PATRIOT NATIONAL BANCORP INC
Form 10-Q
August 11, 2017

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 June 30, 2017

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 000-29599

PATRIOT NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	**06-1559137**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**
900 Bedford Street, Stamford, Connecticut	**06901**
(Address of principal executive offices)	**(Zip Code)**

(203) 324-7500

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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	(Do not check if a smaller reporting company)	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 ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of August 10, 2017, there were 3,894,128 shares of the registrant's common stock outstanding.

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PART I- FINANCIAL INFORMATION

Item 1: Consolidated Financial Statements

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands, except share data)	**June 30, 2017**	**December 31, 2016**
ASSETS		
Cash and due from banks:		
Noninterest bearing deposits and cash	$3,210	2,596
Interest bearing deposits	7,633	89,693
Total cash and cash equivalents	10,843	92,289
Investment securities:		
Available-for-sale securities, at fair value	24,981	24,428
Other investments, at cost	4,450	4,450
Total investment securities	29,431	28,878
Federal Reserve Bank stock, at cost	2,424	2,109
Federal Home Loan Bank stock, at cost	5,833	5,609
Loans receivable (net of allowance for loan losses: 2017: $5,944, 2016: $4,675)	673,144	576,982
Accrued interest and dividends receivable	3,208	2,726
Premises and equipment, net	34,471	32,759
Other real estate owned	851	851
Deferred tax asset	11,212	12,632
Other assets	2,003	1,819
Total assets	$773,420	756,654
Liabilities		
Deposits:		
Noninterest bearing deposits	$77,778	76,772
Interest bearing deposits	484,261	452,552
Total deposits	562,039	529,324
Federal Home Loan Bank and correspondent bank borrowings	120,000	138,000
Senior notes, net	11,666	11,628
Junior subordinated debt owed to unconsolidated trust	8,082	8,079
Note payable	1,675	1,769
Advances from borrowers for taxes and insurance	3,111	2,676
Accrued expenses and other liabilities	1,547	2,608
Total liabilities	708,120	694,084

Commitments and Contingencies		
Shareholders' equity		
Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, $.01 par value, 100,000,000 shares authorized; 2017: 3,967,769 shares issued; 3,894,128 shares outstanding. 2016: 3,965,538 shares issued; 3,891,897 shares outstanding	40	40
Additional paid-in capital	106,797	106,729
Accumulated deficit	(40,368)	(42,902)
Less: Treasury stock, at cost: 2017 and 2016, 73,641 and 73,641 shares, respectively	(1,177)	(1,177)
Accumulated other comprehensive gain (loss)	8	(120)
Total shareholders' equity	65,300	62,570
Total liabilities and shareholders' equity	$773,420	756,654

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended		**Six Months Ended**	
	June 30,		**June 30,**	
(In thousands, except per share amounts)	**2017**	**2016**	**2017**	**2016**
Interest and Dividend Income				
Interest and fees on loans	$7,591	5,783	14,198	11,623
Interest on investment securities	242	132	413	274
Dividends on investment securities	93	90	175	176
Other interest income	19	28	83	69
Total interest and dividend income	7,945	6,033	14,869	12,142
Interest Expense				
Interest on deposits	1,129	496	2,118	969
Interest on Federal Home Loan Bank borrowings	183	64	261	185
Interest on senior debt	228	-	457	-
Interest on subordinated debt	89	83	174	165
Interest on note payable	8	8	17	16
Total interest expense	1,637	651	3,027	1,335
Net interest income	6,308	5,382	11,842	10,807
Provision (Credit) for Loan Losses	260	1,959	(1,489)	1,959
Net interest income after provision (credit) for loan losses	6,048	3,423	13,331	8,848
Non-interest Income				
Loan application, inspection and processing fees	15	21	36	88
Deposit fees and service charges	146	150	295	301
Rental Income	91	104	185	207
Loss on sale of investment securities	-	-	(78)	-
Other income	97	90	188	179
Total non-interest income	349	365	626	775
Non-interest Expense				
Salaries and benefits	2,497	2,615	4,927	5,165
Occupancy and equipment expense	807	750	1,582	1,530
Data processing expense	326	241	446	526
Professional and other outside services	550	364	1,202	773
Advertising and promotional expense	111	96	185	213
Loan administration and processing expense	14	8	23	16
Regulatory assessments	163	147	342	294

Insurance expense	56	56	115	111
Material and communications	103	115	190	208
Other operating expense	387	344	696	664
Total non-interest expense	5,014	4,736	9,708	9,500
Income (loss) before income taxes	1,383	(948)	4,249	123
Expense (benefit) for Income Taxes	579	(366)	1,715	52
Net income (loss)	$804	(582)	2,534	71
Basic earnings per share	$0.21	(0.15)	0.65	0.02
Diluted earnings per share	$0.21	(0.15)	0.65	0.02

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(In thousands)	**Three Months Ended**		**Six Months Ended**	
	June 30,		**June 30,**	
	2017	**2016**	**2017**	**2016**
Net income (loss)	$804	(582)	2,534	71
Other comprehensive income				
Unrealized holding gains on securities	48	59	287	115
Income tax effect	(18)	(23)	(111)	(44)
Reclassification for realized losses on sale of investment securities	-	-	(78)	-
Income tax effect	-	-	30	-
Total other comprehensive income	30	36	128	71
Comprehensive income (loss)	$834	(546)	2,662	142

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)

(In thousands, except shares)	**Number of Shares**	**Common Stock**	**Additional Paid-in Capital**	**Accumulated Deficit**	**Treasury Stock**	**Accumulated Other Comprehensive Loss**	**Total**
Balance at December 31, 2016	3,891,897	$ 40	106,729	(42,902)	(1,177)	(120)	62,570
Comprehensive income:							
Net income	-	-	-	2,534	-	-	2,534
Other comprehensive income	-	-	-	-	-	128	128
Total comprehensive income	-	-	-	2,534	-	128	2,662
Share-based compensation expense	-	-	68	-	-	-	68
Vesting of restricted stock	2,231	-	-	-	-	-	-
Balance at June 30, 2017	3,894,128	$ 40	106,797	(40,368)	(1,177)	8	65,300
Balance at December 31, 2015	3,956,207	40	106,568	(44,832)	(160)	(152)	61,464
Comprehensive income:							
Net income	-	-	-	71	-	-	71
Unrealized holding gain on available-for-sale securities, net of tax	-	-	-	-	-	71	71
Total comprehensive income	-	-	-	71	-	71	142
Share-based compensation expense	-	-	308	-	-	-	308
Vesting of restricted stock	2,526	-	-	-	-	-	-
Balance at June 30, 2016	3,958,733	$ 40	106,876	(44,761)	(160)	(81)	61,914

