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Section 1: 10-K (FORM 10-K)

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

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended: December 31, 2012

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

For the transition period from __________ to __________

Commission File No. 0-20957

Sun Bancorp, Inc.
(Exact Name of Registrant as Specified in Its Charter)

New Jersey **(State or Other Jurisdiction of Incorporation or Organization)**	**52-1382541** **(IRS Employer Identification No.)**
226 Landis Avenue, Vineland, New Jersey **(Address of Principal Executive Offices)**	**08360** **(Zip Code)**

Registrant's telephone number, including area code: (856) 691-7700

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

Title of each class	Name of each exchange on which registered
Common Stock, $1.00 par value	The NASDAQ Global Select Market

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

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☐ NO ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒

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

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

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☐

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the closing price of the registrant's Common Stock as of June 30, 2012 was approximately $126.3 million.

As of March 8, 2013, there were 86,258,106 outstanding shares of the registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Shareholders for the Fiscal Year Ended December 31, 2012. (Parts I and II)
2. Portions of the Definitive Proxy Statement for the 2013 Annual Meeting of Shareholders (Part III)

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SUN BANCORP, INC
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Forward-Looking Statements

This Form 10-K of Sun Bancorp, Inc. (the "Company") and the documents incorporated by reference herein may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and are intended to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. We are including this statement for the purpose of invoking those safe harbor provisions. Forward-looking statements often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar expressions or future or conditional verbs such as "may," "will," "should," "would" and "could." These forward-looking statements may include, among other things:

- statements and assumptions relating to financial performance;
- statements relating to the anticipated effects on results of operations or financial condition from recent or future developments or events;
- statements relating to our business and growth strategies and our regulatory capital levels;
- statements relating to potential sales of our criticized and classified assets; and
- any other statements, projections or assumptions that are not historical facts.

Actual future results may differ materially from our forward-looking statements, and we qualify all forward-looking statements by various risks and uncertainties we face, some of which are beyond our control, as well as the assumptions underlying the statements, including, among others, the following factors:

- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- market volatility;
- the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs;
- the overall quality of the composition of our loan and securities portfolios;
- the market for criticized and classified assets that we may sell;
- legislative and regulatory changes, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and impending regulations, changes in banking, securities and tax laws and regulations and their application by our regulators and changes in the scope and cost of Federal Deposit Insurance Corporation ("FDIC") insurance and other coverages;
- the effects of, and changes in, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (the "FRB");
- inflation, interest rate, market and monetary fluctuations;
- fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas;
- the effect of and our compliance with the terms of the Agreement by and between our wholly owned subsidiary, Sun National Bank (the "Bank") and the Office of the Comptroller of the Currency (the "OCC") dated April 15, 2010 (the "OCC Agreement") as well as compliance with the individual minimum capital ratios established for the Bank by the OCC;
- the results of examinations of us by the Federal Reserve Bank of Philadelphia (the "Federal Reserve") and of the Bank by the OCC, including the possibility that the OCC may, among other things, require the Bank to increase its allowance for loan losses or to write-down assets;
- our ability to control operating costs and expenses;
- our ability to manage delinquency rates;
- our ability to retain key members of our senior management team;
- the costs of litigation, including settlements and judgments;
- the increased competitive pressures among financial services companies;
- the timely development of and acceptance of new products and services and the perceived overall value of these products and services by businesses and consumers, including the features, pricing and quality compared to our competitors' products and services;
- technological changes;
- acquisitions;

- changes in consumer and business spending, borrowing and saving habits and demand for financial services in our market area;
- adverse changes in securities markets;
- the inability of key third-party providers to perform their obligations to us;
- changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies, the Financial Accounting Standards Board;
- war or terrorist activities;
- other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services and the other risks described elsewhere herein or in the documents incorporated by reference herein and our other filings with the Securities and Exchange Commission ("SEC"); and
- our success at managing the risks involved in the foregoing.

Some of these and other factors are discussed under Item 1A. Risk Factors and in the documents incorporated by reference herein. The development of any or all of these factors could have an adverse impact on our financial position and results of operations.

Any forward-looking statements are based upon management's beliefs and assumptions at the time they are made. We undertake no obligation to publicly update or revise any forward-looking statements included or incorporated by reference herein or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise, unless otherwise required to do so by law or regulation. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed herein or in the documents incorporated by reference herein might not occur, and you should not put undue reliance on any forward-looking statements.

PART I

Item 1. Business.

General

The Company, a New Jersey corporation, is a bank holding company headquartered in Vineland, New Jersey with its executive office in Mt. Laurel, New Jersey. The Company's principal subsidiary is the Bank. At December 31, 2012, the Company had total assets of $3.2 billion, total liabilities of $3.0 billion and total shareholders' equity of $262.6 million. The Company's principal business is to serve as a holding company for the Bank. As a registered bank holding company, the Company is subject to the supervision and regulation of the FRB. At December 31, 2012, the Company had 685 full-time and 65 part-time employees. As of December 31, 2012, the Company had 62 locations throughout New Jersey.

Through the Bank, the Company provides a comprehensive array of commercial and consumer banking services. The Company's lending services to businesses include term loans and lines of credit, mortgage loans, construction loans and equipment leasing. The Company is a Preferred Lender with both the Small Business Administration ("SBA") and the New Jersey Economic Development Authority. The Company's commercial deposit services include business checking accounts and cash management services such as electronic banking, sweep accounts, lockbox services, Internet banking, remote deposit and controlled disbursement services. The Company's lending services to consumers include residential mortgage loans, residential construction loans, second mortgage loans, home equity loans and installment loans. The Company's consumer deposit services include checking accounts, savings accounts, money market accounts, certificates of deposit and individual retirement accounts. In addition, the Company offers mutual funds, securities brokerage, annuities and investment advisory services.

The Company's website address is www.sunnb.com. The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other documents filed by the Company with the Securities and Exchange Commission are available free of charge on the Company's website under the Investor Relations menu.

Private Placements and Common Stock Offerings

On July 7, 2010, the Company entered into securities purchase agreements with WLR SBI AcquisitionCo, LLC, an affiliate of WL Ross & Co. LLC ("WL Ross"), members and affiliates of the Bank's founding Brown Family (the "Brown Family"), certain affiliates of Siguler Guff & Company, LP (the "Siguler Guff Shareholders") and certain other institutional and accredited investors (the "Other Investors"). On September 22, 2010, the Company completed the issuance and sale of 4,672,750 shares of its common stock and 88,009 shares of its Mandatorily Convertible Cumulative Non-Voting Perpetual Stock, Series B (the "Series B Preferred Stock") for net proceeds of $98.5 million. At the Company's Annual Meeting of Shareholders held on November 1, 2010, its shareholders approved an amendment to our Amended and Restated Certificate of Incorporation allowing for the conversion of the 88,009 shares of Series B Preferred Stock into 22,002,250 shares of common stock at a conversion price of $4.00 per share.

On March 22, 2011, the Company completed a public offering of 28,750,000 shares of common stock at a public offering price of $3.00 per share, which included the full exercise of the over-allotment option granted to the underwriters to purchase an additional 3,750,000 shares of common stock. After deducting the underwriting discount and offering expenses payable by the Company, the net proceeds were $81.4 million. The Company's three largest shareholders, WL Ross, the Siguler Guff Shareholders, and the Brown Family, along with certain officers and directors, purchased an aggregate of 10,193,224 shares in the offering. WL Ross and the Siguler Guff Shareholders maintained their percentage interest in the Company in the offering. Pursuant to the terms of the securities purchase agreements entered into between WL Ross, the Siguler Guff Shareholders, the Brown Family and the Company in connection with the private placement of Company securities in July 2010, each of these investors was entitled to purchase shares in the offering at $2.85 per share which represented the public offering price less the underwriting discount of $0.15 per share paid to the underwriters on the other shares sold.

On April 11, 2011, the Company issued and sold in a private placement transaction an additional 3,802,131 shares at $2.85 per share totaling $10.8 million in additional stock proceeds pursuant to the exercise of gross-up rights contained in the previously executed securities purchase agreements with the three investors noted above. The gross-up rights were triggered by the underwriters' exercise of the over-allotment option in the public offering. On August 8, 2011, the Company issued approximately 2,378,232 additional shares at $2.85 per share totaling $6.8 million in stock proceeds pursuant to the exercise of gross-up rights. The transactions were triggered pursuant to the gross-up rights issued to Anchorage Capital Group, LLC ("Anchorage"), in connection with its purchase of shares in the public offering.

At December 31, 2012, WL Ross beneficially owned approximately 24.7% of our outstanding common stock, the Brown Family beneficially owned approximately 18.1% of our outstanding common stock and the Siguler Guff Shareholders and Anchorage each beneficially owned approximately 9.8% of our outstanding common stock. None of the Other Investors beneficially owned more than 2% of our common stock.

Minimum Capital Ratios

The OCC has also established individual minimum capital ratios which require the Bank to maintain Tier 1 Capital at least equal to 8.50% of adjusted total assets, Tier 1 Capital at least equal to 9.50% of risk-weighted assets and to achieve and thereafter maintain Total Capital at least equal to 11.50% of risk-weighted assets. At December 31, 2012, the Bank was in compliance with these three individual minimum capital ratios. The Bank had Tier 1 Capital equal to 9.24% of adjusted total assets, Tier 1 Capital equal to 11.76% of risk-weighted assets and Total Capital equal to 13.02% of risk-weighted assets at December 31, 2012.

Market Area

The Company's corporate headquarters is located in Vineland, New Jersey, approximately 30 miles southeast of Philadelphia, Pennsylvania and 37 miles west of Atlantic City, New Jersey. The Company also maintains a regional headquarters in Mt. Laurel, New Jersey, which is located in close proximity to both the New Jersey Turnpike and Interstate 295, two major thoroughfares that provide convenient access to both the southern and northern regions of New Jersey.

The Company's operations have a primary market area in the State of New Jersey with a market presence in New York and Pennsylvania. The Company's deposit-gathering base and lending area is concentrated in the communities surrounding its offices in New Jersey. The Company believes these markets are attractive and have strong growth potential based on key economic indicators. The State of New Jersey has the third highest median household income and the third highest personal income per capita in the nation. The Company's markets are home to a diverse pool of businesses and industries, representing key opportunities for growth in the business and commercial banking products and services. Related to the Company's consumer growth, New Jersey is the most densely populated state in the U.S., providing a deep consumer base as well. The Company's market area is also home to many affluent suburbs, catering to commuters who live in New Jersey and work in New York and Philadelphia.

Lending Activities

General. The principal lending activity of the Company is the origination of commercial and industrial loans and commercial real estate loans. The Company also offers home equity loans, residential real estate and second mortgage loans and other consumer loans, including installment loans. Substantially all loans are originated in the Company's primary market area. For more information about the Company's lending activities, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Loans" in the Company's 2012 Annual Report, included herein as Exhibit 13.

Commercial and Industrial Loans. The Company's primary lending focus is the origination of commercial and industrial loans, including short-term and long-term business loans, lines of credit, mortgage loans on commercial real estate and construction loans to developers and builders. Over the past few years, the Company has expanded its loan portfolio to include asset based lending and healthcare.

The trend of the Company's lending continues to reflect the geographic and borrower diversification of the commercial loan portfolio. As the Company's marketplace has expanded within the State of New Jersey, commercial lending activities have grown, especially in the central and northern parts of the state. The slow economic recovery has impacted all aspects of the national and regional economy. While the Company has seen some improvement in 2012, there continued to be stress on our portfolio during the year. At December 31, 2012 and 2011, the Company did not have more than 10% of its total loans outstanding concentrated in any one industry category including, but not limited to, the hospitality, entertainment and leisure industries and general office space. The Company's loan categories are determined based upon borrowers engaged in similar activities who would be similarly impacted by economic or other conditions.

Many of the Company's commercial and industrial loans have a real estate component as part of the collateral securing the accommodation. Additionally, the Company makes commercial real estate loans for the acquisition, refinance, improvement and construction of real property. Loans secured by owner occupied properties are dependent upon the successful operation of the borrower's business. If the operating company experiences difficulties in terms of sales volume and/or profitability, the borrower's ability to repay the loan may be impaired. Loans secured by properties where repayment is dependent upon payment of rent by third party tenants or the sale of the property may be impacted by loss of tenants, lower lease rates needed to attract new tenants or the inability to sell a completed project in a timely fashion and at a profit. At December 31, 2012, commercial and industrial loans secured by commercial real estate properties totaled $1.1 billion of which $527.8 million, or 47.4%, were classified as owner occupied and $584.9 million, or 52.6%, were classified as non-owner occupied. These loans are diversified across multiple industries.

Home Equity Lines of Credit ("HELOC"). The Company originates home equity lines of credit, secured by first or second homes owned or being purchased by the loan applicant. HELOCs are consumer revolving lines of credit. The interest rates charged on such loans can be fixed or floating and are generally related to the prime lending rate. HELOC loans, which are underwritten to reflect the borrower's ability to pay the full principal and interest, may provide for interest only payments for the first three years with principal payments to begin in the fourth year. A home equity line is typically originated as a twenty-year note that allows the borrower to draw upon the approved line of credit during the same period as the note. The Company generally permits a loan-to-value ratio up to 80% of the appraised value, less any outstanding mortgage. HELOC loans expose the Company to the risk that falling collateral values may leave such credits inadequately secured especially in the current economic environment where residential real estate values have been negatively impacted.

Second Mortgage Loans. The Company originates second mortgage loans secured by mortgage liens against the borrower's primary, secondary or investment property. Second mortgage loans are consumer term loans. The interest rate charged on such loans is usually a fixed rate which is determined based on the Company's cost of funds and market conditions. These loans typically require fixed payments of principal and interest and have an average term between five and fifteen years. The Company generally permits a loan-to-value ratio of up to 80% of the appraised value, less any outstanding mortgages. Second mortgage loans expose the Company to the risk that falling collateral values may leave such credits inadequately secured.

Residential Real Estate Loans. The Company originates residential mortgages through the Bank. The majority of these loans are for owner occupied single-family residences, a significant portion of which are originated with a forward commitment to sell the loan in the secondary market with servicing released. In 2012, the Company recognized a gain of $10.5 million from the sale of such loans. The Company's mortgage loans are typically sold with recourse in the event of default within the first six months after origination, depending on the terms with the investor. The Company repurchased four previously sold mortgage loans during 2012. The Company also originates residential real estate loans for its portfolio, including both conventional and jumbo loans.

