to the individual assets held by a bank. The guidelines also assign weights to the "credit-equivalent" amounts of certain off-balance sheet items, such as letters of credit and interest rate and currency swap contracts.

In July 2013, the federal bank regulatory agencies adopted revisions to the agencies' capital adequacy guidelines and prompt corrective action rules, which were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III. The final rules generally implemented higher minimum capital requirements, added a new common equity tier 1 capital requirement, and established criteria that instruments must meet to be considered common equity tier 1 capital, additional tier 1 capital or tier 2 capital. Under the capital rules, risk-based capital ratios are calculated by dividing common equity Tier 1, Tier 1, and total risk-based capital, respectively, by risk-weighted assets. Assets and off-balance sheet credit equivalents are assigned to one of several categories of risk-weights, based primarily on relative risk. Under the Federal Reserve's rules, Republic is required to maintain a minimum common equity Tier 1 capital ratio requirement of 4.5%, a minimum Tier 1 capital ratio requirement of 6%, a minimum total capital requirement of 8% and a minimum leverage ratio requirement of 4%. Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The capital conservation buffer, which is composed of common equity tier 1 capital, began on January 1, 2016 at the 0.625% level and will be phased in over a three year period (increasing by that amount on each January 1, until it reaches 2.5% on January 1, 2019). Implementation of the deductions and other adjustments to common equity tier 1 capital began on January 1, 2015 and will be phased-in over a three-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter).

The following table shows the required capital ratios with the conversation buffer over the phase-in period.

|  | Basel III Community Banks<br>Minimum Capital Ratio<br>Requirements |        |        |         |
|--|--|--------|--------|---------|
|  | 2016   | 2017   | 2018   | 2019    |
| Common equity tier 1 capital (CET1)      | 5.125%   | 5.750% | 6.375% | 7.000%  |
| Tier 1 capital (to risk-weighted assets) | 6.625%   | 7.250% | 7.875% | 8.500%  |
| Total capital (to risk-weighted assets)  | 8.625%   | 9.250% | 9.875% | 10.500% |

The risk-based capital ratios measure the adequacy of a bank's capital against the riskiness of its assets and off-balance sheet activities. Failure to maintain adequate capital is a basis for "prompt corrective action" or other regulatory enforcement action. In assessing a bank's capital adequacy, regulators also consider other factors such as interest rate

risk exposure; liquidity, funding and market risks; quality and level of earnings; concentrations of credit, quality of loans and investments; risks of any nontraditional activities; effectiveness of bank policies; and management's overall ability to monitor and control risks.

Management believes that the Company and Republic met, as of September 30, 2018 and December 31, 2017, all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if all such requirements were currently in effect. In the current year, the FDIC categorized Republic as well capitalized under the regulatory framework for prompt corrective action provisions of the Federal Deposit Insurance Act. There are no calculations or events since that notification which management believes would have changed Republic's category.

The Company and Republic's ability to maintain the required levels of capital is substantially dependent upon the success of their capital and business plans, the impact of future economic events on Republic's loan customers and Republic's ability to manage its interest rate risk, growth and other operating expenses.

The following table presents the capital regulatory ratios for both Republic and the Company as of September 30, 2018, and December 31, 2017 (dollars in thousands):