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)	**Six Months Ended June 30, 2017**	**2016**
Cash Flows from Operating Activities:		
Net income	$2,534	71
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premiums, net	53	35
Amortization and accretion of purchase loan premiums and discounts, net to loans	260	8
Amortization of debt issuance costs	41	3
(Credit) provision for loan losses	(1,489)	1,959
Depreciation and amortization	590	616
Loss on sales of available-for-sale securities	78	-
Share-based compensation	68	308
Deferred income taxes	1,339	(117)
Gain on acquisition of OREO	-	(11)
Changes in assets and liabilities:		
Increase in accrued interest and dividends receivable	(482)	(110)
Increase in other assets	(184)	(344)
(Decrease) increase in accrued expenses and other liabilities	(1,061)	231
Net cash provided by operating activities	1,747	2,649
Cash Flows from Investing Activities:		
Proceeds from sales on available-for-sale securities	13,848	5,031
Principal repayments on available-for-sale securities	1,244	1,389
Purchases of available-for-sale securities	(15,567)	-
Purchases of Federal Reserve Bank stock	(315)	(48)
(Purchases) redemptions of Federal Home Loan Bank stock	(224)	711
Increase in net originations of loans receivable	(21,911)	(45,125)
Purchase of loan pools receivable	(73,022)	-
Purchase of premises and equipment	(2,302)	(1,167)
Net cash used in investing activities	(98,249)	(39,209)
Cash Flows from Financing Activities:		
Increase in deposits, net	32,715	1,656
(Repayments of) FHLB and correspondent bank borrowings	(18,000)	(4,000)
Principal repayments of note payable	(94)	(93)
Increase in advances from borrowers for taxes and insurance	435	84
Net cash provided by (used in) financing activities	15,056	(2,353)

Net decrease in cash and cash equivalents	(81,446)	(38,913)
Cash and cash equivalents at beginning of year	92,289	85,400
Cash and cash equivalents at end of year	$10,843	46,487
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	$2,974	1,173
Cash paid for income taxes	$375	-
Supplemental Disclosures of Noncash Investing Activities:		
Transfers of loans receivable to other real estate owned	$-	840

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 1: Basis of Financial Statement Presentation

The accompanying unaudited condensed consolidated financial statements of Patriot National Bancorp, Inc. (the “Company”) and its wholly-owned subsidiaries including Patriot Bank, N.A. (the “Bank”) (collectively, “Patriot”), have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) have been omitted. The accompanying unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included on the Form 10-K for the year ended December 31, 2016.

The Consolidated Balance Sheet at December 31, 2016 presented herein has been derived from the audited consolidated financial statements of the Company at that date, but does not include all of the information and footnotes required by US GAAP for complete financial statements.

The preparation of consolidated financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified accounting for the allowance for loan losses, the analysis and valuation of its investment securities, and the valuation of deferred tax assets as certain of Patriot’s more significant accounting policies and estimates, in that they are critical to the presentation of Patriot’s financial condition and results of operations. As they concern matters that are inherently uncertain, these estimates require management to make subjective and complex judgments in the preparation of Patriot’s Consolidated Financial Statements.

Certain prior period amounts have been reclassified to conform to current year presentation.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results of operations that may be expected for the remainder of 2017.

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PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 2: Available-for Sale Securities

The amortized cost, gross unrealized gains and losses and approximate fair values of available-for-sale securities at June 30, 2017 and December 31, 2016 are as follows:

(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized (Losses)**	**Fair Value**
June 30, 2017:				
U. S. Government agency mortgage-backed securities	$ 8,468	31	(77)	8,422
Corporate bonds	9,000	-	(46)	8,954
Subordinated notes	7,500	105	-	7,605
	$ 24,968	136	(123)	24,981
December 31, 2016:				
U. S. Government agency mortgage-backed securities	$ 10,624	9	(192)	10,441
Corporate bonds	9,000	-	(39)	8,961
Subordinated notes	5,000	26	-	5,026
	$ 24,624	35	(231)	24,428

The following table presents the available-for-sale securities' gross unrealized losses and fair value, aggregated by the length of time the individual securities have been in a continuous loss position as of June 30, 2017 and December 31, 2016:

(In thousands)	**Less than 12 Months**		**12 Months or More**		**Total**	
June 30, 2017:	**Fair Value**	**Unrealized (Loss)**	**Fair Value**	**Unrealized (Loss)**	**Fair Value**	**Unrealized (Loss)**
U. S. Government agency mortgage-backed securities	$3,501	(77)	-	-	3,501	(77)

Corporate bonds	8,954	(46)	-	-	8,954	(46)
	$12,455	(123)	-	-	12,455	(123)
December 31, 2016:						
U. S. Government agency mortgage-backed securities	$5,969	(144)	3,356	(48)	9,325	(192)
Corporate bonds	-	-	5,961	(39)	5,961	(39)
	$5,969	(144)	9,317	(87)	15,286	(231)

At June 30, 2017 and December 31, 2016, five of eleven and seven out of twelve available-for-sale securities had unrealized losses with an aggregate depreciation of 1.0% and 1.5% from amortized cost, respectively.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Based on its quarterly reviews, management believes that none of the losses on available-for-sale securities noted above constitute an other-than-temporary impairment ("OTTI"). The noted losses are considered temporary due to market fluctuations in available interest rates on U.S. Government agency debt, mortgage-backed securities issued by U.S. Government agencies, and corporate debt. Management considers the issuers of the securities to be financially sound, the corporate bonds are investment grade, and the collectability of all contractual principal and interest payments is reasonably expected. Since Patriot is not more-likely-than-not to be required to sell the investments before recovery of the amortized cost basis and does not intend to sell the securities at a loss, none of the available-for-sale securities noted are considered to be OTTI as of June 30, 2017.

At June 30, 2017 and December 31, 2016, available-for-sale securities of $5.1 million and $4.2 million, respectively, were pledged to the FRB of New York, primarily to secure municipal deposits.

The following summarizes, by class and contractual maturity, the amortized cost and estimated fair value of available-for-sale debt securities held at June 30, 2017 and December 31, 2016. The mortgages underlying the mortgage-backed securities are not due at a single maturity date. Additionally, these mortgages often are and generally may be pre-paid without penalty, creating a degree of uncertainty that such investments can be held until maturity. For convenience, mortgage-backed securities have been included in the summary as a separate line item.

(In thousands)	**Amortized Cost**				**Fair Value**			
	Due Within 5 years	**Due After 5 years through 10 years**	**Due After 10 years**	**Total**	**Due Within 5 years**	**Due After 5 years through 10 years**	**Due After 10 years**	**Total**
June 30, 2017:								
Corporate bonds	$-	9,000	-	9,000	-	8,954	-	8,954
Subordinated Notes	1,000	6,500	-	7,500	1,020	6,585	-	7,605
Available-for-sale securities with single maturity dates	1,000	15,500	-	16,500	1,020	15,539	-	16,559
U. S. Government agency mortgage-backed securities	-	-	8,468	8,468	-	-	8,422	8,422
	$1,000	15,500	8,468	24,968	1,020	15,539	8,422	24,981

December 31, 2016:								
Corporate bonds	$9,000	-	-	9,000	8,961	-	-	8,961
Subordinated Notes	1,000	4,000	-	5,000	1,026	4,000	-	5,026
Available-for-sale securities with single maturity dates	10,000	4,000	-	14,000	9,987	4,000	-	13,987
U. S. Government agency mortgage-backed securities	-	2,132	8,492	10,624	-	2,106	8,335	10,441
	$10,000	6,132	8,492	24,624	9,987	6,106	8,335	24,428