Other Loans. Included in the category of "Other Loans" are certain small business loans serving businesses with credit needs up to $250 thousand. These small business loans are generally lines of credit. At December 31, 2012, the Company had $15.2 million of small business loans, of which $9.0 million relates to SBA loans.

Loans secured by recreational vehicles and modular housing are also included in the "Other Loans" category. These loans were generated through third-party arrangements. In April 2007, the Company ceased its relationship with the third-party used to generate the recreational vehicle portfolio and as of December 31, 2012, there was $4.6 million outstanding. In September 2009, the Company ceased its relationship with the third-party used to generate the modular housing portfolio and as of December 31, 2012 the modular housing portfolio was $21.9 million.

Loan Solicitation and Processing. Loan originations are derived from a number of sources such as loan officers, existing customers and borrowers and referrals from real estate professionals, accountants, attorneys, regional advisory boards, regional or money center banks, and the Board of Directors.

Upon the receipt of a loan request, the prospective borrower's financial condition is analyzed, and appropriate agency reports are obtained to verify the applicant's creditworthiness. For the majority of real estate that will secure a loan, the Company obtains an appraisal or evaluation from an independent appraiser approved by the Company and licensed or certified by the state. After all required information is received and evaluated, a credit decision is made. Depending on the loan type, collateral and amount of the credit request, various levels of approval are required. The Company has implemented a Loan Approval Matrix (LAM) which facilitates the timely approval of commercial loans in an environment that promotes responsible use of coordinated lending authority by groups of loan and credit officers. A credit committee comprised of management and members of the Board of Directors approves lending exposures over a certain amount.

On an annual basis, the Chief Executive Officer presents for approval by the Board of Directors the recommended structure of the LAM and also recommends levels of lending authority within the matrix for individual loan and credit officers. Between the annual approval of lending authorities, the Chief Executive Officer may assign interim lending authorities within the LAM to individual loan and credit officers and report his actions to the Board of Directors in a timely fashion.

The positions of credit officer (CO) and senior credit officer (SCO) are an integral feature of the LAM process. CO's and SCO's are granted substantial levels of authority but do not carry a portfolio. These individuals are collectively responsible for maintaining the quality and soundness of the Company's loan portfolio.

Loan Commitments. When a commercial loan is approved, the Company may issue a written commitment to the loan applicant. The loan commitment specifies the terms and conditions of the proposed loan including the amount, interest rate, amortization term, a brief description of the required collateral, and the required insurance coverage. The loan commitment is valid for approximately 30 days. At December 31, 2012, the Company had approximately $48.3 million in commercial loans that were approved but unfunded.

Credit Risk, Credit Administration and Loan Review. Credit risk represents the possibility that a customer or counterparty may not perform in accordance with contractual terms. The Company incurs credit risk whenever it extends credit to, or enters into other transactions with customers. The risks associated with extensions of credit include general risk, which is inherent in the lending business, and risk specific to individual borrowers. The Credit Risk Division is responsible for the overall management of the Company's credit risk and the development, application and enforcement of uniform credit policies and procedures the principal purpose of which is to minimize such risk. Loan review and other loan monitoring practices provide a means for the Company's management to ascertain whether proper credit, underwriting (new, extensions and renewals) and loan documentation policies, procedures and practices are being followed by the Company's loan officers and are being applied uniformly.

The underpinning of the Company's credit process is a numerical risk rating system. All commercial and small business credit accommodations are assigned a risk rating at the time of initial underwriting by the portfolio manager. The risk rating system is well-defined and requires quantification of various risk factors based on a 10 to 90 point scale. Risk rating is a dynamic process and ratings will change in tandem with financial and economic changes. The risk rating system is also the driver of management's methodology for determining and monitoring the adequacy of the allowance for loan losses.

While management continues to review these and other related functional areas, there can be no assurance that the steps the Company has taken to date will be sufficient to enable it to identify, measure, monitor and control all credit risk.

Investment Activities

The investment policy of the Company is established by senior management and approved by the Board of Directors. It is based on asset and liability management goals which are designed to provide a portfolio of high quality investments that optimize interest income within acceptable limits of safety and liquidity. The Company's investments consist primarily of federal funds, securities issued or guaranteed by the United States Government or its agencies, mortgage-backed securities, states and political subdivisions and trust preferred securities. For more information about the investment securities portfolio, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Financial Condition—Investment Securities" in the Annual Report, included herein as Exhibit 13.

Sources of Funds

General. Deposits are the primary source of the Company's funds for lending and other investment purposes. In addition to deposits, the Company derives funds from the repayment, maturities and sales of loans, maturities or calls of investment securities, as well as from a variety of wholesale funding sources. Scheduled loan principal repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and market conditions.

Deposits. Consumer and commercial deposits, as well as deposits from governmental entities are attracted principally from within the Company's primary market area through the offering of a broad selection of deposit instruments including checking, regular savings, money market deposits, term certificate accounts and individual retirement accounts. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. The Company regularly evaluates the internal cost of funds, surveys rates offered by competing institutions, reviews the Company's cash flow requirements for lending and liquidity and executes rate changes when deemed appropriate. The Company participates in the Certificate of Deposit Account Registry Service (CDARS®) program, which enables our local customers to obtain expanded FDIC insurance coverage on their deposits. The Company may also obtain funding through brokered deposits. Pursuant to the terms of the OCC Agreement, however, the Bank had previously agreed that its brokered deposits may not exceed 3.5% of total liabilities without prior OCC approval. Effective October 18, 2012, the OCC approved an increase of this limit to 6.0%. For more information about the Company's deposits, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Financial Condition—Deposits" in the Annual Report, included herein as Exhibit 13.

Borrowings. The Company may obtain advances from the Federal Home Loan Bank of New York ("FHLBNY") to supplement its funding requirements. Such advances must be secured by a pledge of a portion of the Company's assets which may include securities, first mortgage loans and other collateral acceptable to the FHLBNY. The Company, if the need arises, may also access the FRB discount window to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The Company has additional secured borrowing capacity with the FRB of approximately $174.4 million and the FHLBNY of approximately $202.5 million, of which $0 and $61.4 million, respectively, was utilized as of December 31, 2012. As of December 31, 2012, the Company had $364.4 million and $180.7 million in loans and securities, respectively, pledged as collateral on secured borrowings. The Company has additional unsecured borrowing capacity through lines of credit with other financial institutions of approximately $55.0 million. For more information about the Company's borrowings, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Financial Condition—Borrowings" in the Annual Report, included herein as Exhibit 13.

Securities Sold Under Agreements to Repurchase. The Company has overnight repurchase agreements with customers as well as term repurchase agreements with the FHLBNY. The Company obtains funds through overnight repurchase agreements with customers pursuant to which the Company sells U.S. Treasury notes or securities issued or guaranteed by one of the government sponsored enterprises to customers under an agreement to repurchase them, at par, on the next business day. At December 31, 2012, the amount of securities under agreements to repurchase with customers totaled $2.0 million. In addition, the Company may obtain funds through term repurchase agreements with the FHLBNY. At December 31, 2012, the Company had no outstanding repurchase agreements with the FHLBNY. For more information regarding repurchase agreements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Financial Condition—Borrowings" and Note 13 of the Notes to Consolidated Financial Statements included in the Annual Report, included herein as Exhibit 13.

Fee Income Services

The Company offers an array of full-service banking capabilities through products and services designed to enhance the overall relationship with its customers.

Cash Management Services. The Company offers comprehensive cash management services designed to meet the more sophisticated needs of its commercial and small business customers. The Cash Management department offers additional products and services such as electronic banking, sweep accounts, lockbox services, internet banking, remote deposit and controlled disbursement services. Many of these services are provided through third-party vendors with links to the Company's data center.

Sun Financial Services. The Company's investment services division, in conjunction with its broker-dealer affiliation, offers experienced professionals that deliver a full range of products and services to meet the specific needs of the Company's customers. The products offered include insurance, annuities, mutual funds, securities and real estate investment trusts.

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Leasing. The Company has a relationship with a third-party to develop a referral program with lease financing products. Under this program, the third-party assists the Company in offering leasing products to its commercial customers. Leases are underwritten by the Company based on the creditworthiness of the Company's customer who is the lessee with the third-party being the lessor. A loan is made to the third-party leasing company on a non-recourse basis for the purchase of the asset being leased. The loan is secured by an assignment of the third-party's interest as lessor and by a lien on the asset being leased. The third-party makes an effective equity investment into each transaction for the balance of the total funded amount based on an accelerated repayment of the Company's loan. The third-party provides complete documentation services, portfolio administration and disposal or sale of equipment. Under the program, the Company can provide leases to its customers with minimal operating expense and no additional risk beyond normal underwriting.

Customer Derivatives. To accommodate customer needs, the Company also enters into financial derivative transactions primarily consisting of interest rate swaps. Market risk exposure from customer positions is managed through transactions with third-party dealers. The credit risk associated with derivatives executed with customers is essentially the same as that involved in extending loans and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer. The positions of customer derivatives are recorded at fair value and changes in value are included in non-interest income on the consolidated statement of operations.

Competition

The Company faces substantial competition in all phases of its operations. The banking business in the State of New Jersey is highly competitive. The State of New Jersey has a high density of financial institutions, many of which are branches of significantly larger institutions which have greater financial resources than the Company, all of which are competitors of the Company to varying degrees. In order to compete with the many financial institutions serving its primary market area, the Company's strategy is to focus on providing a superior level of personalized service to local businesses and individual customers.

The competition for deposits comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional and money center banks in the Company's market area. Competition for funds also includes a number of insurance products sold by local agents and investment products such as mutual funds and other securities sold by local and regional brokers.

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SUPERVISION AND REGULATION

Introduction

Bank holding companies and banks are extensively regulated under both federal and state law. The description of statutory provisions and regulations applicable to banking institutions and their holding companies set forth in this Form 10-K does not purport to be a complete description of such statutes and regulations and their effects on the Bank and the Company. The discussion is qualified in its entirety by reference to all particular statutory or regulatory provisions.

The Company is a legal entity separate and distinct from the Bank. Accordingly, the right of the Company, and consequently the right of creditors and shareholders of the Company, to participate in any distribution of the assets or earnings of the Bank is necessarily subject to the prior claims of creditors of the Bank, except to the extent that claims of the Company in its capacity as creditor may be recognized. The principal sources of the Company's revenue and cash flow are management fees and dividends from the Bank. There are legal limitations on the extent to which a subsidiary bank can finance or otherwise supply funds to its parent holding company.

Enforcement

OCC Agreement. On April 15, 2010, the Board of Directors of the Bank entered into an agreement with the OCC to develop and implement a profitability and capital plan that provides for the maintenance of adequate capital to support the Bank's risk profile in the current economic environment. The capital plan was also required to contain a dividend policy allowing dividends only if the Bank is in compliance with the capital plan, and obtains prior approval from the OCC. During the second quarter of 2010, the Company delivered its profit and capital plans to the OCC.

The Bank has also agreed to (i) adopt and implement a program to protect the Bank's interest in criticized or classified assets; (ii) review and revise the Bank's loan review program; (iii) adopt and implement a program for the maintenance of an adequate allowance for loan and lease losses; and (iv) revise the Bank's credit administration policies. The Bank also agreed that its brokered deposits will not exceed 3.5% of total deposits unless approved by the OCC. Effective October 18, 2012, the OCC approved an increase of this limit to 6.0%. Additional regulatory restrictions require prior OCC approval before appointing or changing the responsibilities of directors and senior executive officers, entering into any employment agreement or other agreement or plan providing for the payment of a "golden parachute payment" or the making of any golden parachute payment.

The Company

General. As a registered bank holding company, the Company is regulated under the Bank Holding Company Act of 1956 and is subject to supervision and regular inspection by the Federal Reserve.

Sarbanes Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 mandated significant reforms in various aspects of accounting and corporate governance and was intended to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of disclosure under federal securities laws. The Securities and Exchange Commission promulgated new regulations pursuant to the Sarbanes-Oxley Act and may continue to propose additional implementing or clarifying regulations as necessary. The cost of compliance with the Sarbanes-Oxley Act and corresponding regulations has increased and is expected to continue to affect the Company's non-interest expenses.

Financial Modernization. The Gramm-Leach-Bliley Act ("GLB") permits qualifying bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. GLB defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve has determined to be closely related to banking. A qualifying national bank also may engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development, and real estate investment, through a financial subsidiary of the bank.

Regulatory Capital Requirements. The Federal Reserve has adopted capital adequacy guidelines under which it assesses the adequacy of capital in examining and supervising bank holding companies, such as the Company and in processing applications to it under the Bank Holding Company Act. The Federal Reserve's capital adequacy guidelines are similar to those imposed on the Bank by the OCC. At December 31, 2012, the Company was in compliance with all applicable regulatory capital requirements. See Note 23 of the Notes to Consolidated Financial Statements included in the Annual Report, included herein as Exhibit 13. In addition, see "Proposed Changes to Regulatory Capital Requirements" below for further discussion of certain proposed new capital requirements which may apply to the Company and the Bank in the future.

Source of Strength Policy. Under the Dodd-Frank Act and Federal Reserve policy, a bank holding company is expected to serve as a source of financial strength to each of its subsidiary banks and to commit resources to support each such bank. Consistent with its "source of strength" policy for subsidiary banks, the Federal Reserve has stated that, as a matter of prudent banking, a bank holding company generally should not maintain a rate of cash dividends unless its net income available to common shareholders has been sufficient to fund fully the dividends, and the prospective rate of earnings retention appears to be consistent with the corporation's capital needs, asset quality and overall financial condition.

The Bank

General. The Bank is subject to supervision and examination by the OCC. In addition, the Bank is insured by and subject to certain regulations of the FDIC. The Bank is also subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types, amount and terms and conditions of loans that may be granted and limitations on the types of investments that may be made and the types of services that may be offered. Various consumer laws and regulations also affect the operations of the Bank.