| (dollars in thousands)    | Actual                 |        | Minimum Capital Adequacy |       | Minimum Capital Adequacy with Capital Buffer |        | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|---------------------------|------------------------|--------|--------------------------|-------|--|--------|--|--------|
|                           | Amount                 | Ratio  | Amount                   | Ratio | Amount                                       | Ratio  | Amount   | Ratio  |
|                           | At September 30, 2018: |        |                          |       |  |        |  |        |
| Total risk-based capital  |                        |        |                          |       |  |        |  |        |
| Republic                  | \$226,488              | 13.44% | \$134,785                | 8.00% | \$166,375                                    | 9.875% | \$168,481  | 10.00% |
| Company                   | 259,618                | 15.39% | 134,979                  | 8.00% | 166,614                                      | 9.875% | -  | -      |
| Tier 1 risk-based capital |                        |        |                          |       |  |        |  |        |
| Republic                  | 218,404                | 12.96% | 101,089                  | 6.00% | 132,679                                      | 7.875% | 134,785  | 8.00%  |
| Company                   | 251,534                | 14.91% | 101,234                  | 6.00% | 132,870                                      | 7.875% | -  | -      |
| CET 1 risk-based capital  |                        |        |                          |       |  |        |  |        |
| Republic                  | 218,404                | 12.96% | 75,817                   | 4.50% | 107,407                                      | 6.375% | 109,513  | 6.50%  |
| Company                   | 240,534                | 14.26% | 75,926                   | 4.50% | 107,561                                      | 6.375% | -  | -      |
| Tier 1 leveraged capital  |                        |        |                          |       |  |        |  |        |
| Republic                  | 218,404                | 8.47%  | 103,096                  | 4.00% | 103,096                                      | 4.00%  | 128,870  | 5.00%  |
| Company                   | 251,534                | 9.75%  | 103,201                  | 4.00% | 103,201                                      | 4.00%  | -  | -      |
| At December 31, 2017:     |                        |        |                          |       |  |        |  |        |
| Total risk-based capital  |                        |        |                          |       |  |        |  |        |
| Republic                  | \$187,732              | 12.57% | \$119,446                | 8.00% | \$138,109                                    | 9.25%  | \$149,307  | 10.00% |
| Company                   | 249,510                | 16.70% | 119,521                  | 8.00% | 138,197                                      | 9.25%  | -  | -      |
| Tier 1 risk-based capital |                        |        |                          |       |  |        |  |        |
| Republic                  | 179,133                | 12.00% | 89,584                   | 6.00% | 108,248                                      | 7.25%  | 119,446  | 8.00%  |
| Company                   | 240,911                | 16.13% | 89,641                   | 6.00% | 108,316                                      | 7.25%  | -  | -      |
| CET 1 risk-based capital  |                        |        |                          |       |  |        |  |        |
| Republic                  | 179,133                | 12.00% | 67,188                   | 4.50% | 85,852                                       | 5.75%  | 97,050   | 6.50%  |
| Company                   | 220,433                | 14.75% | 67,231                   | 4.50% | 85,906                                       | 5.75%  | -  | -      |
| Tier 1 leveraged capital  |                        |        |                          |       |  |        |  |        |
| Republic                  | 179,133                | 7.91%  | 90,531                   | 4.00% | 90,531                                       | 4.00%  | 113,164  | 5.00%  |
| Company                   | 240,911                | 10.64% | 90,586                   | 4.00% | 90,586                                       | 4.00%  | -  | -      |

Dividend Policy

We have not paid any cash dividends on our common stock. We have no plans to pay cash dividends in 2018. Our ability to pay dividends depends primarily on receipt of dividends from our subsidiary, Republic. Dividend payments from Republic are subject to legal and regulatory limitations. The ability of Republic to pay dividends is also subject to profitability, financial condition, capital expenditures and other cash flow requirements.



## Liquidity

A financial institution must maintain and manage liquidity to ensure it has the ability to meet its financial obligations. These obligations include the payment of deposits on demand or at their contractual maturity; the repayment of borrowings as they mature; the payment of lease obligations as they become due; the ability to fund new and existing loans and other funding commitments; and the ability to take advantage of new business opportunities. Liquidity needs can be met by either reducing assets or increasing liabilities. Our most liquid assets consist of cash and amounts due from banks.

Regulatory authorities require us to maintain certain liquidity ratios in order for funds to be available to satisfy commitments to borrowers and the demands of depositors. In response to these requirements, we have formed an asset/liability committee ("ALCO"), comprised of certain members of Republic's Board of Directors and senior management to monitor such ratios. The ALCO committee is responsible for managing the liquidity position and interest sensitivity. That committee's primary objective is to maximize net interest income while configuring Republic's interest-sensitive assets and liabilities to manage interest rate risk and provide adequate liquidity for projected needs. The ALCO committee meets on a quarterly basis or more frequently if deemed necessary.