There were $13.8 million sales and $15.6 million purchases of available-for-sale securities in 2017. No loss on the sale of available-for-sale securities was recorded during the second quarter ended June 30, 2017. A loss on the sale of available-for-sale securities of $78,000 was recorded during the six months ended June 30, 2017. There were no realized gains (losses) of available-for sale securities during the three and six months ended June 30, 2016.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 3: Loans Receivable and Allowance for Loan Losses

As of June 30, 2017 and December 31, 2016, loans receivable, net, consists of the following:

(In thousands)

Loan portfolio segment:	**June 30, 2017**	**December 31, 2016**
Commercial Real Estate	$280,059	271,229
Residential Real Estate	152,428	86,514
Commercial and Industrial	94,884	60,977
Consumer and Other	94,830	101,449
Construction	49,222	53,895
Construction to permanent - CRE	7,665	7,593
Loans receivable, gross	679,088	581,657
Allowance for loan losses	(5,944)	(4,675)
Loans receivable, net	$673,144	576,982

Patriot's lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County in New York, and the five Boroughs of New York City. Patriot originates commercial real estate loans, commercial business loans, a variety of consumer loans, and construction loans. All commercial and residential real estate loans are collateralized primarily by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent to some degree on the status of the regional economy as well as upon the regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

Patriot has established credit policies applicable to each type of lending activity in which it engages and evaluates the creditworthiness of each borrower. Unless extenuating circumstances exist, Patriot limits the extension of credit on commercial real estate loans to 75% of the market value of the underlying collateral. Patriot’s loan origination policy for multi–family residential real estate is limited to 80% of the market value of the underlying collateral. In the case of construction loans, the maximum loan-to-value is 75% of the “as completed” appraised value of the real estate project.

Management monitors the appraised value of collateral on an on-going basis and additional collateral is requested when warranted. Real estate is the primary form of collateral, although other forms of collateral do exist and may include such assets as accounts receivable, inventory, marketable securities, time deposits, and other business assets.

Risk characteristics of the Company’s portfolio classes include the following:

Commercial Real Estate Loans

In underwriting commercial real estate loans, Patriot evaluates both the prospective borrower’s ability to make timely payments on the loan and the value of the property securing the loans. Repayment of such loans may be negatively impacted should the borrower default, the value of the property collateralizing the loan substantially decline, or there are declines in general economic conditions. Where the owner occupies the property, Patriot also evaluates the business’ ability to repay the loan on a timely basis and may require personal guarantees, lease assignments, and/or the guarantee of the operating company.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Residential Real Estate Loans

In 2013, Patriot discontinued offering primary mortgages on personal residences. Repayment of residential real estate loans may be negatively impacted should the borrower have financial difficulties, should there be a significant decline in the value of the property securing the loan, or should there be declines in general economic conditions.

In March 2017, Patriot purchased $73 million of residential real estate loans.

Commercial and Industrial Loans

Patriot’s commercial and industrial loan portfolio consists primarily of commercial business loans and lines of credit to businesses and professionals. These loans are generally for the financing of accounts receivable, purchases of inventory, purchases of new or used equipment, or for other short- or long-term working capital purposes. These loans are generally secured by business assets, but are also occasionally offered on an unsecured basis. In granting these types of loans, Patriot considers the borrower’s cash flow as the primary source of repayment, supported by the value of collateral, if any, and personal guarantees, as applicable. Repayment of commercial and industrial loans may be negatively impacted by adverse changes in economic conditions, ineffective management, claims on the borrower’s assets by others that are superior to Patriot’s claims, a loss of demand for the borrower’s products or services, or the death or disability of the borrower or other key management personnel.

Consumer and Other Loans

Patriot offers individual consumers various forms of credit including installment loans, credit cards, overdraft protection, and reserve lines of credit. Repayments of such loans are generally dependent on the personal income of the borrower, which may be negatively impacted by adverse changes in economic conditions. The Company does not place a high emphasis on originating these types of loans.

The Company does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories that are typically characterized by payment delinquencies, previous charge-offs, judgments against the consumer, a history of bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burdened ratios.

Construction Loans

Construction loans are of a short-term nature, generally of eighteen-months or less, that are secured by land intended for commercial, residential, or mixed-use development. Loan proceeds may be used for the acquisition of or improvements to the land under development and funds are generally disbursed as phases of construction are completed.

Included in this category are loans to construct single family homes where no contract of sale exists, based upon the experience and financial strength of the builder, the type and location of the property, and other factors. Construction loans tend to be personally guaranteed by the principal(s). Repayment of such loans may be negatively impacted by an inability to complete construction, a downturn in the market for new construction, by a significant increase in interest rates, or by decline in general economic conditions.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Construction to Permanent – CRE

One time close of a construction facility with simultaneous conversion to an amortizing mortgage loan. Construction to permanent loans combine a short term period similar to a construction loan, generally with a variable rate, and a longer term CRE loan typically 20-25 years, resetting every five years to the FHLB rate.

Close of the construction facility typically occurs when events dictate, such as receipt of a certificate of occupancy and property stabilization, which is defined as cash flow sufficient to support a pre-defined minimum debt coverage ratio and other conditions and covenants particular to the loan. Construction facilities are typically variable rate instruments that, upon conversion to an amortizing mortgage loan, reset to a fixed rate instrument that is the greater of the in-force variable rate plus a predetermined spread over a reference rate (e.g., prime) or a minimum interest rate.

Allowance for Loan Losses

The following tables summarize the activity in the allowance for loan losses, allocated to segments of the loan portfolio, for the three months ended June 30, 2017 and 2016:

(In thousands)	**Commercial Real Estate**	**Residential Real Estate**	**Commercial and Industrial**	**Consumer and Other**	**Construction**	**Construction to Permanent [CRE]**	**Unallocated**	**Total**
Three months ended June 30, 2017								
Allowance for loan losses:								
March 31, 2017	$ 2,198	1,073	1,049	583	591	77	126	5,697
Charge-offs	-	-	-	(13)	-	-	-	(13)
Recoveries	-	-	-	-	-	-	-	-
Provisions (credits)	20	(32)	404	23	(101)	(4)	(50)	260

June 30, 2017	$ 2,218	1,041	1,453	593	490	73	76	5,944
Three months ended June 30, 2016								
Allowance for loan losses:								
March 31, 2016	$ 1,943	624	1,083	609	650	121	217	5,247
Charge-offs	-	-	-	(1)	-	-	-	(1)
Recoveries	-	1	3	-	-	-	-	4
Provisions (credits)	352	22	2,314	(77)	(481)	24	(195)	1,959
June 30, 2016	$ 2,295	647	3,400	531	169	145	22	7,209

The following tables summarize the activity in the allowance for loan losses, allocated to segments of the loan portfolio, for the six months ended June 30, 2017 and 2016:

(In thousands)	**Commercial Real Estate**	**Residential Real Estate**	**Commercial and Industrial**	**Consumer and Other**	**Construction**	**Construction to Permanent [CRE]**	**Unallocated**	**Total**
Six months ended June 30, 2017								
Allowance for loan losses:								
December 31, 2016	$ 1,853	534	740	641	712	69	126	4,675
Charge-offs	-	-	-	(13)	-	-	-	(13)
Recoveries	2	-	2,769	-	-	-	-	2,771
Provisions (credits)	363	507	(2,056)	(35)	(222)	4	(50)	(1,489)
June 30, 2017	$ 2,218	1,041	1,453	593	490	73	76	5,944
Six months ended June 30, 2016								
Allowance for loan losses:								
December 31, 2015	$ 1,970	740	1,027	677	486	123	219	5,242
Charge-offs	-	(4)	-	(2)	-	-	-	(6)
Recoveries	-	1	12	1	-	-	-	14
Provisions (credits)	325	(90)	2,361	(145)	(317)	22	(197)	1,959
June 30, 2016	$ 2,295	647	3,400	531	169	145	22	7,209

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize, by loan portfolio segment, the amount of loans receivable evaluated individually and collectively for impairment as of June 30, 2017 and December 31, 2016:

(In thousands)	**Commercial Real Estate**	**Residential Real Estate**	**Commercial and Industrial**	**Consumer and Other**	**Construction**	**Construction to Permanent [CRE]**	**Unallocated**	**Total**
June 30, 2017								
Allowance for loan losses:								
Individually evaluated for impairment	$ -	-	231	-	-	-	-	231
Collectively evaluated for impairment	2,218	1,041	1,222	593	490	73	76	5,713
Total allowance for loan losses	$ 2,218	1,041	1,453	593	490	73	76	5,944
Loans receivable, gross:								
Individually evaluated for impairment	$ 6,142	1,905	269	540	-	-	-	8,856
Collectively evaluated for impairment	273,917	150,523	94,615	94,290	49,222	7,665	-	670,232
Total loans receivable, gross	$ 280,059	152,428	94,884	94,830	49,222	7,665	-	679,088

(In thousands)	**Commercial Real Estate**	**Residential Real Estate**	**Commercial and Industrial**	**Consumer and Other**	**Construction**	**Construction to Permanent [CRE]**	**Unallocated**	**Total**
December 31, 2016								
Allowance for loan losses:								

Individually evaluated for impairment	$ -	-	231	-	-	-	-	231
Collectively evaluated for impairment	1,853	534	509	641	712	69	126	4,444
Total allowance for loan losses	$ 1,853	534	740	641	712	69	126	4,675
Loans receivable, gross:								
Individually evaluated for impairment	$ 6,267	1,911	231	542	-	-	-	8,951
Collectively evaluated for impairment	264,962	84,603	60,746	100,907	53,895	7,593	-	572,706
Total loans receivable, gross	$ 271,229	86,514	60,977	101,449	53,895	7,593	-	581,657

Patriot monitors the credit quality of its loans receivable on an ongoing basis. Credit quality is monitored by reviewing certain indicators, including loan to value ratios, debt service coverage ratios, and credit scores.

Patriot employs a risk rating system as part of the risk assessment of its loan portfolio. At origination, lending officers are required to assign a risk rating to each loan in their portfolio, which is ratified or modified by the Loan Committee to which the loan is submitted for approval. If financial developments occur on a loan in the lending officer's portfolio of responsibility, the risk rating is reviewed and adjusted, as applicable. In carrying out its oversight responsibilities, the Loan Committee can adjust a risk rating based on available information. In addition, the risk ratings on all commercial loans over $250,000 are reviewed annually by the Credit Department.

Additionally, Patriot retains a third-party objective loan reviewing expert to perform a quarterly analysis of the results of its risk rating process. The quarterly review is based on a randomly selected sample of loans within established parameters (e.g., value, concentration), in order to assess and validate the risk ratings assigned to individual loans. Any changes to the assigned risk ratings, based on the quarterly review, are required to be approved by the Loan Committee.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

When assigning a risk rating to a loan, management utilizes the Bank's internal eleven-point risk rating system. An asset is considered "special mention" when it has a potential weakness based on objective evidence, but does not currently expose the Bank to sufficient risk to warrant classification in one of the following categories:

Sub-standard: An asset is considered "substandard" if it is not adequately protected by the current net worth and paying capacity of the obligor or the collateral pledged, if any. Sub-standard assets have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that the Company will sustain some loss, if noted deficiencies are not corrected.

Doubtful: Assets classified as "doubtful" have all of the weaknesses inherent in those classified "sub-standard", with the added characteristic that the weaknesses present make collection or liquidation-in–full improbable, on the basis of currently existing facts, conditions, and values.

Charge–offs, to reduce the loan to its recoverable value, generally commence after the loan is classified as "doubtful".

In accordance with Federal Financial Institutions Examination Council published policies establishing uniform criteria for the classification of retail credit based on delinquency status, "Open-end" and "Closed-end" credits are charged off when 180 days and120 days delinquent, respectively.

If an account is classified as "Loss", the full balance of the loan receivable is charged off, regardless of the potential recovery from a sale of the underlying collateral. Any amount that may be recovered on the sale of collateral underlying a loan is recognized as a "recovery" in the period in which the collateral is sold.

In March 2017, the Bank reached a settlement agreement with its insurance carrier for a loss recognized in 2016, related to a single Commercial and Industrial loan, resulting in cash receipts of $2.8 million, net of related deductibles and other amounts excluded pursuant to the insurance policy.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize non-performing (i.e., non-accruing) loans by aging category and status, within the applicable loan portfolio segment as of June 30, 2017 and December 31, 2016:

(In thousands)	**Non-accruing Loans**					
	30 - 59 Days Past Due	**60 - 89 Days Past Due**	**90 Days or Greater Past Due**	**Total Past Due**	**Current**	**Total Non-accruing Loans**
<u>As of June 30, 2017:</u>						
Loan portfolio segment:						
Residential Real Estate:						
Sub-standard	$ -	-	1,590	1,590	-	1,590
Commercial and Industrial:						
Sub-standard	-	-	269	269	-	269
Total non-accruing loans	**$ -**	**-**	1,859	1,859	-	1,859
<u>As of December 31, 2016:</u>						
Loan portfolio segment:						
Residential Real Estate:						
Sub-standard	$ -	-	1,590	1,590	-	1,590
Commercial and Industrial:						
Sub-standard	-	-	231	231	-	231
Total non-accruing loans	$ -	-	1,821	1,821	-	1,821

If non-accrual loans had been performing in accordance with the original contractual terms, additional interest income of $22,000 and $43,000 would have been recognized in income during the three and six months ended June 30, 2017, respectively. For the three and six months ended June 30, 2016, additional interest income of $58,000 and $196,000 would have been recognized in income.

Additionally, certain loans for which the borrower cannot demonstrate sufficient cash flow to continue loan payments in the future and certain troubled debt restructurings ("TDRs") are placed on non-accrual status. During the three and six months ended June 30, 2017 and 2016, no interest income was collected and recognized on non-accruing loans.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due for payment unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual status or charged-off, at an earlier date, if collection of principal or interest is considered doubtful. All interest accrued, but not collected for loans that are placed on non-accrual status or charged off, is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, future payments are reasonably assured, and there is six months of performance. Management considers all non-accrual loans and troubled debt restructurings to be impaired. In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered collection delays and not an indication of loan impairment. The Bank considers consumer installment loans to be pools of smaller homogeneous loan balances, which are collectively evaluated for impairment.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize performing and non-performing loans receivable by portfolio segment, by aging category, by delinquency status as of June 30, 2017 and December 31, 2016.