Dividend Restrictions. Dividends from the Bank have historically constituted the principal source of income to the Company. However, as discussed in Note 23, the amount available for payment of dividends to the Company by the Bank was $0 at December 31, 2012. The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends to the Company. The OCC has the authority to prohibit the Bank from paying dividends, depending upon the Bank's financial condition, if such payment is deemed to constitute an unsafe or unsound practice. Further, pursuant to the terms of the OCC Agreement, the Bank may not pay any dividends if it is not in compliance with its approved capital plan or if the effect of the dividend would be to cause the Bank to not be in compliance and, in either event, not without prior OCC approval. As a result of the Bank's restricted dividend capacity, any proposed dividends from the Bank to the Company will be subject to regulatory approval until net income for the current year combined with the prior two years is sufficient. The Company believes it is capable of funding the interest obligation on its junior subordinated debenture interest obligations through available cash balances maintained at the Company for the period of time necessary until earnings are expected to support a dividend from the Bank.

Legal Lending Limits. The National Bank Act imposes restrictions on the amount of loans that a national bank can lend to one borrower. Based upon these legal lending limits, the Bank's total outstanding loans and extensions of credit to one borrower may not exceed 15% of the Bank's capital and surplus, plus an additional 10% for loans fully secured by readily marketable collateral, as such term is defined in the applicable regulation.

Affiliate Transaction Restrictions. The Bank is subject to federal laws that limit the transactions by a subsidiary bank to or on behalf of its parent company and to or on behalf of any nonbank subsidiaries. Such transactions by a subsidiary bank to its parent company or to any nonbank subsidiary are limited to 10% of a bank subsidiary's capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of such bank subsidiary's capital and surplus. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also prohibits banks from purchasing "low-quality" assets from affiliates.

Insurance of Deposit Accounts. The Bank's deposits are insured to applicable limits by the FDIC. Pursuant to the Dodd-Frank Act, the Federal Deposit Insurance Act was amended to increase the maximum deposit insurance amount from $100 thousand to $250 thousand and extended the unlimited deposit insurance coverage for noninterest-bearing transaction accounts until December 31, 2012, at which time the extension expired. Upon expiration, these types of deposits were only insured up to the same $250 thousand limit as other types of deposit accounts.

The Bank is subject to deposit insurance assessments by the FDIC pursuant to its regulations establishing a risk-related deposit insurance assessment system, based on the institution's capital levels and risk profile. Under the FDIC's risk-based assessment system, insured institutions are assigned to one of four risk-weighted categories based on supervisory evaluations, regulatory capital levels, and certain other factors with less risky institutions paying lower assessments. An institution's initial assessment rate depends upon the category to which it is assigned. There are also adjustments to a bank's initial assessment rates based on levels of long-term unsecured debt, secured liabilities in excess of 25% of domestic deposits and, for certain institutions, brokered deposit levels. Under the rules in effect through March 31, 2011, initial assessments ranged from 12 to 45 basis points of assessable deposits. However, pursuant to FDIC rules adopted under the Dodd-Frank Act (described below), effective April 1, 2011, initial assessments ranged from five to 35 basis points of the institution's total assets minus its tangible equity. The Bank paid deposit insurance assessments of $3.9 million during the year ended December 31, 2012. For 2012, the deposit insurance assessment rate before applying one time credits was approximately 0.139% of insured deposits. No institution may pay a dividend if it is in default of the federal deposit insurance assessment.

On December 30, 2009, banks were required to pay the fourth quarter assessment and to prepay estimated insurance assessments for the years 2010 through 2012. The pre-payment did not affect the Bank's earnings on that date. The Bank paid an aggregate of $19.5 million in premiums on December 30, 2009, $18.3 million of which constituted prepaid premiums. At December 31, 2012, the remaining balance of the prepaid assessment was $2.6 million.

Under the Dodd-Frank Act, the assessment base for deposit insurance premiums changed from adjusted domestic deposits to average consolidated total assets minus average tangible equity. Tangible equity for this purpose means Tier 1 capital. Since this is a larger base than adjusted domestic deposits, assessment rates are expected to be lower. In February 2011, the FDIC approved a new rule effective April 1, 2011 which implemented these changes. The new rule includes new rate schedules scaled to the increase in the assessment base, including schedules that will go into effect when the reserve ratio reaches 1.15%, 2%, and 2.5%. The FDIC staff projected that the new rate schedules would be approximately revenue neutral. The schedule would reduce the initial base assessment rate in each of the four risk-based pricing categories. For small Risk category I banks, the rates would range from five to nine basis points. The proposed rates for small institutions in Risk Categories II, III and IV would be 14, 23 and 35 basis points, respectively. For large institutions and large, highly complex institutions, the proposed rate schedule ranges from five to 35 basis points. There are also adjustments made to the initial assessment rates based on long-term unsecured debt, depository institution debt, and brokered deposits. The FDIC also revised the assessment system for large depository institutions with over $10 billion in assets.

In addition to risk-based deposit insurance premiums, additional assessments may be imposed by the Financing Corporation ("FICO"), a separate U.S. government agency affiliated with the FDIC, on insured deposits to pay for the interest cost of FICO bonds. FICO assessment rates for 2012 ranged from $.0066 to $.0068 for each $100 of deposits.

Under federal law, deposits and certain claims for administrative expenses and employee compensation against an insured depository institution are afforded a priority over other general unsecured claims against such an institution, including federal funds and letters of credit, in the liquidation or other resolution of such an institution by any receiver appointed by regulatory authorities. Such priority creditors would include the FDIC.

Regulatory Capital Requirements. The OCC has promulgated capital adequacy requirements for national banks. The OCC's capital regulations establish a minimum leverage ratio (Tier 1 capital to total adjusted average assets) of 3% for highly rated national banks meeting certain criteria, including that such banks have the highest regulatory examination rating and are not contemplating or experiencing significant growth. Banks not meeting these criteria are required to maintain a leverage ratio that exceeds the 3% minimum by at least 100 to 200 basis points. Tier 1, or core, capital is defined as the sum of common stockholders' equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain mortgage and non-mortgage servicing assets and purchased credit card relationships.

The OCC's regulations also require that national banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of total capital (which is defined as Tier 1 capital and supplementary (Tier 2) capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the OCC believes are inherent in the type of asset or item. The components of Tier 1 capital for the risk-based standards are the same as those for the leverage capital requirement. The components of supplementary (Tier 2) capital include cumulative perpetual preferred stock, mandatory subordinated debt, perpetual subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on equity securities and a bank's allowance for loan and lease losses, subject to certain limitations. Overall, the amount of supplementary capital that may be included in total capital is limited to 100% of Tier 1 capital.

The OCC may, in addition, establish higher capital requirements than those set forth in its capital regulations when particular circumstances warrant. Pursuant to this authority, the OCC established individual minimum capital requirements for the Bank to continue to maintain a Leverage ratio at least equal to 8.50% of adjusted total assets, to continue to maintain a Tier 1 Capital ratio at least equal to 9.50% of risk-weighted assets and to achieve by June 30, 2010 and thereafter maintain a Total Capital ratio at least equal to 11.50% of risk-weighted assets. Under the federal banking laws, failure to meet the minimum regulatory capital requirements could subject a bank to a variety of enforcement remedies available to federal bank regulatory agencies. At December 31, 2012, the Bank's capital ratios exceeded all of the OCC's regulatory capital requirements as well as these individual minimum capital requirements. See Note 23 of the Notes to Consolidated Financial Statements included in the Annual Report, included herein as Exhibit 13.

In addition, see “Proposed Changes to Regulatory Capital Requirements” below for further discussion of certain proposed new capital requirements which may apply to the Company and the Bank in the future.

Enforcement Powers of Federal Banking Agencies. Federal banking agencies possess broad powers to make corrective and other supervisory action as deemed appropriate for an insured depository institution and its holding company. The extent of these powers depends on whether the institution in question is considered “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized.” At December 31, 2012, the Bank exceeded the required ratios for classification as “well capitalized,” although due to the fact that it was subject to the OCC Agreement, it cannot be deemed “well capitalized.” The classification of depository institutions is primarily for the purpose of applying the federal banking agencies’ prompt corrective action and other supervisory powers and is not intended to be, and should not be interpreted as, a representation of the overall financial condition or prospects of any financial institution.

Under the OCC’s prompt corrective action regulations, the OCC is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution’s degree of undercapitalization. Generally, a bank is considered “well capitalized” if its ratio of total capital to risk-weighted assets is at least 10%, its ratio of Tier 1 (core) capital to risk-weighted assets is at least 6%, its ratio of core capital to total assets is at least 5%, and it is not subject to any order or directive by the OCC to meet a specific capital level. A bank generally is considered “adequately capitalized” if its ratio of total capital to risk-weighted assets is at least 8%, its ratio of Tier 1 (core) capital to risk-weighted assets is at least 4%, and its ratio of core capital to total assets is at least 4% (3% if the institution receives the highest CAMELS rating). A bank that has lower ratios of capital is categorized as “undercapitalized,” “significantly undercapitalized,” or “critically undercapitalized.” Numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion.

The OCC’s prompt corrective action powers can include, among other things, requiring an insured depository institution to adopt a capital restoration plan which cannot be approved unless guaranteed by the institution’s parent company; placing limits on asset growth and restrictions on activities; including restrictions on transactions with affiliates; restricting the interest rate the institution may pay on deposits; prohibiting the payment of principal or interest on subordinated debt; prohibiting the bank from making capital distributions without prior regulatory approval and, ultimately, appointing a receiver for the institution. In addition, only a “well capitalized” depository institution may accept brokered deposits without prior regulatory approval and only an “adequately capitalized” depository institution may accept brokered deposits with prior regulatory approval. The OCC could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors.

Proposed Changes to Regulatory Capital Requirements

The federal banking agencies have proposed rules that would substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The proposed rules implement the reforms and changes required by the Dodd-Frank Act and conform the regulatory capital rules to the international regulatory standards agreed to by the Basel Committee on Banking Supervision in the accord often referred to as “Basel III.” The proposed revisions would establish new higher capital ratio requirements, tighten the definitions of capital, impose new operating restrictions on banking organizations with insufficient capital buffers and increase the risk weighting of certain assets including residential mortgages. The proposed new capital requirements would apply to all banks and savings associations, bank holding companies with more than $500 million in assets and all savings and loan holding companies regardless of asset size. The following discussion summarizes the proposed changes which are most likely to affect the Company and the Bank.

New and Higher Capital Requirements. The proposed regulations would establish a new capital measure called “Common Equity Tier 1 Capital,” which would consist of common stock instruments and related surplus (net of treasury stock), retained earnings, accumulated other comprehensive income and, subject to certain adjustments, minority common equity interests in subsidiaries. Unlike the current rules, which exclude unrealized gains and losses on available-for-sale debt securities from regulatory capital, the proposed rules would generally require accumulated other comprehensive income to flow through to regulatory capital. Depository institutions and their holding companies would be required to maintain Common Equity Tier 1 Capital equal to 4.5% of risk-weighted assets by 2015.

The proposed regulations would increase the required ratio of Tier 1 Capital to risk-weighted assets from the current 4% to 6% by 2015. Tier 1 Capital would consist of Common Equity Tier 1 Capital plus Additional Tier 1 Capital elements which would include non-cumulative perpetual preferred stock. Neither cumulative preferred stock (other than cumulative preferred stock issued to the U.S. Treasury under the TARP Capital Purchase Program or the Small Business Lending Fund) nor trust preferred would qualify as Additional Tier 1 Capital. These elements, however, could be included in Tier 2 Capital which could also include qualifying subordinated debt. The proposed regulations would also require a minimum Tier 1 leverage ratio of 4% for all institutions eliminating the 3% option for institutions with the highest supervisory ratings. The minimum required ratio of total capital to risk-weighted assets would remain at 8%.

Capital Buffer Requirement. In addition to higher capital requirements, depository institutions and their holding companies would be required to maintain a capital buffer of at least 2.5% of risk-weighted assets over and above the minimum risk-based capital requirements. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement would be phased in over four years beginning in 2016. The capital buffer requirement effectively raises the minimum required risk-based capital ratios to 7% Common Equity Tier 1 Capital, 8.5% Tier 1 Capital and 10.5% Total Capital on a fully phased-in basis.

Changes to Prompt Corrective Action Capital Categories. The prompt corrective action rules adopted by the federal banking agencies under the Federal Deposit Insurance Corporation Improvement Act of 1991 would be amended to incorporate a Common Equity Tier 1 Capital requirement and to raise the capital requirements for certain capital categories. In order to be adequately capitalized for purposes of the prompt corrective action rules, a banking organization would be required to have at least an 8% Total Risk-Based Capital Ratio, a 6% Tier 1 Risk-Based Capital Ratio, a 4.5% Common Equity Tier 1 Risk Based Capital Ratio and a 4% Tier 1 Leverage Ratio. To be well capitalized, a banking organization would be required to have at least a 10% Total Risk-Based Capital Ratio, an 8% Tier 1 Risk-Based Capital Ratio, a 6.5% Common Equity Tier 1 Risk Based Capital Ratio and a 5% Tier 1 Leverage Ratio.

Additional Deductions from Capital. Banking organizations would be required to deduct goodwill and other intangible assets (other than certain mortgage servicing assets), net of associated deferred tax liabilities, from Common Equity Tier 1 Capital. Deferred tax assets arising from temporary timing differences that could not be realized through net operating loss carrybacks would continue to be deducted if they exceed 10% of Common Equity Tier 1 Capital. Deferred tax assets that could be realized through NOL carrybacks would not be deducted but would be subject to 100% risk weighting. Defined benefit pension fund assets, net of any associated deferred tax liability, would be deducted from Common Equity Tier 1 Capital unless the banking organization has unrestricted and unfettered access to such assets. Reciprocal cross-holdings in the capital instruments of any other financial institution would now be deducted from capital, not just holdings in other depository institutions. For this purpose, financial institutions are broadly defined to include securities and commodities firms, hedge and private equity funds and non-depository lenders. Banking organizations would also be required to deduct non-significant investments (less than 10% of outstanding stock) in other financial institutions to the extent these exceed 10% of Common Equity Tier 1 Capital subject to a 15% of Common Equity Tier 1 Capital cap. Greater than 10% investments must be deducted if they exceed 10% of Common Equity Tier 1 Capital. If the aggregate amount of certain items excluded from capital deduction due to a 10% threshold exceeds 17.65% of Common Equity Tier 1 Capital, the excess must be deducted.