Our target and actual liquidity levels are determined by comparisons of the estimated repayment and marketability of interest-earning assets with projected future outflows of deposits and other liabilities. Our most liquid assets, comprised of cash and cash equivalents on the balance sheet, totaled \$146.3 million at September 30, 2018, compared to \$61.9 million at December 31, 2017. Loan maturities and repayments are another source of asset liquidity. At September 30, 2018, Republic estimated that more than \$110.0 million of loans would mature or repay in the six-month period ending March 31, 2019. Additionally, a significant portion of our investment securities are available to satisfy liquidity requirements through sales on the open market or by pledging as collateral to access credit facilities. At September 30, 2018, we had outstanding commitments (including unused lines of credit and letters of credit) of \$283.7 million. Certificates of deposit scheduled to mature in one year totaled \$82.6 million at September 30, 2018. We anticipate that we will have sufficient funds available to meet all current commitments.

Daily funding requirements have historically been satisfied by generating core deposits and certificates of deposit with competitive rates, buying federal funds or utilizing the credit facilities of the FHLB. We have established a line of credit with the FHLB of Pittsburgh. Our maximum borrowing capacity with the FHLB was \$684.8 million at September 30, 2018. At September 30, 2018 and December 31, 2017, we had no outstanding term borrowings with the FHLB. At September 30, 2018 and December 31, 2017, we had no outstanding short-term borrowings. As of September 30, 2018, FHLB had issued letters of credit, on Republic's behalf, totaling \$75.0 million against our available credit line. We also established a contingency line of credit of \$10.0 million with ACBB and a Fed Funds line of credit with Zions Bank in the amount of \$15.0 million to assist in managing our liquidity position. We had no amounts outstanding against the ACBB line of credit or the Zions Fed Funds line at both September 30, 2018 and December 31, 2017.

## Investment Securities Portfolio

At September 30, 2018, we identified certain investment securities that were being held for indefinite periods of time, including securities that will be used as part of our asset/liability management strategy and that may be sold in response to changes in interest rates, prepayments and similar factors. These securities are classified as available-for-sale and are intended to increase the flexibility of our asset/liability management. Our investment securities classified as available for sale consist primarily of CMOs, MBSs, municipal securities, corporate bonds, ABSs, and a CDO. Available for sale securities totaled \$487.5 million and \$464.4 million as of September 30, 2018 and December 31, 2017, respectively. At September 30, 2018, securities classified as available for sale had a net unrealized loss of \$23.4 million and a net unrealized loss of \$11.2 million at December 31, 2017.



## Loan Portfolio

Our loan portfolio consists of secured and unsecured commercial loans including commercial real estate loans, construction and land development loans, commercial and industrial loans, owner occupied real estate loans, consumer and other loans, and residential mortgages. Commercial loans are primarily secured term loans made to small to medium-sized businesses and professionals for working capital, asset acquisition and other purposes. Commercial loans are originated as either fixed or variable rate loans with typical terms of 1 to 5 years. Republic's commercial loans typically range between \$250,000 and \$5.0 million, but customers may borrow significantly larger amounts up to Republic's legal lending limit of approximately \$28.5 million at September 30, 2018. Individual customers may have several loans often secured by different collateral.

## Credit Quality

Republic's written lending policies require specified underwriting, loan documentation and credit analysis standards to be met prior to funding, with independent credit department approval for the majority of new loan balances. A committee consisting of senior management and certain members of the Board of Directors oversees the loan approval process to monitor that proper standards are maintained, while approving the majority of commercial loans.