(In thousands)	**Performing (Accruing) Loans**							
As of June 30, 2017:	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**90 Days or Greater Past Due**	**Total**	**Current**	**Total Performing Loans**	**Non-accruing Loans**	**Loans Receivable Gross**
Loan portfolio segment:								
Commercial Real Estate:								
Pass	$-	-	-	-	252,424	252,424	-	252,424
Special Mention	-	-	-	-	16,421	16,421	-	16,421
Substandard	3,097	-	-	3,097	8,117	11,214	-	11,214
	3,097	-	-	3,097	276,962	280,059	-	280,059
Residential Real Estate:								
Pass	478	9	1,447	1,934	148,904	150,838	-	150,838
Substandard	-	-	-	-	-	-	1,590	1,590
	478	9	1,447	1,934	148,904	150,838	1,590	152,428
Commercial and Industrial:								
Pass	47	4	750	801	93,324	94,125	-	94,125
Substandard	-	-	-	-	490	490	269	759
	47	4	750	801	93,814	94,615	269	94,884
Consumer and Other:								
Pass	9	134	-	143	94,687	94,830	-	94,830
Construction:								
Pass	-	-	-	-	49,222	49,222	-	49,222
Construction to permanent - CRE:								
Pass	-	-	-	-	7,665	7,665	-	7,665
Total	$3,631	147	2,197	5,975	671,254	677,229	1,859	679,088
Loans receivable, gross:								
Pass	$534	147	2,197	2,878	646,226	649,104	-	649,104
Special Mention	-	-	-	-	16,421	16,421	-	16,421
Substandard	3,097	-	-	3,097	8,607	11,704	1,859	13,563

Loans receivable, gross	$3,631	147	2,197	5,975	671,254	677,229	1,859	679,088

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PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

(In thousands)	**Performing (Accruing) Loans**							
As of December 31, 2016:	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**90 Days or Greater Past Due**	**Total**	**Current**	**Total Performing Loans**	**Non-accruing Loans**	**Loans Receivable Gross**
Loan portfolio segment:								
Commercial Real Estate:								
Pass	$-	-	-	-	265,246	265,246	-	265,246
Special Mention	-	-	-	-	4,531	4,531	-	4,531
Substandard	-	-	-	-	1,452	1,452	-	1,452
	-	-	-	-	271,229	271,229	-	271,229
Residential Real Estate:								
Pass	131	9	1,449	1,589	83,335	84,924	-	84,924
Substandard	-	-	-	-	-	-	1,590	1,590
	131	9	1,449	1,589	83,335	84,924	1,590	86,514
Commercial and Industrial:								
Pass	47	4	-	51	60,692	60,743	-	60,743
Substandard	-	-	-	-	3	3	231	234
	47	4	-	51	60,695	60,746	231	60,977
Consumer and Other:								
Pass	75	-	3	78	101,371	101,449	-	101,449
Construction:								
Pass	-	-	-	-	53,895	53,895	-	53,895
Construction to permanent - CRE:								
Pass	-	-	-	-	7,593	7,593	-	7,593
Total	$253	13	1,452	1,718	578,118	579,836	1,821	581,657
Loans receivable, gross:								
Pass	$253	13	1,452	1,718	572,132	573,850	-	573,850
Special Mention	-	-	-	-	4,531	4,531	-	4,531
Substandard	-	-	-	-	1,455	1,455	1,821	3,276
Loans receivable, gross	$253	13	1,452	1,718	578,118	579,836	1,821	581,657

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Troubled Debt Restructurings ("TDR")

On a case-by-case basis, Patriot may agree to modify the contractual terms of a borrower's loan to assist customers who may be experiencing financial difficulty. If the borrower is experiencing financial difficulties and a concession has been made, the loan is classified as a TDR.

There were no loans modified as TDRs and no defaults of TDRs during the three and six months ended June 30, 2017 and 2016. At June 30, 2017 and December 31, 2016, there were no commitments to advance additional funds under TDRs.

Substantially all TDR loan modifications involve lowering the monthly payments on such loans through either a reduction in interest rate below the contract rate, an extension of the term of the loan, or a combination of adjusting these two contractual attributes. TDR loan modifications may result in the forgiveness of principal or accrued interest. In addition, when modifying commercial loans, Patriot frequently obtains additional collateral or guarantor support. If the borrower has performed under the existing contractual terms of the loan and Patriot's underwriters determine that the borrower has the capacity to continue to perform under the terms of the TDR, the loan continues accruing interest. Non-accruing TDRs may be returned to accrual status when there has been a sustained period of performance (generally six consecutive months of payments) and both principal and interest are reasonably assured of collection.

Impaired Loans

Impaired loans may consist of non-accrual loans and/or performing and non-performing TDRs. As of June 30, 2017 and December 31, 2016, based on the on-going monitoring and analysis of the loan portfolio, impaired loans of $8.8 million and $8.9 million were identified, for which $231,000 and $231,000 specific reserves were established, respectively. Loans not requiring specific reserves had sufficient collateral values, less costs to sell, supporting the carrying amount of the loans. Once a borrower is in default, Patriot is under no obligation to advance additional funds on unused commitments.

At June 30, 2017 exposure to the $8.8 million of impaired loans was related to 11 borrowers. In all cases, appraisal reports of the underlying collateral, if any, have been obtained from independent licensed appraisal firms. For non-performing loans, the independently determined appraised values were reduced by an estimate of the costs to sell the assets, in order to estimate the potential loss, if any, that may eventually be realized. Performing loans are monitored to determine when, if at all, additional loan loss reserves may be required for a loss of underlying collateral value.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following summarizes the investment in, outstanding principal balance of, and the related allowance, if any, for impaired loans as of June 30, 2017 and December 31, 2016:

(In thousands)

	June 30, 2017			**December 31, 2016**		
	Recorded Investment	**Principal Outstanding**	**Related Allowance**	**Recorded Investment**	**Principal Outstanding**	**Related Allowance**
With no related allowance recorded:						
Commercial Real Estate	$6,142	6,593	-	6,267	6,721	-
Residential Real Estate	1,905	1,938	-	1,911	2,915	-
Commercial and Industrial	38	38	-	-	-	-
Consumer and Other	540	629	-	542	631	-
Construction	-	287	-	-	-	-
	8,625	9,485	-	8,720	10,267	-
With a related allowance recorded:						
Commercial Real Estate	-	-	-	-	-	-
Residential Real Estate	-	-	-	-	-	-
Commercial and Industrial	231	231	231	231	231	231
Consumer and Other	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Construction to permanent - CRE	-	-	-	-	-	-
	231	231	231	231	231	231
Impaired Loans, Total:						
Commercial Real Estate	6,142	6,593	-	6,267	6,721	-
Residential Real Estate	1,905	1,938	-	1,911	2,915	-
Commercial and Industrial	269	269	231	231	231	231
Consumer and Other	540	629	-	542	631	-
Construction	-	287	-	-	-	-
Construction to permanent - CRE	-	-	-	-	-	-
Impaired Loans, Total	$8,856	9,716	231	8,951	10,498	231

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize additional information regarding impaired loans for the three and six months ended June 30, 2017 and 2016.