Changes in Risk-Weightings. The proposed regulations would apply a 250% risk-weighting to mortgage servicing rights, deferred tax assets that cannot be realized through NOL carrybacks and significant (greater than 10%) investments in other financial institutions. The proposed rules would also significantly change the risk-weighting for residential mortgages. Current capital rules assign a 50% risk-weighting to “qualifying mortgage loans” which generally consist of residential first mortgages with an 80% loan-to-value ratio (or which carry mortgage insurance that reduces the bank’s exposure to 80%) that are not more than 90 days past due. All other mortgage loans have a 100% risk weight. Under the proposed regulations, one-to-four family residential mortgage loans would be divided into two broad risk categories with their risk-weighting determined by their loan-to-value ratio without regard to mortgage insurance. Prudently underwritten 30-year residential mortgages providing for regular periodic payments that do not result in negative amortization or balloon payments or allow payment deferrals and caps on annual and lifetime interest rate adjustments and which are not more than 90 days past due would be assigned a risk weighting from 35% for loans with a 60% or lower loan-to-value ratio to 100% for loans over 90%. Residential mortgage loans in this category with a loan-to-value ratio greater than 60% but not more than 80% would continue to carry a 50% risk weighting. All other residential mortgage loans would be risk-weighted between 100% and 200%. The proposal also creates a new 150% risk-weighting category for “high volatility commercial real estate loans” which are credit facilities for the acquisition, construction or development of real property other than one-to four-family residential properties or commercial real estate projects where: (i) the loan-to-value ratio is not in excess of interagency real estate lending standards; and (ii) the borrower has contributed capital equal to not less than 15% of the real estate’s “as completed” value before the loan was made.

Item 1A. Risk Factors.

The following is a summary of the material risks related to our business and an investment in the Company’s securities.

Risks Related to Our Business

We may be unable to satisfy the written agreement with the OCC which requires us to designate a significant amount of resources in order to remain in compliance.

On April 15, 2010, the Bank entered into the OCC Agreement. The OCC Agreement requires the Bank to take certain actions, including, but not limited to:

- Establishing and submitting to the OCC a written capital plan, covering at least a three-year period providing for the maintenance of adequate capital to support the Bank's risk profile and containing a dividend policy allowing dividends only if the Bank is in compliance with its capital plan and obtains the prior approval of the OCC;
- Implementing a program to protect the Bank's interest in criticized or classified assets;
- Reviewing and revising the Bank's loan review program;
- Revising the Bank's credit administration policies; and
- Limiting the Bank's brokered deposits to not more than 3.5% of total deposits without the prior approval of the OCC; subsequently amended to 6.0% as of October 18, 2012.

During the second quarter of fiscal 2010, we delivered the profit and capital plans to the OCC, and revised and implemented changes to our credit policies and procedures pursuant to the OCC Agreement. The OCC has established individual minimum capital ratio requirements of the Bank, which were to be achieved by June 30, 2010, and thereafter maintained. At December 31, 2012, the Bank met the individual minimum capital requirements as its Leverage ratio was 9.24%, its Tier 1 Capital ratio was 11.76%, and its Total Capital ratio was 13.02%.

While we are subject to the OCC Agreement, our management and board of directors will continue to be required to focus considerable time and attention on taking corrective actions to comply with its terms. There also is no assurance that we will successfully address the OCC's concerns in the OCC Agreement or that we will be able to fully comply with the OCC Agreement. If we do not fully comply with the OCC Agreement, the Bank, as well as its officers and directors could be subject to further regulatory enforcement actions, including administrative sanctions and civil money penalties.

The OCC Agreement's limitation on brokered deposits could impact our liquidity.

Per the terms of the OCC Agreement, brokered deposits may not exceed 3.5% of total liabilities without the prior approval of the OCC. Effective October 18, 2012, the OCC approved an increase of this limit to 6.0%. At December 31, 2012, brokered deposits represented 4.0% of total liabilities. We have historically used brokered deposits as part of our liquidity strategy and to supplement other funding sources such as customer deposits, federal funds and FHLB advances. This restriction may limit our potential sources of liquidity in the future.

Our agreement not to take dividends from the Bank without prior regulatory approval could impact our liquidity and debt service capability.

In October 2011, our Board of Directors resolved not to accept any dividends from the Bank without the prior approval of the Federal Reserve. Under the OCC Agreement, the Bank cannot pay a dividend without prior OCC approval. Dividends from the Bank have historically been our primary source of revenue. While we maintain certain liquid assets at the Company level, we also have debt service obligations on the subordinated debentures we have issued. While we believe we are capable of funding the interest obligation on our junior subordinated debentures through available cash balances, the absence of dividends from the Bank may restrict our ability to service our debt at the Company level.

We have incurred significant losses and cannot assure you that we will be profitable in the near term or at all.

We have incurred losses over the past few years, including net losses of approximately $50.5 million, $67.5 million, and $185.4 million for the fiscal years ended December 31, 2012, 2011, and 2010, respectively, primarily due to credit costs, including significant provisions for loan and lease losses in 2012 and 2011 and write-down of our goodwill and our deferred tax assets in fiscal 2010. Although we have taken a number of steps to reduce our credit exposure, at December 31, 2012, we had approximately $103.1 million in nonperforming assets and it is possible that we will continue to incur elevated credit costs over the near term, which would adversely impact our overall financial performance and results of operations. We cannot assure you that we will return to profitability in the near term or at all.

Increases in nonperforming assets will have an adverse effect on our financial condition and results of operations.

Our nonperforming assets (which consist of nonaccrual loans, assets acquired through foreclosure and troubled debt restructurings), totaled $103.1 million at December 31, 2012, which is a decrease of $9.6 million, or 8.5%, from the $112.7 million in nonperforming assets at December 31, 2011 and a decrease of $74.6 million, or 42.0%, over the $177.7 million in non-performing assets at December 31, 2010. Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans and assets acquired through foreclosure. We must establish an allowance for loan losses that reserves for losses inherent in the loan portfolio that are both probable and reasonably estimable through current period provisions for loan losses. From time to time, we also write down the value of properties in our portfolio of assets acquired through foreclosure to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to assets acquired through foreclosure. The resolution of nonperforming assets requires the active involvement of management, which can distract management from its overall supervision of operations and other income producing activities. Finally, if our estimate of the allowance for loan losses is inadequate, we will have to increase the allowance for loan losses accordingly, which will have an adverse effect on financial condition and results of operations.

We may sell a portion of our commercial real estate and industrial loan portfolios at a significant loss.

In February 2013, we sold $43.1 million of primarily non-performing commercial real estate loans, having a book balance of $33.5 million to a third-party investor for gross proceeds of $20.9 million. In May 2011, we sold $174.3 million of primarily non-performing commercial real estate loans with a book balance of $159.8 million, for a net loss of $44.3 million.

We continue to evaluate other potential sales of criticized and classified assets. In our evaluation process, management analyzes, among other things, factors surrounding the borrower, the borrower's business operation, the economy and industry specifics. A sale of all or a portion of such loans, after accounting for loan loss reserves, could result in a significant loss. Such sale could also result in significant dilution to our tangible book value per share. We may evaluate potential loan sales to strategic buyers or rehabilitate relationships through troubled debt restructuring. Selling or restructuring loans below their net book or carrying value will result in additional charge-offs and net losses on the sale of such loans, as well as dilution to our tangible book value per share, which will materially adversely affect our results of operations and financial condition. As we evaluate all of these options, we are mindful and continue to balance the strengthening of our asset quality with the potential impact on book value, diluting book value and maintaining prudent tangible equity to assets ratios. We cannot estimate with certainty the willingness of potential buyers to purchase our loans or the amounts such buyers will be willing to pay for such loans. Accordingly, there can be no assurance that we can complete the sale of loans or that the net losses to operations we may incur from such sale will not be significant.

The current economic and banking environments pose significant challenges for us and could adversely affect our financial condition and results of operations.

Currently, the U.S. economy appears to be slowly recovering from one of its longest and most severe economic recessions in recent history. It is not clear at this time how quickly the economy will recover and whether regulatory and legislative efforts to stimulate job growth and spending will be successful. In addition, although there have been some signs of improvement, the U.S. housing market continues to struggle from the effects of home price depreciation, elevated foreclosures, and high levels of unemployment. The values of real estate collateral supporting many loans have declined and may continue to decline. Further declines in real estate values, home sales volumes, as well as financial stress on borrowers as a result of the uncertain economic environment could have an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations.

General downward economic trends, reduced availability of commercial credit and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Further concerns over the stability of the financial markets, the banking system and the economy have resulted in decreased lending by financial institutions to their customers and to each other. This market turmoil and tightening of credit has led to increased commercial and consumer deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. Competition among depository institutions for deposits has increased significantly. Financial institutions have experienced decreased access to deposits or borrowings. The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition, results of operations, cash flows and stock price. We do not expect that the difficult market conditions will significantly improve in the near future. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in our industry. In particular, we may face the following risks in connection with these events:

- Economic conditions that negatively affect housing prices and the job market may continue to result in a deterioration in credit quality of our loan portfolios, and such deterioration in credit quality could continue to have, a negative impact on our business;
- Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies, foreclosures, customer bankruptcies and default rates on loans and other credit facilities;

- The methodologies that we use to establish our allowance for loan losses may no longer be reliable because they rely on complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation;
- Continued turmoil in the market, and loss of confidence in the banking system, could require the Bank to pay higher interest rates to obtain deposits to meet the needs of its depositors and borrowers, resulting in reduced margin and net interest income.
- If conditions worsen significantly, it is possible that banks such as the Bank may be unable to meet the needs of their depositors and borrowers, which could, in the worst case, result in the Bank being placed into receivership;
- Compliance with increased regulation of the banking industry (and possible additional regulatory actions against us) may increase our costs, limit our ability to pursue business opportunities, and divert management efforts.
- Our ability to assess the creditworthiness of customers and to estimate the losses inherent in our credit exposure is made more complex by these difficult market and economic conditions;
- Our ability to borrow from other financial institutions or the FHLBNY on favorable terms or at all could be adversely affected by further disruptions in the capital markets or other events; and
- We may experience a decrease in dividend income from our investment in FHLBNY stock.

As these conditions or similar ones continue to exist or worsen, we may experience continuing or increased adverse effects on our financial condition and results of operations.

The Dodd-Frank Act may significantly affect our business and results of operations.

On July 21, 2010, the President signed the Dodd-Frank Act into law. This legislation makes extensive changes to the laws regulating financial services firms and requires significant rule-making. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on our operations is unclear.

The Dodd-Frank Act created a new, independent federal agency called the Consumer Financial Protection Bureau, (the "Bureau"). The Bureau is granted rulemaking authority over several federal consumer financial protection laws and, in some instances, has the authority to examine and enforce compliance with these laws and regulations. In addition, on July 27, 2012, the FRB adopted a rule addressing interchange fees for debit card transactions. The rule became effective on October 1, 2012 and is expected to lower fee income generated from this source. Although this rule technically only applies to institutions with assets in excess of $10 billion, market forces are likely to drive business to the lowest cost option and community banks are expected to feel the impact. As a result of this rule change, merchants, particularly, big box retailers, have an incentive to encourage consumers to use only debit cards offered by larger banks, which may prompt them to move their checking accounts to the larger banks.

The Dodd-Frank Act also permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and permits state attorneys general to, in certain circumstances, enforce compliance with both the state and federal laws and regulations. Federal preemption of state law requirements, traditionally a component of the Bank's national bank charter, has also been modified by the Dodd-Frank Act and now requires a case-by-case determination of preemption by the OCC and eliminates preemption for subsidiaries of the Bank. Depending on the implementation of this revised federal preemption standard, the operations of the Bank could become subject to additional compliance burdens in the states in which it operates.

We may be required to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements under the Dodd-Frank Act. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to our investors.

Our residential mortgage banking operations expose us to risks that are different from community banking.

The Bank's residential mortgage banking operations expose us to risks that are different from our retail banking operations. Our mortgage banking operations are dependent upon the level of demand for residential mortgages. During higher and rising interest rate environments, the level of refinancing activity tends to decline, which can lead to reduced volumes of business and lower revenues than currently recognized and that may not exceed our fixed costs to run the business. In addition, mortgages sold to third-party investors are typically subject to certain repurchase provisions related to borrower refinancing, defaults, fraud or other reasons stipulated in the applicable third-party investor agreements. If the fair value of a loan when repurchased is less than the fair value when sold, the Bank may be required to charge such shortfall to earnings.

In addition, the Bank has made in the past, and may make in the future, residential mortgage loans that do not qualify as "Qualified Mortgage Loans" under the Dodd-Frank Act and the mortgage regulations recently issued by the Bureau. The Dodd-Frank Act imposes new obligations on originators of residential mortgage loans, such as the Bank. Among other things, the Dodd-Frank Act requires originators to make a reasonable and good faith determination based on documented information that a borrower has a reasonable ability to repay a particular mortgage loan over the long term. If the originator cannot meet this standard, the loan may be unenforceable in foreclosure proceedings. The Dodd Frank Act contains an exception from this ability to repay rule for "qualified mortgages," which are deemed to satisfy the rule; however, it did not define the term, and left authority to the Bureau to adopt a definition. A rule issued by the Bureau in January 2013, and effective January 10, 2014, sets forth specific underwriting criteria for a loan to qualify as a Qualified Mortgage Loan. The criteria generally exclude loans that are interest-only, have excessive upfront points or fees, have negative amortization features or balloon payments, or have terms in excess of 30 years. The underwriting criteria also impose a maximum debt to income ratio of 43%. If a loan meets these criteria and is not a "higher priced loan" as defined in regulations of the FRB, the Bureau rule establishes a safe harbor that prevents a borrower from asserting as a defense to foreclosure the failure of the originator to establish the borrower's ability to repay. To the extent the Bank's residential mortgage loans do not qualify for the Bureau rules' safe harbor, such loans may expose the Bank and the Company to greater losses, or litigation related expenses and delays in taking title to collateral real estate, if these loans do not perform and borrowers challenge whether the Bank satisfied the ability to repay rule on originating the loan.