Loans, including impaired loans, are generally classified as non-accrual if they are past due as to maturity or payment of interest or principal for a period of more than 90 days, unless such loans are well secured and in the process of collection. Loans that are on a current payment status or past due less than 90 days may also be classified as non-accrual if repayment in full of principal and/or interest is in doubt. Loans may be returned to accrual status when all principal and interest amounts contractually due are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms.

While a loan is classified as non-accrual, any collections of interest and principal are generally applied as a reduction to principal outstanding. When the future collectability of the recorded loan balance is expected, interest income may be recognized on a cash basis. For non-accrual loans, which have been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

The following table shows information concerning loan delinquency and non performing assets as of the dates indicated (dollars in thousands):

|   | September<br>30,<br>2018 | December<br>31,<br>2017 |
|---|--------------------------|-------------------------|
| Loans accruing, but past due 90 days or more                                | \$ -                     | \$ -                    |
| Non-accrual loans   | 13,479                   | 14,845                  |
| Total non-performing loans  | 13,479                   | 14,845                  |
| Other real estate owned   | 6,768                    | 6,966                   |
| Total non-performing assets   | \$ 20,247                | \$ 21,811               |
| Non-performing loans as a percentage of total loans, net of unearned income | 0.98%                    | 1.28%                   |
| Non-performing assets as a percentage of total assets                       | 0.76%                    | 0.94%                   |

Non-performing asset balances decreased by \$1.6 million to \$20.2 million as of September 30, 2018 from \$21.8 million at December 31, 2017. Non-accrual loans decreased \$1.4 million to \$13.5 million at September 30, 2018, from \$14.8 million at December 31, 2017 due to \$2.3 million in loan charge-offs, \$316,000 in paydowns, and \$315,000 in transfers to other real estate owned during the nine months ended September 30, 2018 which were offset by \$1.7 million in loans transferred to non-accrual status during the period. The \$2.3 million in charge-offs during the nine months ended September 30, 2018 was primarily driven by a single loan relationship for which loan loss provisions had been recorded in prior periods. Management determined this amount to be uncollectible and accordingly charged-off the balance in the first quarter. There were no loans accruing, but past due 90 days or more at September 30, 2018 and December 31, 2017. At September 30, 2018 and December 31, 2017, all identified impaired loans are internally classified and individually evaluated for impairment in accordance with the guidance under ASC 310.

The following table presents our 30 to 89 days past due loans at September 30, 2018 and December 31, 2017.

| (dollars in thousands)             | September<br>30,<br>2018 | December<br>31,<br>2017 |
|------------------------------------|--------------------------|-------------------------|
| 30 to 59 days past due             | \$ 1,494                 | \$ 1,113                |
| 60 to 89 days past due             | 236                      | -                       |
| Total loans 30 to 89 days past due | \$ 1,730                 | \$ 1,113                |

#### Other Real Estate Owned

The balance of other real estate owned was \$6.8 million at September 30, 2018 and \$7.0 million at December 31, 2017. The following table presents a reconciliation of other real estate owned for the nine months ended September 30, 2018 and the year ended December 31, 2017:

| (dollars in thousands)                     | September<br>30,<br>2018 | December<br>31,<br>2017 |
|--|--------------------------|-------------------------|
| Beginning Balance, January 1 <sup>st</sup> | \$ 6,966                 | \$ 10,174               |
| Additions                                  | 315                      | 291                     |
| Valuation adjustments                      | (18)                     | (3,000)                 |
| Dispositions                               | (495)                    | (499)                   |
| Ending Balance                             | \$ 6,768                 | \$ 6,966                |

At September 30, 2018, we had no credit exposure to "highly leveraged transactions" as defined by the FDIC.

#### Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable losses inherent in the loan portfolio. We evaluate the need to establish an allowance against loan losses on a quarterly basis. When an increase in this allowance is necessary, a provision for loan losses is charged to earnings. The allowance for loan losses consists of three components. The first component is allocated to individually evaluated loans found to be impaired and is calculated in accordance with ASC 310 Receivables. The second component is allocated to all other loans that are not individually identified as impaired. This component is calculated for all non-impaired loans on a collective basis in accordance with ASC 450 Contingencies. The third component is an unallocated allowance to account for a level of imprecision in management's estimation process.