(In thousands)	**Three Months Ended June 30,**			
	2017		**2016**	
	Average Recorded Investment	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
With no related allowance recorded:				
Commercial Real Estate	$6,188	75	7,524	79
Residential Real Estate	1,907	3	4,525	31
Commercial and Industrial	37	-	116	-
Consumer and Other	541	5	545	5
	8,673	83	12,710	115
With a related allowance recorded:				
Commercial Real Estate	-	-	-	-
Residential Real Estate	-	-	-	-
Commercial and Industrial	232	-	2,977	-
Consumer and Other	-	-	2	-
	232	-	2,979	-
Impaired Loans, Total:				
Commercial Real Estate	6,188	75	7,524	79
Residential Real Estate	1,907	3	4,525	31
Commercial and Industrial	269	-	3,093	-
Consumer and Other	541	5	547	5
Impaired Loans, Total	$8,905	83	15,689	115

(In thousands)	**Six Months Ended June 30,**			
	2017		**2016**	
	Average Recorded Investment	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
With no related allowance recorded:				

Commercial Real Estate	$6,213	148	7,597	159
Residential Real Estate	1,909	5	4,535	62
Commercial and Industrial	37	-	148	-
Consumer and Other	541	10	546	9
	8,700	163	12,826	230
With a related allowance recorded:				
Commercial and Industrial	232	-	1,914	-
Consumer and Other	-	-	2	-
	232	-	1,916	-
Impaired Loans, Total:				
Commercial Real Estate	6,213	148	7,597	159
Residential Real Estate	1,909	5	4,535	62
Commercial and Industrial	269	-	2,062	-
Consumer and Other	541	10	548	9
Impaired Loans, Total	$8,932	163	14,742	230

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 4: Deposits

The following table presents the balance of deposits held, by category as of June 30, 2017 and December 31, 2016.

(In thousands)	**June 30, 2017**	**December 31, 2016**
Non-interest bearing	$77,778	$76,772
Interest bearing:		
NOW	27,947	29,912
Savings	148,408	131,429
Money market	14,687	15,593
Certificates of deposit, less than $250,000	169,526	160,609
Certificates of deposit, $250,000 or greater	63,434	51,077
Brokered deposits	60,259	63,932
Interest bearing, Total	484,261	452,552
Total Deposits	$562,039	$529,324

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 5: Share-Based Compensation and Employee Benefit Plan

The Company maintains the Patriot National Bancorp, Inc. 2012 Stock Plan (the "Plan") to provide an incentive to directors and employees of the Company by the grant of restricted stock awards ("RSA"), options, or phantom stock units. Since 2013, the Company's practice is to grant RSAs; as of June 30, 2017 and December 31, 2016, there were no options or phantom stock units outstanding or that have been exercised.

The Plan provides for the issuance of up to 3,000,000 shares of the Company's common stock subject to certain limitations. As of June 30, 2017, 2,886,432 shares of stock are available for issuance under the Plan. In accordance with the terms of the Plan, the vesting of RSAs and options may be accelerated at the discretion of the Compensation Committee of the Board of Directors. The Compensation Committee sets the terms and conditions applicable to the vesting of RSAs and stock option grants. RSAs granted to directors and employees generally vest in quarterly or annual installments over a three, four or five year period from the date of grant. During the three and six months ended June 30, 2017, the Company granted 5,084 RSAs to directors and zero RSA to employees. During the six months ended June 30, 2016, the Company granted 52,200 restricted shares to employees and 5,884 restricted shares to directors, respectively. During the three and six months ended June 30, 2017, 0 and 2,231 shares of restricted stock became vested, 6,000 and 6,000 shares of restricted stock forfeited, respectively. All RSAs are non- participating grants.

The Company recognizes compensation expense for all director and employee share-based compensation awards on a straight-line basis over the requisite service period, which is equal to the vesting schedule of each award, for each vesting portion of an award equal to its grant date fair value. For the three and six months ended June 30, 2017, the Company recognized share-based compensation expense of $25,000 and $68,000, respectively. The share-based compensation attributable to employees of Patriot amounted to $4,000 and $32,000, respectively.

For the three and six months ended June 30, 2016, the Company recognized share-based compensation expense of $154,000 and $308,000, respectively. The share-based compensation attributable to employees of Patriot amounted to $139,000 and $279,000, respectively.

Included in share-based compensation expense for the three and six months ended June 30, 2017 were $21,000 and $36,000 attributable to Patriot's external Directors, who received total compensation of $77,000 and $146,000 for each of those periods, respectively, which amounts are included in Other Operating Expenses in the Consolidated

Statements of Operations.

The share-based compensation expense for the three and six months ended June 30, 2016 were $15,000 and $29,000 attributable to Patriot's external Directors, who received total compensation of $80,000 and $152,000 for each of those periods, respectively, which amounts are included in Other Operating Expenses in the Consolidated Statements of Operations.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following is a summary of the status of the Company's restricted shares as of June 30, 2017 and 2016 and changes therein during the periods indicated:

Three months ended June 30, 2017:	**Number of Shares Awarded**	**Weighted Average Grant Date Fair Value**
Unvested at March 31, 2017	33,033	$ 12.55
Granted	5,084	$ 15.05
Forfeited	(6,000)	$ 15.50
Unvested at June 30, 2017	32,117	$ 12.39
Six months ended June 30, 2017:		
Unvested at December 31, 2016	35,264	$ 12.84
Granted	5,084	$ 15.05
Vested	(2,231)	$ 13.05
Forfeited	(6,000)	$ 15.50
Unvested at June 30, 2017	32,117	$ 12.39

Three months ended June 30, 2016:	**Number of Shares Awarded**	**Weighted Average Grant Date Fair Value**
Unvested at March 31, 2016	113,938	$ 14.06
Vested	(2,526)	$ 14.72
Forfeited	(4,213)	$ 11.31
Unvested at June 30, 2016	107,199	$ 14.16

Six months ended June 30, 2016:		
Unvested at December 31, 2015	55,854	$ 12.83
Granted	58,084	$ 15.25
Vested	(2,526)	$ 14.72
Forfeited	(4,213)	$ 11.31
Unvested at June 30, 2016	107,199	$ 14.16

Compensation expense attributable to the unvested restricted shares outstanding as of June 30, 2017 amounts to $367,000, which amount is expected to be recognized over the weighted average remaining life of the awards of 2.56 years.

RSA Grant - Non-executive Employees

On January 4, 2016, the Company granted 100 restricted shares of common stock to each of eighty-seven full- and part-time non-executive employees as of December 31, 2015. The total number of shares granted was 8,700 at a grant date fair value of $15.50 per share, resulting in expected future employee compensation of $135,000. The shares granted vest in three-years on January 2, 2019 and are non-participating during the vesting period.