The repeal of federal prohibitions on the payment of interest on demand deposits could increase our interest expense and reduce our net interest margin.

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, beginning on July 21, 2011, financial institutions could commence offering interest on demand deposits to compete for clients. We do not know what interest rates or products other institutions may offer. Our interest expense could increase and our net interest margin could decrease if we begin offering interest on demand deposits to attract additional customers or maintain current customers. Consequently, our business, financial condition or results of operations could be adversely affected.

The short-term and long-term impact of the changing regulatory capital requirements and anticipated new capital rules is uncertain.

The federal banking agencies have proposed rules that would substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The proposed rules implement the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. The proposed rules include new minimum risk-based capital and leverage ratios, which would be phased in during 2013 and 2014, and would refine the definition of what constitutes “capital” for purposes of calculating those ratios. The proposed new minimum capital level requirements applicable to the Company and the Bank would include: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The proposed rules would also establish a “capital conservation buffer” of 2.5% above the new regulatory minimum capital ratios, and would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement would be phased in beginning in January 2016 at 0.625% of risk-weighted assets and would increase each year until fully implemented in January 2019. An institution would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations would establish a maximum percentage of eligible retained income that could be utilized for such actions. While the proposed Basel III changes and other regulatory capital requirements will likely result in generally higher regulatory capital standards, it is difficult at this time to predict when or how any new standards will ultimately be applied to the Company and the Bank.

The application of more stringent capital requirements to the Company and the Bank could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying out dividends or buying back shares.

The occurrence of various events may adversely affect our ability to fully utilize net operating losses or recover our deferred tax asset.

We have experienced and may continue to experience substantial operating losses. Under Section 382 (“Section 382”) of the Internal Revenue Code, as amended (the “Code”), and rules promulgated by the Internal Revenue Service, we may “carry forward” our net operating losses (“NOLs”) in certain circumstances to offset any current and future earnings and thus reduce our federal income tax liability, subject to certain requirements and restrictions. To the extent that the NOLs do not otherwise become limited, we believe that we will be able to carry forward a significant amount of the NOLs, and therefore these NOLs could be a substantial asset to us. If, however, we experience a Section 382 ownership change, our ability to use the NOLs may be substantially limited, and the timing of the usage of the NOLs could be substantially delayed, which could therefore significantly impair the value of that asset.

In general, an ownership change occurs when, as of any testing date, the percentage of stock of a corporation owned by one or more “5-percent shareholders” as defined in Section 382 and the related Treasury Regulations, has increased by more than 50 percentage points over the lowest percentage of stock of the corporation owned by such shareholder at any time during the three year period preceding such date. In general, persons who own 5% or more of a corporation’s stock are 5-percent shareholders, and all other persons who own less than 5% of a corporation’s stock are treated, together, as a single, public group 5-percent shareholder, regardless of whether they own an aggregate of 5% or more of a corporation’s stock. However, U.S. Treasury regulations provide circumstances which result in multiple public group 5-percent shareholders. If a corporation experiences an ownership change, it is generally subject to an annual limitation in the use of NOLs, which limits its ability to use its NOLs to an amount equal to the equity value of the corporation multiplied by the federal long-term tax-exempt rate.

If we were to experience an ownership change, we could potentially have, in the future, higher United States federal income tax liabilities than we would otherwise have had and it may also result in certain other adverse tax consequences to us.

In the third quarter of 2010, we recorded a valuation allowance of $49.9 million against our entire deferred tax asset due to a sustained period of quarterly losses. The valuation allowance had a negative impact on earnings and capital. At December 31, 2012, the Company had a valuation allowance of $113.4 million against its deferred tax asset. The release of this valuation allowance would have a positive impact on earnings and capital but is dependent on our ability to provide positive evidence of a return to sustained profitability. There can be no assurance as to when we could be in a position to recapture the benefits of our deferred tax asset.

Governmental regulation and regulatory actions against us may impair our operations or restrict our growth.

We are subject to significant governmental supervision and regulation. These regulations are intended primarily for the protection of depositors. Statutes and regulations affecting our business may be changed at any time and the interpretation of these statutes and regulations by examining authorities may also change. Within the last several years, Congress and the President have passed and enacted significant changes to these statutes and regulations. There can be no assurance that such changes to the statutes and regulations or to their interpretation will not adversely affect our business. In addition to governmental supervision and regulation, we are subject to changes in other federal and state laws, including changes in tax laws, which could materially affect the banking industry. We are subject to the rules and regulations of the FRB and the OCC. If we fail to comply with federal bank regulations, the regulators may limit our activities or growth, fine us or ultimately put us out of business. Banking laws and regulations change from time to time. Bank regulations can hinder our ability to compete with financial services companies that are not regulated in the same manner or are less regulated. Federal and state bank regulatory agencies regulate many aspects of our operations. These areas include:

- The capital that must be maintained;
- The kinds of activities that we can engage in;
- The kinds and amounts of investments that we can make;
- The locations of our offices;
- Insurance of deposits and the premiums that we must pay for this insurance; and
- How much cash we must set aside as reserves for deposits.

In addition, we are subject to other federal and state laws and regulations regarding corporate governance and permissible business activities, processing of Federal Housing Authority (“FHA”) insured mortgage loans, acquisition and merger restrictions, limitations on intercompany transactions, capital adequacy requirements and requirements for anti-money laundering programs and other compliance matters. These regulations are also designed primarily for the protection of the deposit insurance funds and consumers, but not for the benefit of our shareholders. Financial institution regulation has been the subject of significant legislation in recent years and may continue to be the subject of further significant legislation in the future, which is not in our control. Significant new laws, or changes to existing laws, could have a material adverse effect on our business, financial condition, results of operations and cash flows. Overall compliance with the regulation increases our operating expenses, requires a significant amount of management’s attention and could be a competitive disadvantage with respect to non-regulated competitors.

In addition, due to the ongoing economic downturn and the resultant deterioration in the real estate markets and adverse impact on our loan portfolio and financial results, we may be the subject of additional regulatory actions in the future and face further limitations on our business, which would impair our operations and restrict our growth. If we fail to meet any regulatory capital requirement or are otherwise deemed to be operating in an unsafe and unsound manner or in violation of law, we may be subject to a variety of informal or formal remedial measures and enforcement actions, in addition to the OCC Agreement and individual minimum capital ratios currently imposed on us by the OCC. Such informal remedial measures and enforcement actions may include a memorandum of understanding, which is initiated by the regulator and outlines an institution’s agreement to take specified actions within specified time periods to correct violations of law or unsafe and unsound practices. In addition, as part of our regular examination process, regulators may advise us to operate under various restrictions as a prudential matter. Any of these restrictions, in whatever manner imposed, could have a material adverse effect on our business, financial condition and results of operations.

In addition to informal remedial actions, we may be subject to additional formal enforcement actions beyond those to which we are currently subject. Formal enforcement actions include written agreements, cease and desist orders, the imposition of substantial fines and other civil penalties and, in the most severe cases, the termination of deposit insurance or the appointment of a conservator or receiver. Furthermore, if the Bank fails to meet any regulatory capital requirement, it will be subject to the prompt corrective action framework of the Federal Deposit Insurance Corporation Improvements Act of 1991, which imposes progressively more restrictive constraints on operations, management and capital distributions as the capital category of an institution declines, up to and including ultimately, the appointment of a conservator or receiver. A failure to meet regulatory capital requirements could also subject us to capital raising requirements. Possible enforcement actions against us could include the issuance of a cease-and-desist order that could be judicially enforced, the imposition of civil monetary penalties, the issuance of directives to increase capital or to enter into a strategic transaction, whether by merger or otherwise, with a third party, the appointment of a conservator or receiver, the termination of insurance of deposits, the issuance of removal and prohibition orders against institution-affiliated parties, and the enforcement of such actions through injunctions or restraining orders. Any remedial measure or enforcement action, whether formal or informal, could impose restrictions on our ability to operate our business and adversely affect our prospects, financial condition or results of operations. In addition, any formal enforcement action could harm our reputation and our ability to retain and attract customers and impact the trading price of our common stock.

If we fail to maintain our FHA license, our ability to issue FHA-insured mortgages and our results of operations could be adversely affected.

We are licensed by the FHA, an agency within the Department of Housing and Urban Development, to process single-family mortgages that are backed by FHA insurance. If we fail to maintain proper FHA licensure, we would lose access to a portion of the mortgage market, and our mortgage business would be adversely affected. In addition, our FHA-insured mortgage loans are typically sold to investors with recourse upon the occurrence of such events. If any such event occurred, we may be required to repurchase mortgage loans from investors.

We may be required to pay significantly higher FDIC premiums, special assessments or taxes that could adversely affect our results of operations.

Market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. As a result, we may be required to pay significantly higher premiums or additional special assessments or taxes that could adversely affect our results of operations. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay even higher FDIC premiums than the levels imposed in 2012. These increases and any future increases or required prepayments in FDIC insurance premiums or taxes may materially adversely affect our results of operations.

Concerns of Customers over Deposit Insurance May Cause a Decrease in Deposits.

With recent regulation changes, customers increasingly are concerned about the extent to which their deposits are insured by the FDIC. Customers may withdraw deposits in an effort to ensure that the amount they have on deposit with their bank is fully insured. Unlimited deposit insurance coverage on non-interest-bearing transaction accounts expired on December 31, 2012. Upon expiration, these types of deposits were only insured up to the same $250 thousand limit as other types of deposit accounts. It is possible that upon the expiration of unlimited deposit insurance coverage, we will experience a decrease in our transaction account balances due to deposit insurance concerns. To the extent these deposits are replaced by other types of deposits, our interest expense may increase.

The market value of our securities portfolio may be impacted by the level of interest rates and the credit quality and strength of the underlying issuers.

If a decline in market value of a security is determined to be other-than-temporary, under accounting principles generally accepted in the United States of America, we are required to write these securities down to their estimated fair value through a charge to earnings. At December 31, 2012, we owned one non-rated single issuer trust preferred security classified as available for sale with an amortized cost of $3.8 million and an estimated fair value of $1.9 million on which we were required to recognize a credit-related impairment loss of $0 and $250 thousand in 2012 and 2011, respectively. The cumulative other-than-temporary impairment on this security is $1.2 million as of December 31, 2012. We perform an ongoing analysis of this security. Future changes in interest rates or the credit quality and strength of the underlying issuers may reduce the market value of this and other securities we own from time to time.

We are, through the Bank, a member of the FHLBNY, and are required to maintain an investment in shares of its capital stock, which are restricted in that they can only be redeemed by the issuer at par value. On January 8, 2009, Moody's Global Banking issued a report stating the potential for a significant other-than-temporary impairment ("OTTI") charge on private label mortgage-backed securities held by the Federal Home Loan Banks ("FHLBanks"). Of the 12 regional FHLBanks, capital levels for eight of these banks would be in jeopardy of meeting minimum regulatory capital requirements under a "worst-case" scenario that assumes all private-label securities owned by the FHLBanks are deemed to be impaired. The capital levels of the other four FHLBanks, which includes FHLBNY, would remain above minimum regulatory capital requirements under the same scenario. We do not believe that an OTTI of its holdings exists as of December 31, 2012 and will continue to monitor the financial performance of the FHLBNY. If the FHLBNY is unable to meet minimum regulatory capital requirements or is required to aid the remaining FHLBanks, our holdings in the FHLBNY may be determined to be other than temporarily impaired and may require a charge to our earnings which could have a material impact on our financial condition, results of operations and cash flows.

Our loan portfolio includes a substantial amount of commercial real estate and commercial and industrial loans. The credit risk related to these types of loans is greater than the risk related to residential loans.

Our commercial and industrial loan portfolios, which include commercial real estate loans, totaled $1.7 billion at December 31, 2012, comprising approximately 76% of our total gross loans held-for-investment. Commercial and industrial loans generally carry larger loan balances and involve a greater degree of risk of nonpayment or late payment than home equity loans or residential mortgage loans.

Furthermore, commercial real estate loans secured by owner-occupied properties are dependent upon the successful operation of the borrower's business. If the operating company suffers difficulties in terms of sales volume and/or profitability, the borrower's ability to repay the loan may be impaired. Loans secured by properties where repayment is dependent upon payment of rent by third party tenants or the sale of the property may be impacted by loss of tenants, lower lease rates needed to attract new tenants or the inability to sell a completed project in a timely fashion and at a profit. The collateral for our commercial loans that are secured by real estate are classified as 47% owner-occupied properties and 53% non-owner occupied properties.

Overall, our market has expanded within the State of New Jersey. Likewise, our commercial lending activities have grown, especially in the central and more recently the northern parts of the State. A significant broad based deterioration in economic conditions throughout New Jersey, including the real estate markets, could have a material adverse effect on the credit quality of our loan portfolios and, consequently, on our financial condition, results of operations and cash flows.

If we fail to provide an adequate allowance for loan losses, there could be a significant negative impact on our results of operations.

The risk of loan losses varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value of the collateral for the loan. Based upon factors such as historical experience, an evaluation of economic conditions and a regular review of delinquencies and loan portfolio quality, management makes various assumptions and judgments about the ultimate collectability of the loan portfolio and provides an allowance for loan losses. At December 31, 2012, our allowance for loan losses was approximately $45.9 million which represented approximately 2.02% of total loans held-for-investment and approximately 48.0% of nonperforming loans. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb future credit losses, or if the bank regulatory authorities require us to increase our allowance for loan losses, our financial condition, results of operations and cash flows could be significantly and adversely affected. Given that the components of the allowance are based partially on historical losses and on risk rating changes in response to recent events, required reserves may trail the emergence of any unforeseen deterioration in credit quality.

We may not be able to achieve our growth plans or effectively manage our growth.

We intend to continue pursuing a growth strategy for our business. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in significant growth stages of development. Particularly in light of prevailing economic conditions, we cannot assure you we will be able to expand our market presence in our existing markets or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations, and could adversely affect our ability to successfully implement our business strategy. Also, if our growth occurs more slowly than anticipated or declines, our operating results could be materially adversely affected.