We evaluate loans for impairment and potential charge-off on a quarterly basis. Management regularly monitors the condition of borrowers and assesses both internal and external factors in determining whether any loan relationships have deteriorated. Any loan rated as substandard or lower will have an individual collateral evaluation analysis prepared to determine if a deficiency exists. We first evaluate the primary repayment source. If the primary repayment source is determined to be insufficient and unlikely to repay the debt, we then look to the secondary repayment sources. Secondary sources are conservatively reviewed for liquidation values. Updated appraisals and financial data are obtained to substantiate current values. If the reviewed sources are deemed to be inadequate to cover the outstanding principal and any costs associated with the resolution of the troubled loan, an estimate of the deficient amount will be calculated and a specific allocation of loan loss reserve is recorded.

Factors considered in the calculation of the allowance for non-impaired loans include several qualitative and quantitative factors such as historical loss experience, trends in delinquency and nonperforming loan balances, changes in risk composition and underwriting standards, experience and ability of management, and general economic conditions along with other external factors. Historical loss experience is analyzed by reviewing charge-offs over a three year period to determine loss rates consistent with the loan categories depicted in the allowance for loan loss table below.

The factors supporting the allowance for loan losses do not diminish the fact that the entire allowance for loan losses is available to absorb losses in the loan portfolio and related commitment portfolio, respectively. Our principal focus, therefore, is on the adequacy of the total allowance for loan losses. The allowance for loan losses is subject to review by banking regulators. Our primary bank regulators regularly conduct examinations of the allowance for loan losses and make assessments regarding the adequacy and the methodology employed in their determination.

An analysis of the allowance for loan losses for the nine months ended September 30, 2018 and 2017, and the twelve months ended December 31, 2017 is as follows:

| (dollars in thousands)                           | For the nine months ended<br>September 30,<br>2018 | For the twelve months<br>ended December 31,<br>2017 | For the nine months ended<br>September 30,<br>2017 |
|--|--|---|--|
| Balance at beginning of period                   | \$ 8,599   | \$ 9,155  | \$ 9,155   |
| Charge offs:                                     |  |   |  |
| Commercial real estate                           | 1,535  | -   | -  |
| Construction and land<br>development             | -  | -   | -  |
| Commercial and industrial                        | 151  | 1,366   | 1,347  |
| Owner occupied real estate                       | 465  | 157   | 157  |
| Consumer and other                               | 213  | 53  | 12   |
| Residential mortgage                             | -  | -   | -  |
| Total charge offs                                | 2,364  | 1,576   | 1,516  |
| Recoveries:                                      |  |   |  |
| Commercial real estate                           | 50   | 54  | 54   |
| Construction and land<br>development             | -  | -   | -  |
| Commercial and industrial                        | 77   | 64  | 64   |
| Owner occupied real estate                       | 20   | -   | -  |
| Consumer and other                               | 2  | 2   | 1  |
| Residential mortgage                             | -  | -   | -  |
| Total recoveries                                 | 149  | 120   | 119  |
| Net charge offs/(recoveries)                     | 2,215  | 1,456   | 1,397  |
| Provision for loan losses                        | 1,700  | 900   | 500  |
| Balance at end of period                         | \$ 8,084   | \$ 8,599  | \$ 8,258   |
| Average loans outstanding <sup>(1)</sup>         | \$ 1,310,750                                       | \$ 1,090,851  | \$ 1,063,581                                       |
| As a percent of average<br>loans: <sup>(1)</sup> |  |   |  |
| Net charge offs (annualized)                     | 0.23%  | 0.13%   | 0.18%  |
| Provision for loan losses<br>(annualized)        | 0.17%  | 0.08%   | 0.06%  |
| Allowance for loan losses                        | 0.62%  | 0.79%   | 0.78%  |

Allowance for loan losses to:

|                                     |        |        |        |
|-------------------------------------|--------|--------|--------|
| Total loans, net of unearned income | 0.59%  | 0.74%  | 0.75%  |
| Total non performing loans          | 59.97% | 57.93% | 60.06% |

<sup>(1)</sup>Includes non-accruing loans.