During the three and six months ended June 30, 2017, none of the shares granted were forfeited. The remaining 6,900 shares continue to vest and $54,000 of compensation expense is expected to be recognized through the January 2019 vesting date.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The Company offers a 401K retirement plan (the “401K”), which provides for tax-deferred salary deductions for eligible employees. Employees may choose to make voluntary contributions to the 401K, limited to an annual maximum amount as set forth periodically by the Internal Revenue Service. The Company matches 50% of such contributions, up to a maximum of six percent. During the three and six months ended June 30, 2017, compensation expense under the 401K aggregated $60,000 and $94,000, respectively. During the three and six months ended June 30, 2016, compensation expense under the 401K aggregated $38,000 and $81,000, respectively.

Note 6: Earnings per share

The Company is required to present basic earnings per share and diluted earnings per share in its Consolidated Statements of Operations. Basic earnings per share amounts are computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding unvested RSAs granted to directors and employees. The dilutive effect resulting from these potential shares is determined using the treasury stock method. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted earnings per share.

The computation of basic and diluted earnings per share for the three and six months ended June 30, 2017 and 2016 follows.

(Net income in thousands)	**Three Months Ended June 30,**		**Six Months Ended June 30,**	
	2017	**2016**	**2017**	**2016**
<u>Basic earnings per share:</u>				
Net income attributable to Common shareholders	$804	(582)	2,534	71
<u>Divided by:</u>				
Weighted average shares outstanding	3,894,128	3,957,012	3,893,431	3,956,609
Basic earnings per common share	$0.21	(0.15)	0.65	0.02

<u>Diluted earnings per share:</u>

Net income attributable to Common shareholders	$804	(582	)	2,534	71
Weighted average shares outstanding	3,894,128	3,957,012		3,893,431	3,956,609
Effect of potentially dilutive restricted common shares	7,400	-	(1)	5,289	33,366
Divided by:					
Weighted average diluted shares outstanding	3,901,528	3,957,012		3,898,720	3,989,975
Diluted earnings per common share	$0.21	(0.15	)	0.65	0.02

(1) There were 1,073 shares excluded from the calculation of diluted net loss per share due to their anti-dilutive effect for the three month period ended June 30, 2016.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 7: Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, Patriot is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contractual amounts of these instruments reflect the extent of involvement Patriot has in particular classes of financial instruments.

The contractual amount of commitments to extend credit and standby letters of credit represents the maximum amount of potential accounting loss should: the contract be fully drawn upon; the customer default; and the value of any existing collateral becomes worthless. Patriot applies its credit policies to entering commitments and conditional obligations and, as with its lending activates, evaluates each customer's creditworthiness on a case-by-case basis. Management believes that it effectively mitigates the credit risk of these financial instruments through its credit approval processes, establishing credit limits, monitoring the on-going creditworthiness of recipients and grantees, and the receipt of collateral as deemed necessary.

Financial instruments with credit risk at June 30, 2017 are as follows:

(In thousands)

	As of June 30, 2017
Commitments to extend credit:	
Unused lines of credit	$44,158
Undisbursed construction loans	14,121
Home equity lines of credit	21,745
Future loan commitments	19,773
Financial standby letters of credit	1,299
	$101,096

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 to extend credit generally have fixed expiration dates or other termination clauses, and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary upon extending credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include commercial property, residential property, deposits and securities. Patriot has established a $5,000 reserve for credit loss as of June 30, 2017, which is included in accrued expenses and other liabilities.

Standby letters of credit are written commitments issued by Patriot to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loan facilities to customers. Guarantees that are not derivative contracts are recorded at fair value and included in the Consolidated Balance Sheet.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 8: Regulatory and Operational Matters

Federal and State regulatory authorities have adopted standards requiring financial institutions to maintain increased levels of capital. Effective January 1, 2015, Federal banking agencies imposed four minimum capital requirements on community bank’s risk-based capital ratios consisting of Total Capital, Tier 1 Capital, Common Equity Tier 1 (“CET1”) Capital, and a Tier 1 Leverage Capital ratio. The risk-based capital ratios measure the adequacy of a bank's capital against the riskiness of its on- and off-balance sheet assets and 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, nontraditional activity risk, policy effectiveness, and management's overall ability to monitor and control risk.

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. Under the instituted regulatory framework, to be considered “well capitalized”, a financial institution must generally have a Total Capital ratio of at least 10%, a Tier 1 Capital ratio of at least 8.0%, a CET1 Capital ratio at least 6.5%, and a Tier 1 Leverage Capital ratio of at least 5.0%. However, regardless of a financial institution’s ratios, the OCC may require increased capital ratios or impose dividend restrictions based on the other factors it considers in assessing a bank’s capital adequacy.

Management continuously assesses the adequacy of the Bank’s capital in order to maintain its “well capitalized” status.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The Company's and the Bank's regulatory capital amounts and ratios at June 30, 2017 and December 31, 2016 are summarized as follows:

(In thousands)	**Patriot National Bancorp, Inc.**				**Patriot Bank, N.A.**			
	June 30, 2017		**December 31, 2016**		**June 30, 2017**		**December 31, 2016**	
	Amount ($)	**Ratio (%)**	**Amount ($)**	**Ratio (%)**	**Amount ($)**	**Ratio (%)**	**Amount ($)**	**Ratio (%)**
Total Capital (to risk weighted assets):								
Actual	71,547	10.309	66,254	10.603	80,258	11.594	74,303	11.928
To be Well Capitalized(1)	-	-	-	-	69,226	10.000	62,292	10.000
For capital adequacy with Capital Buffer(2)	-	-	-	-	64,034	9.250	53,727	8.625
For capital adequacy	55,522	8.000	49,989	8.000	55,381	8.000	49,834	8.000
Tier 1 Capital (to risk weighted assets):								
Actual	65,595	9.451	61,571	9.854	74,306	10.734	69,620	11.176
To be Well Capitalized(1)	-	-	-	-	55,381	8.000	49,834	8.000
For capital adequacy with Capital Buffer(2)	-	-	-	-	50,189	7.250	41,269	6.625
For capital adequacy	41,641	6.000	37,491	6.000	41,536	6.000	37,375	6.000
Common Equity Tier 1 Capital (to risk weighted assets):								
Actual	57,595	8.299	53,571	8.573	74,306	10.734	69,620	11.176
To be Well Capitalized(1)	-	-	-	-	44,997	6.500	40,490	6.500
For capital adequacy with Capital Buffer(2)	-	-	-	-	39,805	5.750	31,925	5.125
For capital adequacy	31,231	4.500	28,119	4.500	31,152	4.500	28,031	4.500
Tier 1 Leverage Capital (to average assets):								
Actual	65,595	8.804	61,571	9.296	74,306	9.974	69,620	10.518
To be Well Capitalized(1)	-	-	-	-	37,250	5.000	33,096	5.000
For capital adequacy	29,803	4.000	26,494	4.000	29,800	4.000	26,477	4.000

(1)

Designation as "Well Capitalized" does not apply to bank holding companies - - the Company. Such categorization of capital adequacy only applies to insured depository institutions - - the Bank.

(2) The Capital Conservation Buffer implemented by the FDIC began to be phased in beginning January 1, 2016. It was not applicable to periods prior to that date and does not apply to bank holding companies - - the Company.