Our ability to successfully grow depends on a variety of factors including the continued availability of desirable business opportunities, the competitive responses from other financial institutions in our market areas and our ability to manage our growth. There can be no assurance that growth opportunities will be available or that growth will be successfully managed.

We face risks with respect to any future acquisitions.

We may acquire other financial institutions or part of those institutions in the future. We may also consider and enter into other new lines of business or offer new products or services. Acquisitions and mergers involve a number of risks.

Our success depends on, among other things, our ability to realize anticipated cost savings and revenue enhancements from acquisitions and to combine the businesses of the acquired companies in a manner that permits growth without materially disrupting existing customer relationships or resulting in decreased revenue due to a loss of customers. If we are not able to successfully achieve these objectives, the anticipated benefits of such acquisitions may not be realized fully or at all or may take longer to realize than expected. Additionally, if the integration efforts following acquisitions are not successfully managed, the failure of these integration efforts could result in loan losses, deposit attrition, operating costs, loss of key employees, disruption of our ongoing business or inconsistencies in standards, controls, procedures and policies that could adversely affect our ability to maintain relationships with customers and employees or to achieve the anticipated benefits of such acquisitions or result in unanticipated losses.

Competition from other financial institutions in originating loans, attracting deposits and providing various financial services may adversely affect our profitability and results of operations.

The market areas in which we operate are among the most highly competitive in the country. There is substantial competition in originating loans and in attracting and retaining deposits. The competition comes principally from other banks (both larger and smaller) savings institutions, credit unions, mortgage banking companies and the myriad of nonbanking competitors, such as full service brokerage firms, money market mutual funds, insurance companies and other institutional lenders.

Ultimately, competition may adversely affect the rates we pay on deposits and charges on loans, thereby potentially adversely affecting our profitability and results of operations.

We rely on other companies to provide certain services and key components of our business infrastructure.

Third party vendors provide certain services and key components of our business infrastructure, including certain of our fee income services such as cash management services and leasing. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of their not providing us their services for any reason or their performing their services poorly, could adversely affect our ability to deliver products and services to our customers or otherwise conduct our business efficiently and effectively. Replacing these third party vendors could also entail significant delay and expense.

System failure or cybersecurity breaches of our network security could subject us to increased operating costs as well as litigation and other potential losses.

The computer systems and network infrastructure we use could be vulnerable to unforeseen hardware and cybersecurity issues. Our operations are dependent upon its ability to protect its computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in its operations could have an adverse effect on our financial condition and results of operations. In addition, our operations are dependent upon the ability to protect our computer systems and network infrastructure, including Internet banking activities, against damage from physical break-ins, cybersecurity breaches and other disruptive problems caused by the Internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through its computer systems and network infrastructure, which may result in significant liability, damage to our reputation and inhibit current and potential customers from using our Internet banking services.

We may not be able to attract and retain skilled people.

Our success depends, in large part, on our ability to attract and retain skilled people. Competition for the best people in most activities engaged in by us can be intense, and we may not be able to hire sufficiently skilled people or to retain them. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our markets, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Changes in interest rates may reduce our profits.

The most significant component of our net income is net interest income, which accounted for 77% of total revenue in fiscal 2012. Net interest income is the difference between the interest income generated on interest-earning assets, such as loans and investments, and the interest expense paid on the funds required to support earning assets, namely deposits and borrowed funds. Interest income, which represents income from loans, investment securities and short-term investments is dependent on many factors including the volume of earning assets, the level of interest rates, the interest rate sensitivity of the earning assets and the levels of nonperforming loans. The cost of funds is a function of the amount and type of funds required to support the earning assets, the rates paid to attract and retain deposits, rates paid on borrowed funds and the levels of non-interest bearing demand deposits.

Interest rate sensitivity is a measure of how our assets and liabilities react to changes in market interest rates. We expect that this interest sensitivity will not always be perfectly balanced. This means that either our interest-earning assets will be more sensitive to changes in market interest rates than its interest bearing liabilities, or vice versa. If more interest-earning assets than interest –bearing liabilities reprice or mature during a time when interest rates are declining, then our net interest income may be reduced. If more interest-bearing liabilities than interest-earning assets reprice or mature during a time when interest rates are rising, then our net income may be reduced.

Interest rates are sensitive to many factors that are beyond our control, including general economic conditions, competition and policies of various governmental and regulatory agencies, particularly the policies of the FRB. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investment securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, including the available for sale securities portfolio, and (iii) the average duration of our interest-earning assets. Changes in monetary policy could also expose us to the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rate indices underlying various interest-earning assets and interest-bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk), including a prolonged flat or inverted yield curve environment. Any substantial, unexpected and prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have historically led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. There is no assurance that any such losses would not materially and adversely affect our financial condition and results of operations.

If the goodwill and intangible assets that we have recorded in connection with our acquisitions becomes impaired, there could be a negative impact on our profitability.

Under the acquisition method of accounting for all business combinations, if the purchase price of an acquired company exceeds the fair value of the company's net assets, the excess is carried on the acquirer's balance sheet as goodwill and identifiable intangible assets. At December 31, 2012, we had $41.5 million of goodwill and identifiable intangible assets on our balance sheet. Companies must evaluate goodwill for impairment at least annually.

Write-downs of the amount of any impairment are to be charged to the results of operations in the period in which the impairment is determined. No impairment was identified in 2012. At December 31, 2012, $38.2 million of goodwill remained on our balance sheet. Our intangible asset balances were not impaired at December 31, 2012 and 2011. Based on the goodwill impairment analysis conducted during 2010, we recorded an impairment charge of approximately $89.7 million. There can be no assurance that the future evaluations of goodwill and identifiable intangible assets will not result in determinations of further impairments and write-downs which could have an adverse non-cash impact on our financial condition and results of operations.

Litigation or legal proceedings could expose us to significant liabilities and damage our reputation.

From time to time, we are party to various litigation claims and legal proceedings. Management evaluates these claims and proceedings to assess the likelihood of unfavorable outcomes and estimates, if possible, the amount of potential losses. We may establish a reserve, as appropriate, based upon our assessments and estimates in accordance with our accounting policies. We base our assessments, estimates and disclosures on the information available to us at the time and rely on the judgment of our management with respect to those assessments, estimates and disclosures. Actual outcomes or losses may differ materially from assessments and estimates, which could adversely affect our reputation, financial condition and results of operations.

Risks Related to Our Common Stock

The price of our common stock may fluctuate significantly, which may make it difficult for investors to resell shares of common stock at times or prices they find attractive.

Our stock price may fluctuate significantly as a result of a variety of factors, many of which are beyond our control. These factors include, in addition to those described in the "Forward Looking Statements," the following:

- Actual or anticipated quarterly fluctuations in our operating results and financial condition;
- Changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to us or other financial institutions;
- Speculation in the press or investment community generally or relating to our reputation or the financial services industry;
- Strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;
- Fluctuations in the stock price and operating results of our competitors;
- Future sales of our equity or equity-related securities;
- Proposed or adopted regulatory changes or developments;
- Domestic and international economic factors unrelated to our performance; and
- General market conditions and, in particular, developments related to market conditions for the financial services industry.

In addition, in recent years, the stock market in general has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities of many companies, often unrelated to such companies' operating performance. These broad market fluctuations may adversely affect our stock price, notwithstanding our operating results. We expect that the market price of our common stock will continue to fluctuate and there can be no assurances about the levels of the market prices for our common stock.

Trading volume of our common stock is less than that of other larger financial services companies which may adversely affect the market price and limit shareholders' ability to quickly and easily sell their common stock, particularly in large quantities.

Although our common stock is listed for trading on the NASDAQ Global Select Market, the trading volume is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause the price of our common stock to decline. As a result, shareholders may find it difficult to sell a significant number of shares at the prevailing market price.

The terms of the securities purchase agreements grant certain rights to WL Ross, the Brown Family, Siguler Guff Shareholders, Anchorage and Other Investors that other shareholders do not have.

On September 22, 2010, the Company completed the issuance and sale of 4,672,750 shares of our common stock and 88,009 shares of our Series B Preferred Stock to WL Ross, the Siguler Guff Shareholders, the Brown Family and the Other Investors pursuant to securities purchase agreements dated July 7, 2010. The Series B Preferred Stock converted into 22,002,250 shares of common stock at a conversion price of $4.00 per share.

On March 22, 2011, the Company completed a public offering of 28,750,000 shares of common stock at a public offering price of $3.00 per share, which included the full exercise of the over-allotment option granted to the underwriters to purchase an additional 3,750,000 shares of common stock. After deducting the underwriting discount and offering expenses payable by the Company, the net proceeds were $81.4 million.

The Company's three largest shareholders, WL Ross, Siguler Guff, and the Brown family, along with certain officers and directors, purchased an aggregate of 10,193,224 shares in the offering. WL Ross and the Siguler Guff Shareholders maintained their percentage interest in the Company in the offering. Pursuant to the terms of the securities purchase agreements entered into between WL Ross, the Siguler Guff Shareholders, the Brown family and the Company in connection with the private placement of Company securities in July 2010, each of these investors was entitled to purchase shares in the offering at $2.85 per share which represented the public offering price less the underwriting discount of $0.15 per share paid to the underwriters on the other shares sold.

On April 11, 2011, the Company issued and sold in a private placement transaction an additional 3,802,131 shares at $2.85 per share totaling $10.8 million in additional stock proceeds pursuant to the exercise of gross-up rights contained in the previously executed security purchase agreements with the three investors noted above. The gross-up rights were triggered by the underwriters' exercise of the over-allotment option in the public offering. On August 8, 2011, the Company issued approximately 2,378,232 additional shares at $2.85 per share totaling $6.8 million in stock proceeds pursuant to the exercise of gross-up rights. The transactions were triggered pursuant to the gross-up rights issued to Anchorage, in connection with its purchase of shares in the public offering.

Pursuant to the securities purchase agreements, we granted registration rights to WL Ross, the Siguler Guff Shareholders, Anchorage, the Brown Family and the Other Investors, which provide them with the right to include their shares of our common stock in any future registration statement filed by us with the SEC for resale by them ("piggyback registration rights"). We filed a registration statement to cover the resale of these shares which has been declared effective.

In addition, pursuant to the securities purchase agreements entered into with each of WL Ross, the Siguler Guff Shareholders and the Brown Family and the gross-up agreement entered into with Anchorage, each has certain "gross-up" rights in connection with certain securities offerings that we may conduct at the same price (net of underwriting discounts) and on the same terms as those proposed in the offering in an aggregate amount sufficient to enable them to maintain their respective ownership interest in us.

We may issue additional equity securities, or engage in other transactions which dilute our book value or affect the priority of the common stock, which may adversely affect the market price of our common stock.

Our board of directors may determine from time to time that we need to raise additional capital by issuing additional shares of our common stock or other securities. Except pursuant to the rules of the NASDAQ Stock Market, we are not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future offerings, or the prices at which such offerings may be affected. Such offerings could be dilutive to common shareholders or reduce the market price of our common stock. Holders of our common stock are not entitled to preemptive rights or protection against dilution. New investors also may have rights, preferences and privileges that are senior to, and that adversely affect, our then current common shareholders.

We may attempt to increase our capital resources or, if our or the Bank's capital ratios fall below the required minimums, we or the Bank could be forced to raise additional capital by making offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock.

Our board of directors is authorized to issue one or more classes or series of preferred stock from time to time without any action on the part of our shareholders. Our board of directors also has the power, without shareholder approval, to set the terms of any such classes or series of preferred stock that may be issued, including voting rights, dividend rights and preferences over our common stock with respect to dividends or upon our dissolution, winding-up and liquidation and other terms. If we issue preferred stock in the future that has a preference over our common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of holders of our common stock or the market price of our common stock could be adversely affected.

Our directors and executive officers and their affiliates own approximately 45% of the outstanding common stock. As a result of their combined ownership, our directors and executive officers could make it more difficult to obtain approval for some matters submitted to a shareholder vote, including acquisitions of our Company. The results of the vote may be contrary to the desires or interests of the other shareholders.

Directors and executive officers and their affiliates own approximately 45% of the outstanding shares of common stock at December 31, 2012, excluding shares which may be acquired upon the exercise of stock options or upon the vesting of restricted stock. By voting against a proposal submitted to shareholders, the directors and officers, as a group, may be able to make approval more difficult for proposals requiring the vote of shareholders, such as some mergers, share exchanges, asset sales, and amendments to our amended and restated certificate of incorporation.

Provisions of our Amended and Restated Certificate of Incorporation and the New Jersey Business Corporation Act could deter takeovers which are opposed by the Board of Directors.

Our amended and restated certificate of incorporation requires the approval of 80% of our outstanding shares for any merger or consolidation unless the transaction meets certain fair price criteria or the business combination has been approved or authorized by the Board of Directors. As a New Jersey corporation with a class of securities registered with the SEC, we are governed by certain provisions of the New Jersey Business Corporation Act that also restrict business combinations with shareholders owning 10% or more of our outstanding shares ("interested shareholders") for a period of five years after such interested shareholder achieves such status unless the business combination is approved by the Board of Directors prior to the shareholder becoming an interested shareholder. The New Jersey Shareholders' Protection Act also restricts business combinations with an interested shareholder after the five-year period unless the transaction receives the approval of two-thirds of the shares outstanding, exclusive of the shares held by the interested shareholder or the transaction satisfies certain fair price requirements. In addition, with certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be "acting in concert" from, directly or indirectly, acquiring more than 10% (5% if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of directors or otherwise direct the management or policies of any banking holding company without prior notice or application to and the approval of the Federal Reserve.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC or any other deposit insurance fund or by any other public or private entity. Investment in the common stock is inherently risky for the reasons described in this "Risk Factors" section and elsewhere in this document or in the documents incorporated by reference herein or therein and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you may lose some or all of your investment.

We are subject to various restrictions on our ability to pay cash dividends.

As a bank holding company, our ability to declare and pay dividends is dependent on certain federal regulatory considerations. We have not historically paid a cash dividend on our common stock and are subject to various restrictions on our ability to pay cash dividends.