We recorded a provision for loan losses of \$500,000 for the three month period ended September 30, 2018 and \$1.7 million for the nine months ended September 30, 2018. We did not record a provision for loan losses during the three month period ended September 30, 2017. A provision for loan losses in the amount of \$500,000 was recorded for the nine months ended September 2017. During the three and nine months ended September 30, 2018, there was an increase in the allowance required for loans collectively evaluated for impairment driven by an increase in loans receivable.

The allowance for loan losses as a percentage of non-performing loans (coverage ratio) was 60.0% at September 30, 2018, compared to 57.9% at December 31, 2017 and 60.1% at September 30, 2017. Total non-performing loans were \$13.5 million, \$14.8 million, and \$13.8 million at September 30, 2018, December 31, 2017 and September 30, 2017, respectively.

Management makes at least a quarterly determination as to an appropriate provision from earnings to maintain an allowance for loan losses that it determines is adequate to absorb inherent losses in the loan portfolio. The Board of Directors periodically reviews the status of all non-accrual and impaired loans and loans classified by the management team. The Board of Directors also considers specific loans, pools of similar loans, historical charge-off activity, economic conditions and other relevant factors in reviewing the adequacy of the allowance for loan losses. Any additions deemed necessary to the allowance for loan losses are charged to operating expenses.

We evaluate loans for impairment and potential charge-offs on a quarterly basis. Any loan rated as substandard or lower will have a collateral evaluation analysis completed in accordance with the guidance under GAAP on impaired loans to determine if a deficiency exists. Our credit monitoring process assesses the ultimate collectability of an outstanding loan balance from all potential sources. When a loan is determined to be uncollectible it is charged-off against the allowance for loan losses. Unsecured commercial loans and all consumer loans are charged-off immediately upon reaching the 90-day delinquency mark unless they are well-secured and in the process of collection. The timing on charge-offs of all other loan types is subjective and will be recognized when management determines that full repayment, either from the cash flow of the borrower, collateral sources, and/or guarantors, will not be sufficient and that repayment is unlikely. A full or partial charge-off is recognized equal to the amount of the estimated deficiency calculation.

Serious delinquency is often the first indicator of a potential charge-off. Reductions in appraised collateral values and deteriorating financial condition of borrowers and guarantors are factors considered when evaluating potential charge-offs. The likelihood of possible recoveries or improvements in a borrower's financial condition is also assessed when considering a charge-off.

Partial charge-offs of non-performing and impaired loans can significantly reduce the coverage ratio and other credit loss statistics due to the fact that the balance of the allowance for loan losses will be reduced while still carrying the remainder of a non-performing loan balance in the impaired loan category. The amount of non-performing loans for which partial charge-offs have been recorded amounted to \$4.7 million at September 30, 2018 and \$1.4 million at December 31, 2017.

The following table provides additional analysis of partially charged-off loans.

| (dollars in thousands)   | September<br>30,<br>2018 | December<br>31,<br>2017 |        |   |
|--|--------------------------|-------------------------|--------|---|
| Total nonperforming loans  | \$ 13,479                | \$ 14,845               |        |   |
| Nonperforming and impaired loans with partial charge-offs                          | 4,703                    | 1,449                   |        |   |
| Ratio of nonperforming loans with partial charge-offs to total loans               | 0.34                     | %                       | 0.12   | % |
| Ratio of nonperforming loans with partial charge-offs to total nonperforming loans | 34.89                    | %                       | 9.76   | % |
| Coverage ratio net of nonperforming loans with partial charge-offs                 | 171.89                   | %                       | 593.44 | % |

Our charge-off policy is reviewed on an annual basis and updated as necessary. During the nine month period ended September 30, 2018, there were no changes made to this policy.