Under the final capital rules that became effective on January 1, 2015, there was a requirement for a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets, which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain this required capital buffer become subject to progressively more stringent limitations on the percentage of earnings that may be distributed to shareholders or used for stock repurchases and on the payment of discretionary bonuses to senior executive management.

The capital buffer requirement is being phased in over three years beginning in 2016. The 0.625% capital conversation buffer for 2016 has been included in the minimum capital adequacy ratios in the 2016 column in the table above. The capital conversation buffer increased to 1.25% for 2017, which has been included in the minimum capital adequacy ratios in the 2017 column above.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The capital buffer requirement effectively raises the minimum required Total Capital ratio to 10.5%, the Tier 1 capital ratio to 8.5% and the CET1 capital ratio to 7.0% on a fully phased-in basis, which will be effective beginning on January 1, 2019. Management believes that, as of June 30, 2017, Patriot satisfies 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.

Note 9: Fair Value and Interest Rate Risk

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. A fair value hierarchy has been established that prioritizes the inputs used to measure fair value, requiring entities to maximize the use of observable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs generally require significant management judgment.

The three levels of the fair value hierarchy consist of:

Level 1	Unadjusted quoted market prices for identical assets or liabilities in active markets that the entity has the ability to access at the measurement date (such as active exchange-traded equity securities and certain U.S. and government agency debt securities).
Level 2	Observable inputs other than quoted prices included in Level 1, such as: - Quoted prices for similar assets or liabilities in active markets (such as U.S. agency and government sponsored mortgage-backed securities) - Quoted prices for identical or similar assets or liabilities in less active markets (such as certain U.S. and government agency debt securities, and corporate and municipal debt securities that trade infrequently) - Other inputs that are observable for substantially the full term of the asset or liability (i.e. interest rates, yield curves, prepayment speeds, default rates, etc.).
Level 3	Valuation techniques that require unobservable inputs that are supported by little or no market activity and are significant to the fair value measurement of the asset or liability (such as pricing and discounted cash flow models that typically reflect management’s estimates of the assumptions a market participant would use in pricing the asset or liability).

A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable

The carrying amount is a reasonable estimate of fair value and accordingly these are classified as Level 1. These financial instruments are not recorded at fair value on a recurring basis.

Available-for-Sale 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, or using unobservable inputs employing various techniques and assumptions (Level 3).

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Other Investments

The Bank's investment portfolio includes the Solomon Hess SBA Loan Fund totaling $4.5 million. This investment is utilized by the Bank to satisfy its Community Reinvestment Act ("CRA") lending requirements. As this fund operates as a private fund, shares in the Fund are not publicly traded and therefore have no readily determinable market value. The investment in the Fund is reported in the Consolidated Financial Statements at cost.

Loans

For variable rate loans, which periodically reprice with no apparent change in credit risk, carrying values, adjusted for credit losses inherent in the portfolios, are a reasonable estimate of fair value.

The fair value of fixed rate loans is estimated by discounting the future cash flows using the period-end rates, estimated by using local market data, at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios.

Since individual loans do not trade on an open market and transfer of individual loans are private transactions that are not publicized, the fair value of the loan portfolio is classified within Level 3 of the fair value hierarchy. Patriot does not record loans at fair value on a recurring basis; however, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect the net realizable value expected to be collected on default by the borrower based on observable market inputs or current appraised value of collateral held. Fair values estimated in this manner do not fully incorporate an exit-price approach, but instead are based on a comparison to current market rates for comparable loans, adjusted by management based on the best information available.

OREO

The fair value of other OREO the Bank may obtain is based on current appraised property value less estimated costs to sell. When the fair value is based on unadjusted current appraised values, OREO is classified within Level 2 of the fair value hierarchy. Patriot classifies OREO within Level 3 of the fair value hierarchy when unobservable inputs are used to determine adjustments to appraised values. Patriot does not record OREO at fair value on a recurring basis, but rather initially records OREO at fair value and then monitors property and market conditions that may indicate a change in value is warranted.

Deposits

The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date.

The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits.

The Company does not record deposits at fair value on a recurring basis.

Senior Notes and Junior Subordinated Debt

The senior notes were issued in December 2016 and therefore the carrying value is considered comparable to fair value. Management does not intend to measure the senior notes at fair value on a recurring basis.

Junior subordinated debt reprices quarterly, as a result, the carrying amount is considered a reasonable estimate of fair value. The Company does not record junior subordinated debt at fair value on a recurring basis.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Federal Home Loan Bank Borrowings

The fair value of FHLB advances is estimated using a discounted cash flow calculation that applies current FHLB interest rates for advances of similar maturity to a schedule of maturities of such advances. The Company does not record these borrowings at fair value on a recurring basis.

Off-balance sheet instruments

Off-balance sheet financial instruments are based on interest rate changes and fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The Company does not record its off-balance-sheet instruments at fair value (i.e., commitments to extend credit) on a recurring basis.

The following tables detail the financial assets measured at fair value on a recurring basis and the valuation techniques utilized relative to the fair value hierarchy, as of June 30, 2017 and December 31, 2016:

(In thousands)	**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
June 30, 2017:					
U. S. Government agency mortgage-backed securities	$	-	8,422	-	8,422
Corporate bonds		-	8,954	-	8,954
Subordinated notes		-	5,605	2,000	7,605
Available-for-sale securities	$	-	22,981	2,000	24,981
December 31, 2016:					
U. S. Government agency mortgage-backed securities	$	-	10,441	-	10,441

Corporate bonds		-	8,961	-	8,961
Subordinated notes		-	3,026	2,000	5,026
Available-for-sale securities	$	-	22,428	2,000	24,428

The table below presents the valuation methodology and unobservable inputs for level 3 assets measures at fair value on a non-recurring basis as of June 30, 2017 and December 31, 2016:

(In thousands)	**Fair Value**	**Valuation Methodology**	**Unobservable Inputs**	**Range of Inputs**
June 30, 2017:				
Impaired loans	$8,856	Real Estate Appraisals	Discount for appraisal type	0% - 8%
OREO	851	Real Estate Appraisals	Discount for appraisal type	21%
December 31, 2016:				
Impaired loans	$8,951	Real Estate Appraisals	Discount for appraisal type	0% - 8%
OREO	851	Real Estate Appraisals	Discount for appraisal type	21%

The Company discloses fair value information about financial instruments, whether or not recognized in the Consolidated Balance Sheet, for which it is practicable to estimate that value. Certain financial instruments are excluded from disclosure requirements and, accordingly, the aggregate fair value amounts presented do not necessarily represent the complete underlying value of the financial instruments included in the Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The estimated fair value amounts have been measured as of June 30, 2017 and December 31, 2016 and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of the financial instruments measured may be different than if they had been subsequently valued.

The information presented should not be interpreted as an estimate of the total fair value of the Company’s assets and liabilities, since only a portion of Patriot’s assets and liabilities are liabilities are required to be measured at fair value for financial reporting purposes. Due to the 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 bank holding companies may not be meaningful.

The following table provides a comparison of the carrying amounts and estimated fair values of Patriot’s financial assets and liabilities as of June 30, 2017 and December 31, 2016:

(In thousands)		**June 30, 2017**		**December 31, 2016**	
	Fair Value Hierarchy	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial Assets:					