In October 2011, our Board of Directors resolved, among other things, not to declare or pay any cash dividends or take any cash dividends from the Bank without the prior approval of the Federal Reserve. In addition, pursuant to the terms of the securities purchase agreements entered into by us in July 2010, we also agreed not to declare or pay any dividends on our capital stock through December 31, 2012. Further, pursuant to the terms of the OCC Agreement, the Bank may not pay any dividends if it is not in compliance with its approved capital plan or if the effect of the dividend would be to cause the Bank to not be in compliance and, in either event, not without prior OCC approval. Accordingly, there can be no assurance that we will pay dividends to our shareholders in the future.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

At December 31, 2012, the Company operated from its main office in Vineland, New Jersey and its executive office in Mt. Laurel, New Jersey. The Company has 62 locations. The Company leases its main office, its executive office, 49 Community Banking Centers and all of its Commercial Lending Centers. At December 31, 2012, the Company’s commitments under noncancelable operating leases were $45.6 million which are payable in years subsequent to December 31, 2012. The remainder of the Community Banking Centers are owned by the Company. At December 31, 2012, the Company’s net bank properties and equipment was $50.8 million.

Item 3. Legal Proceedings.

The Company and the Bank are periodically involved in various claims and lawsuits, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, and claims involving the making and servicing of real property loans. While the ultimate outcome of these proceedings cannot be predicted with certainty, the Company’s management, after consultation with counsel representing the Company in these proceedings, does not expect that the resolution of these proceedings will have a material effect on the Company’s financial condition, results of operations or cash flows.

Item 4. Mine Safety Disclosures.

Not applicable

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The information contained under the captions "Common Stock Price Range and Dividends" and "Stock Performance" in the Annual Report, included herein as Exhibit 13 to this Report is incorporated herein by reference.

Item 6. Selected Financial Data.

The information contained under the caption "Selected Financial Data" in the Annual Report included herein as Exhibit 13 is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The information contained under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report included herein as Exhibit 13 is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information contained under the captions "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources—Gap Analysis" and "—Net Interest Income Simulation" in the Annual Report included herein as Exhibit 13 is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

The Consolidated Financial Statements of Sun Bancorp, Inc. and the Summarized Quarterly Financial Data included in the notes thereto, included in the Annual Report, included herein as Exhibit 13 are incorporated herein by reference.

Item 9. Changes in and Disagreements With Accountants On Accounting and Financial Disclosure.

Not applicable.

Item 9A. Controls and Procedures.

(a) **Disclosure Controls and Procedures**

Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")), the Company's principal executive officer and principal financial officer have concluded that as of the end of the period covered by this Annual Report on Form 10-K such disclosure controls and procedures were designed and functioning effectively to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including the principal executive and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

(b) **Internal Control over Financial Reporting**

1. **Management's Annual Report on Internal Control Over Financial Reporting.**

   Management's report on the Company's internal control over financial reporting appears in the Annual Report, included herein as Exhibit 13.

2. **Attestation Report of Independent Public Accounting Firm.**

   The attestation report of Deloitte & Touche LLP on the Company's internal control over financial reporting, as defined in Rule 15d-15e of the Securities Exchange Act of 1934, appears in the Annual Report filed, included herein as Exhibit 13.

3. Changes in Internal Control Over Financial Reporting.

During the last quarter of the year under report, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information.

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information contained under the captions “Proposal I-Election of Directors,” “Corporate Governance,” and “Section 16(a) Beneficial Ownership Reporting Compliance” in the Company’s Proxy Statement for its 2013 Annual Meeting of Shareholders (the “Proxy Statement”) is incorporated herein by reference.

Item 11. Executive Compensation.

The information contained under the captions “Compensation Discussion and Analysis,” “Compensation Committee Report,” “Compensation Risk Assessment,” “Executive Compensation,” and “Director Compensation” in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

(a) Security Ownership of Certain Beneficial Owners

The information contained under the caption “Security Ownership of Certain Beneficial Owners” in the Proxy Statement is incorporated herein by reference.

(b) Security Ownership of Management

The information contained under the caption “Security Ownership of Certain Beneficial Owners” and “Proposal I- Election of Directors” in the Proxy Statement is incorporated herein by reference.

(c) Changes in Control

Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the Company.

(d) Securities Authorized for Issuance Under Equity Compensation Plans

Set forth below is information as of December 31, 2012 with respect to compensation plans under which equity securities of the Company are authorized for issuance.

EQUITY COMPENSATION PLAN INFORMATION

	(a) **Number of securities to be issued upon exercise of outstanding options, warrants and rights (3)**	(b) **Weighted-average exercise price of outstanding options, warrants and rights (4)**	(c) **Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))**
Equity compensation plans approved by shareholders (1)	2,519,139	$ 7.35	7,107,391
Equity compensation plans not approved by shareholders (2)	n/a	n/a	n/a
Total	2,519,139	$ 7.35	7,107,391

(1) Plans approved by shareholders include the 1997 Stock Option Plan, the 2002 Stock Option Plan, the 2004 Stock Based-Incentive Plan, as amended and restated, the Director Stock Purchase Plan, as amended and restated, Employee Stock Purchase Plan, the 2010 Stock-Based Incentive Plan and the 2010 Performance Equity Plan. The amount of securities includes options for 136 shares of our common stock as a result of our assuming obligations under stock option plans of Advantage Bank in connection with an acquisition in 2006. While we assumed the obligations existing under these plans as of the time of merger, we have not and will not in the future, use them to make further grants.

(2) Not applicable.

(3) Amount includes 639,037 restricted stock units that have been granted, but not yet vested, and are therefore not included in shares outstanding. In addition, amount includes 94,945 shares issued and held in the Directors' Deferred Compensation Plan which, although included these shares are included in outstandings, will be issued without restriction upon retirement of the director.
(4) Amount does not reflect the market value of 639,037 nonvested restricted stock units and 94,945 shares issued and held in the Director's Deferred Compensation Plan which are included in column (a) herein.

Item 13. Certain Relationships and Related Transactions and Director Independence.

The information contained under the section captioned "Related Party Transactions" and "Corporate Governance" in the Proxy Statement is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

The information contained under the caption "Proposal II – Ratification of the Appointment of Independent Registered Public Accounting Firm" in the Proxy Statement is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as a part of this report:

(1) The following consolidated financial statements and the report of independent registered public accounting firm of the Registrant included in the Registrant's Annual Report to Shareholders are included herein as Exhibit 13 and also in Item 8 hereof.
Management's Annual Report on Internal Control over Financial Reporting
Reports of Independent Registered Public Accounting Firm
Consolidated Statements of Financial Condition as of December 31, 2012 and 2011
Consolidated Statements of Operations for the Years Ended December 31, 2012, 2011 and 2010
Consolidated Statements of Comprehensive Loss for the Years Ended December 31, 2012, 2011 and 2010
Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2012, 2011 and 2010
Consolidated Statements of Cash Flows for the Years Ended December 31, 2012, 2011 and 2010
Notes to Consolidated Financial Statements

(2) There are no financial statements schedules that are required to be included in Part II, Item 8.

(b) The following exhibits are filed as part of this report:

3.1 Amended and Restated Certificate of Incorporation of Sun Bancorp, Inc. (1)

3.2 Certificate of Amendment to Restated Certificate of Incorporation (2)

3.3 Amended and Restated Bylaws of Sun Bancorp, Inc. (3)

4.1 Common Security Specimen (4)

10.1 1995 Stock Option Plan (5)

10.2 Amended and Restated 1997 Stock Option Plan (6)

10.3 2002 Stock Option Plan (7)

10.4 Amended and Restated 2004 Stock-Based Incentive Plan (8)

10.5 Directors Stock Purchase Plan, as amended and restated (9)

10.6 2010 Stock-Based Incentive Plan (10)

10.7 2010 Performance Equity Plan (11)

10.8 Management Change in Control Severance Agreement, as amended and restated, for Chairman of the Board, Bernard A. Brown (3)

10.9	Management Change in Control Severance Agreement, as amended and restated, for Vice-Chairman of the Board, Sidney R. Brown (3)
10.10	Employment Agreement with President and Chief Executive Officer Thomas X. Geisel (12)
10.11	Letter Agreement, dated October 23, 2012, by and among Sun Bancorp, Inc., Sun National Bank and Thomas R. Brugger (13)
10.12	Salary Continuation Plan for Bernard Brown (14)
10.13	Securities Purchases Agreement, dated as of July 7, 2010, between Sun Bancorp, Inc. and WLR SBI AcquisitionCo, LLC (15)
10.14	Securities Purchase Agreement, dated as of July 7, 2010, between Sun Bancorp, Inc. and Bernard A. Brown, Sidney R. Brown, Jeffrey S. Brown, Anne E. Koons, the Four Bs, Interactive Logistics, LLC, National Distribution Centers, L.R. and National Freight, Inc. (15)
10.15	Securities Purchase Agreement, dated as of July 7, 2010, between Sun Bancorp, Inc. and Maycomb Holdings II, LLC, Maycomb Holdings, III, LLC, Siguler Guff Distressed Opportunities Fund IV, LP and Siguler Guff Distressed Opportunities Fund IV (T), LP (15)
10.16	Form of Securities Purchase Agreement with Other Investors (15)
10.17	Agreement by and between Sun National Bank and the Office of the Comptroller of the Currency (16)
10.18	Letter Agreement, dated April 11, 2011, between Sun Bancorp, Inc. and WLR SBI AcquisitionCo, LLC (17)
10.19	Letter Agreement, dated April 11, 2011, between Sun Bancorp, Inc. and Maycomb Holdings II, LLC, Maycomb Holdings III, LLC and Maycomb Holdings IV, LLC (17)
10.20	Letter Agreement, dated April 11, 2011, between Sun Bancorp, Inc. and Bernard A. Brown, Sidney R. Brown, Jeffrey S. Brown, Anne E. Koons, The Four B's, NFI Interactive Logistics, LLC, National Distribution Centers, L.P. and National Freight, Inc.(17)
10.21	Letter Agreement, dated August 10, 2011, between Sun Bancorp, Inc. and WLR SBI AcquisitionCo, LLC (18)
10.22	Letter Agreement, dated August 10, 2011, between Sun Bancorp, Inc. and Maycomb Holdings II, LLC, Maycomb Holdings III, LLC and Maycomb Holdings IV, LLC (18)
10.23	Letter Agreement, dated August 10, 2011, between Sun Bancorp, Inc. and Bernard A. Brown, Sidney R. Brown, Jeffrey S. Brown, Anne E. Koons, The Four B's, NFI Interactive Logistics, LLC, National Distribution Centers, L.P. and National Freight, Inc. (18)
10.24	Letter Agreement, dated August 10, 2011, between Sun Bancorp, Inc. and a fund managed by Anchorage Capital Group LLC, acting on behalf of Anchorage Capital Master Offshore, Ltd. (18)
10.25	Gross-Up Agreement, dated as of March 16, 2011, between Sun Bancorp, Inc. and a fund managed by Anchorage Capital Group LLC, acting on behalf of an investment fund that it advises (19)
11	Computation regarding earnings per share (13)
13	2012 Annual Report to Shareholders
21	Subsidiaries of the Registrant
23	Consent of Deloitte & Touche LLP
31(a)	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31(b)	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*
101.DEF	XBRL Taxonomy Definition Linkbase Document*

* Attached as Exhibits 101 to this Form 10-K are documents formatted in XBRL (Extensible Business Reporting Language). Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

(1) Incorporated by reference to Exhibit 3.1 of the Company's Registration Statement on Form S-3 filed on February 6, 2009 (Registration Number 333-157131).

(2) Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 27, 2011 (File No. 0-20957).

(3) Incorporated by reference to the exhibits to the Company's Current Report on Form 8-K filed on October 24, 2007 (File No. 0-20957).
(4) Incorporated by reference to the registrant's Registration Statement on Form S-1 filed with the Commission on February 14, 1997 (File No. 333-21903).
(5) Incorporated by reference to Exhibit 10 to the Company's Registration Statement on Form 10 filed on June 28, 1996 (File No. 0-20957).
(6) Incorporated by reference Exhibit 10.3 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999 (File No. 0-20957).
(7) Incorporated by reference to Appendix A to the Company's Proxy Statement for the 2002 Annual Meeting of Shareholders filed with the SEC on April 16, 2002 (File No. 0-20957).
(8) Incorporated by reference to Exhibit 10.1 to the Registrant's Registration on S-8 filed on August 12, 2009 (File No. 333-161289).
(9) Incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-8, filed with the SEC on August 12, 2009 (File No. 333-161288).
(10) Incorporated by reference to Appendix F to the Company's Proxy Statement for the 2010 Annual Meeting of Shareholders filed with the SEC on September 28, 2010 (File No. 0-20957).
(11) Incorporated by reference to Appendix G to the Company's Proxy Statement for the 2010 Annual Meeting of Shareholders filed with the SEC on September 28, 2010 (File No. 0-20957).
(12) Incorporated by reference to the exhibit to the Company's Current Report on Form 8-K filed on July 22, 2009 (File No. 0-20957).
(13) Incorporated by reference to the exhibit to the Company's Current Report on Form 8-K filed on November 9, 2012 (File No. 0-20957).
(14) Incorporated by reference to Exhibit 10.13 of the Company's Annual Report on Form 10-K filed on March 14, 2011.
(15) Incorporated by reference to Exhibits 10.1, 10.2, 10.3 and 10.4 of the Company's Current Report on Form 8-K filed on July 13, 2010. (File No. 0-20957).
(16) Incorporated by reference to Exhibit 10 of the Company's Current Report on Form 8-K filed on April 21, 2010. (File No. 0-20957).
(17) Incorporated by reference to Exhibits 10.1, 10.2 and 10.3 of the Company's Current Report on Form 8-K filed on April 12, 2011 (File No. 0-20957).
(18) Incorporated by reference to Exhibits 10.1, 10.2, 10.3 and 10.4 of the Company's Current Report on Form 8-K filed on August 10, 2011 (File No. 0-20957).
(19) Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on March 22, 2011 (File No. 0-20957).

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 as of March 18, 2013.

SUN BANCORP, INC.

By: /s/ Thomas X. Geisel
Thomas X. Geisel
President and Chief Executive Officer
(Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated as of March 18, 2013.