## Effects of Inflation

The majority of assets and liabilities of a financial institution are monetary in nature. Therefore, a financial institution differs greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. Management believes that the most significant impact of inflation on its financial results is through our need and ability to react to changes in interest rates. Management attempts to maintain an essentially balanced position between rate sensitive assets and liabilities over a one-year time horizon in order to protect net interest income from being affected by wide interest rate fluctuations.

## ITEM 3: QUANTITATIVE AND QUALITATIVE INFORMATION ABOUT MARKET RISK

There has been no material change in the Company's assessment of its sensitivity to market risk since its presentation in the Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC on March 14, 2018.

## ITEM 4: CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

The Company's management, with the participation of the principal executive officer and the principal financial officer, conducted an evaluation, as of the end of the period covered by this report, of the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Exchange Act Rule 13a-15(e). Based on this evaluation, the principal executive officer and the principal financial officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures, as defined in Rule 13a-15(e), were effective at the reasonable assurance level.

### Changes in Internal Controls

The principal executive officer and principal financial officer also conducted an evaluation of the Company's internal control over financial reporting ("Internal Control") to determine whether any changes in Internal Control occurred during the quarter ended September 30, 2018 that have materially affected or which are reasonably likely to materially affect Internal Control. Based on that evaluation, there has been no such change during the quarter ended September 30, 2018.

### Limitations on the Effectiveness of Controls

Control systems, no matter how well designed and operated, can provide only reasonable, not an absolute, level of assurance that the objectives of the control system are met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future

events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company and Republic are from time to time parties (plaintiff or defendant) to lawsuits in the normal course of business. While any litigation involves an element of uncertainty, management is of the opinion that the liability of the Company and Republic, if any, resulting from such actions will not have a material effect on the financial condition or results of operations of the Company and Republic.

### ITEM 1A. RISK FACTORS

Significant risk factors could adversely affect the Company's business, financial condition and results of operation. Risk factors discussing these risks can be found in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and Form 10-Q for the quarter ended June 30, 2018. The risk factors in the Company's Annual Report on Form 10-K have not materially changed. You should carefully consider these risk factors. The risks described in the Company's Form 10-K and Form 10-Q are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

### ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

The following Exhibits are filed as part of this report. (Exhibit numbers correspond to the exhibits required by Item 601 of Regulation S-K for quarterly reports on Form 10-Q).

| Exhibit<br>Number | Description   | Location   |
|-------------------|---|--|
| 3.1               | Amended and Restated Articles of Incorporation of Republic First Bancorp, Inc.  | <u>Incorporated by reference to Form 10-K filed March 14, 2018</u>             |
| 3.2               | Amended and Restated By-laws of Republic First Bancorp, Inc.  | <u>Incorporated by reference to Form S-1 filed April 23, 2010 (333-166286)</u> |
| 31.1              | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Republic First Bancorp, Inc.   | <u>Filed herewith</u>  |
| 31.2              | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Republic First Bancorp, Inc.   | <u>Filed herewith</u>  |
| 32.1              | Section 1350 Certification of Harry D. Madonna  | <u>Furnished herewith</u>  |
| 32.2              | Section 1350 Certification of Frank A. Cavallaro  | <u>Furnished herewith</u>  |
| 101               | <p>The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017, (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017, (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017, (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017, (v) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2018 and 2017, and (vi) Notes to Consolidated Financial Statements.</p> |  |

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.

REPUBLIC FIRST BANCORP, INC.

Date: November 7, 2018 By: /s/ Harry D. Madonna  
Harry D. Madonna  
President and Chief Executive Officer  
(principal executive officer)

Date: November 7, 2018 By: /s/ Frank A. Cavallaro  
Frank A. Cavallaro  
Executive Vice President and Chief Financial Officer  
(principal financial and accounting officer)