/s/ Bernard A. Brown
Bernard A. Brown
Chairman

/s/ Sidney R. Brown
Sidney R. Brown
Vice Chairman, Secretary and Treasurer

/s/ Wilbur L. Ross, Jr.
Wilbur L. Ross, Jr.
Director

/s/ Jeffrey S. Brown
Jeffrey S. Brown
Director

/s/ Anne E. Koons
Anne E. Koons
Director

/s/ Peter Galetto, Jr.
Peter Galetto, Jr.
Director

/s/ Thomas X. Geisel
Thomas X. Geisel
President & Chief Executive Officer and
Director (Principal Executive Officer)

/s/ Eli Kramer
Eli Kramer
Director

/s/ Anthony R. Coscia
Anthony R. Coscia
Director

/s/ William J. Marino
William J. Marino
Director

/s/ Philip A. Norcross
Philip A. Norcross
Director

/s/ Steven A. Kass
Steven A. Kass
Director

/s/ Thomas R. Brugger
Thomas R. Brugger
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ Neil Kalani
Neil Kalani
Senior Vice President and Chief Accounting Officer
(Principal Accounting Officer)

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Section 2: EX-13 (EX-13)

Exhibit 13

SUN BANCORP, INC. AND SUBSIDIARIES
SELECTED FINANCIAL DATA
(Dollars in thousands, except per share amounts)

At or for the Years Ended December 31,	2012	2011	2010	2009	2008
Selected Balance Sheet Data					
Total assets	**$3,224,031**	**$3,183,916**	$3,417,546	$3,578,905	$3,622,126
Cash and investments	**631,596**	**652,537**	680,719	516,312	512,017
Loans receivable, net of allowance for loan losses	**2,351,222**	**2,272,647**	2,453,457	2,657,694	2,702,516
Total deposits	**2,713,224**	**2,667,977**	2,940,460	2,909,268	2,896,364
Borrowings	**70,992**	**31,269**	33,417	146,193	154,097
Junior subordinated debentures	**92,786**	**92,786**	92,786	92,786	92,786
Shareholders' equity	**262,595**	**309,083**	268,242	356,593	358,508
Selected Results of Operations					

Interest income	**$ 115,433**	$ **126,680**	$ 145,603	$ 150,999	$ 174,634
Net interest income	**97,848**	**103,528**	110,962	100,157	99,661
Provision for loan losses	**57,215**	**74,266**	101,518	46,666	20,000
Net interest income after provision for loan losses	**40,633**	**29,262**	9,444	53,491	79,661
Non-interest income	**29,450**	**13,468**	15,512	17,070	32,299
Non-interest expense	**120,608**	**110,225**	201,052	104,067	92,640
Net (loss) income	**(50,491)**	**(67,505)**	(185,418)	(17,131)	14,894
Net (loss) income available to common shareholders	**(50,491)**	**(67,505)**	(185,418)	(22,482)	14,894
Per Share Data (1)					
(Loss) earnings per common share:					
Basic	**$ (0.59)**	$ **(0.88)**	$ (6.56)	$ (0.97)	$ 0.63
Diluted	**(0.59)**	**(0.88)**	(6.56)	(0.97)	0.62
Book Value	**3.05**	**3.61**	5.33	15.29	15.57
Selected Ratios					
Return on average assets	**(1.60)%**	**(2.05)%**	(5.20)%	(0.47)%	0.44%
Return on average equity	**(17.19)**	**(22.57)**	(56.93)	(4.44)	4.09
Ratio of average equity to average assets	**9.31**	**9.10**	9.13	10.69	10.72

(1) Data is adjusted for a 5% stock dividend issued in May 2009.

ORGANIZATION OF INFORMATION

Management’s Discussion and Analysis of Financial Condition and Results of Operations provides a narrative on the financial condition and results of operations of Sun Bancorp, Inc. (the “Company”) and should be read in conjunction with the accompanying consolidated financial statements. It includes the following sections:

- OVERVIEW
- CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES
- RECENT ACCOUNTING PRINCIPLES
- RESULTS OF OPERATIONS
- LIQUIDITY AND CAPITAL RESOURCES
- FINANCIAL CONDITION
- FORWARD-LOOKING STATEMENTS

OVERVIEW

General Overview

The Company is a bank holding company headquartered in Vineland, New Jersey, and has an executive office in Mt. Laurel, New Jersey, with its principal subsidiary being Sun National Bank (the “Bank”). At December 31, 2012, the Company had total assets of $3.2 billion, total liabilities of $3.0 billion and total shareholders’ equity of $262.6 million. The Company’s principal business is to serve as a holding company for the Bank. As a registered bank holding company, the Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “FRB”).

Through the Bank, the Company provides commercial and consumer banking services. As of December 31, 2012, the Company had 62 locations throughout New Jersey.

The Company offers a comprehensive array of lending, depository and financial services to its commercial and consumer customers throughout the marketplace. The Company’s lending services to businesses include term loans and lines of credit, mortgage loans, construction loans and equipment leasing. The Company is a Preferred Lender with both the Small Business Administration (“SBA”) and the New Jersey Economic Development Authority. The Company’s commercial deposit services include business checking accounts and cash management services such as electronic banking, sweep accounts, lockbox services, online banking, remote deposit and controlled disbursement services. The Company’s lending services to consumers include residential mortgage loans, residential construction loans, second mortgage loans, home equity loans and installment loans. The Company’s consumer deposit services include checking accounts, savings accounts, money market deposits, certificates of deposit and individual retirement accounts. In addition, the Company offers mutual funds, securities brokerage, annuities and investment advisory services through a third-party arrangement.

The Company funds its lending activities primarily through retail and brokered deposits, the scheduled maturities of its investment portfolio and other wholesale funding sources.

As a financial institution with a primary focus on traditional banking activities, the Company generates the majority of its revenue through net interest income, which is defined as the difference between interest income earned on loans and investments and interest paid on deposits and borrowings. Growth in net interest income is dependent upon the Company’s ability to prudently manage the balance sheet for growth, combined with how successfully it maintains or increases net interest margin, which is net interest income as a percentage of average interest-earning assets.

The Company also generates revenue through fees earned on the various services and products offered to its customers and through sales of loans, primarily SBA loans and residential mortgages. Offsetting these revenue sources are provisions for credit losses on loans, operating expenses and income taxes.

Market Overview

The economic recovery has been slower than anticipated through most of 2012, but signs of growth have appeared in the fourth quarter of 2012 and continued into 2013. Interest rates have remained near historical lows. The unemployment rate in the U.S. remained stable at 7.8% in December 2012 from September 2012 and decreased from 8.5% in December 2011. According to recently released estimates, the U.S. gross domestic product for the fourth quarter of 2012 decreased at an annual rate of 0.1% as compared to 3.1% growth in the third quarter of 2012. This decrease primarily reflected a decrease in private inventory investment, federal government spending and exports, partially offset by increases in personal consumption and residential fixed investment and a decrease in imports. The increase in job growth which occurred during 2012 coupled with increased spending and some improvement in the housing sector have created some optimism in the markets that an economic recovery may be underway. However, the fiscal cliff talks and the debt crisis, both domestically and in Europe, as well as the continuing weakness in the housing sector have continued to temper that optimism.

At the state level, according to the latest South Jersey Business Survey produced by the Federal Reserve Bank of Philadelphia (the “Federal Reserve”), a modest increase in business activity was reported in the fourth quarter of 2012. Sales have been steady and employment continues to improve. Companies are optimistic about overall business growth over the next six months. In Northern New Jersey, business activity is expected to continue to increase at a slow pace. Overall, New Jersey’s unemployment rate remains one of the highest in the U.S at 9.6% as of December 2012.

At its latest meeting in January 2013, the FRB decided to keep the Federal Funds target rate unchanged in a continued effort to help stimulate economic growth. Since December 2008, the FRB has kept the Federal Funds rate, a key indicator of short-term rates such as credit card rates and HELOC rates, at a range of 0.00%-0.25% with the intent of encouraging consumers and businesses to borrow and spend to help jump start the economy. The FRB expects to maintain the current target range through late 2014. In addition, FRB policymakers decided to continue its program to extend the average maturity of its holdings of securities. The FRB policymakers continue to consider providing additional monetary policy accommodations to support the economic recovery.

The continued uncertainty with the economy, together with the challenging regulatory environment, will continue to affect the Company and the markets in which it does business, and may adversely impact the Company’s results in the future. The following discussion provides further detail on the financial condition and results of operations of the Company at and for the year ended December 31, 2012.

Executive Summary

The Company’s net loss available to common shareholders for 2012 was $50.5 million, or $0.59 per diluted share, compared to a net loss of $67.5 million, or $0.88 per diluted share, in 2011. The following is an overview of key factors affecting the Company’s results for 2012:

- As part of a continuing strategy to reduce balance sheet risk, the Company signed a definitive agreement on January 17, 2013 to sell $45.8 million of loans, having a book balance of $35.1 million, to a third-party investor for gross proceeds of $22.0 million. As the formal approval to sell these loans occurred during 2012, the related loans were transferred to held-for-sale as of December 31, 2012 at lower of cost or market, which resulted in a net loss of $7.6 million after accounting for loan loss reserves, customer derivative termination costs, and other expenses. The transaction closed on February 8, 2013. In addition, the Company reached workout settlements with several troubled borrowers, resulting in a loss of $6.7 million in the fourth quarter of 2012.
- Provision expense totaled $57.2 million during 2012 as compared to $74.3 million during 2011. The allowance for loan losses equaled $45.9 million at December 31, 2012, an increase of $4.2 million from December 31, 2011. The allowance for loan losses equaled 2.02% of gross loans held-for-investment and 55.3% of non-performing loans held for investment at December 31, 2012 as compared to 1.82% and 38.7%, respectively, at December 31, 2011.
- Commercial loan production was $378 million during the year ended December 31, 2012 versus $323 million in the prior year. The Company continues to maintain a disciplined underwriting and pricing strategy in this uncertain economic environment.
- The net interest margin equaled 3.43% for 2012 versus 3.50% in 2011. The net interest margin in 2012 was negatively impacted by the maturity of legacy commercial loans as well as the overall low interest rate environment.

- Non-interest income increased $16.0 million to $29.5 million during 2012 as compared to 2011 primarily due to a reduction of $10.3 million in negative derivative credit adjustments due to significant swap losses resulting from the loan sale and credit deterioration in the prior year. There also was an increase in gains on the sale of mortgage loans of $7.2 million over the same period. The Company's residential mortgage operations were strong as $666 million in residential mortgage loans were closed during 2012 as compared to $192 million in 2011. These increases were partially offset by a decrease of $1.0 million in bank-owned life insurance income due to death benefits recognized in 2011.
- Non-interest expense increased $10.4 million from $110.2 million in 2011 to $120.6 million in 2012. This increase was due primarily to an increase of $10.0 million in salaries and employee benefits resulting from the expansion of the Company's mortgage operations in 2012.
- Total risk-based capital was 13.72% at December 31, 2012, well above 11.50%, the regulatory required level.

Impact of Hurricane Sandy

In late October 2012, many parts of New Jersey were devastated by the impact of Hurricane Sandy. The Company incurred additional expenses as a result of the impact of the storm on its own customers and its business operations. Due to the extent of damages and uninsured losses experienced by some of the Company's commercial borrowers, additional loan loss reserves of $4.3 million were recorded in the fourth quarter of 2012 to reflect potential losses inherent in the portfolio as a result of Hurricane Sandy. Damages resulting from the storm to some of the Company's facilities resulted in repair and clean-up costs of approximately $222 thousand which were also recognized in the fourth quarter of 2012.

CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES

The discussion and analysis of the financial condition and results of operations are based on the Consolidated Financial Statements, which are prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of income and expenses. Management evaluates these estimates and assumptions on an ongoing basis, including those related to the allowance for loan losses, goodwill, intangible assets, income taxes, stock-based compensation and the fair value of financial instruments. Management bases its estimates on historical experience and various other factors and assumptions that are believed to be reasonable under the circumstances. These form the basis for making judgments on the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Allowance for Loan Losses. Through the Bank, the Company originates loans that it intends to hold for the foreseeable future or until, maturity or repayment. The Company may not be able to collect all principal and interest due on these loans. The allowance for loan losses represents management's estimate of probable credit losses inherent in the loan portfolio as of the balance sheet date. The determination of the allowance for loan losses requires management to make significant estimates with respect to the amounts and timing of losses, and market and economic conditions. The allowance for loan losses is maintained at a level that management considers adequate to provide for estimated losses and impairment based upon an evaluation of known and inherent risk in the loan portfolio. Loan impairment is evaluated based on the fair value of collateral or estimated net realizable value. A provision for loan losses is charged to operations based on management's evaluation of the estimated losses that have been incurred in the Company's loan portfolio. It is the policy of management to provide for losses on unidentified loans in its portfolio in addition to classified loans.

Management monitors its allowance for loan losses on a monthly basis and makes adjustments to the allowance through the provision for loan losses as economic conditions and other pertinent factors indicate. The quarterly review and adjustment of the qualitative factors employed in the allowance methodology and the updating of historic loss experience allow for timely reaction to emerging conditions and trends. In this context, a series of qualitative factors are used in a methodology as a measurement of how current circumstances are affecting the loan portfolio. Included in these qualitative factors are:

- Levels of past due, classified and non-accrual loans, troubled debt restructurings and modifications
- Nature and volume of loans
- Changes in lending policies and procedures, underwriting standards, collections, charge-offs and recoveries, and for commercial loans, the level of loans being approved with exceptions to policy
- Experience, ability and depth of management and staff

- National and local economic and business conditions, including various market segments
- Quality of the Company’s loan review system and degree of Board oversight
- Concentrations of credit by industry, geography and collateral type, with a specific emphasis on real estate, and changes in levels of such concentrations
- Effect of external factors, including the deterioration of collateral values on the level of estimated credit losses in the current portfolio
- Hurricane Sandy impact

Additionally, historic loss experience over a three-year loss horizon, based on a rolling 12-quarter migration analysis, is taken into account for commercial loans and historic loss experience over the more conservative of either the trailing four or eight quarters is calculated for non-commercial loans. In determining the allowance for loan losses, management has established both specific and general pooled allowances. Values assigned to the qualitative factors and those developed from historic loss experience provide a dynamic basis for the calculation of reserve factors for both pass-rated loans (general pooled allowance) and those deemed impaired (specific allowance). A specific allowance is calculated on individually identified impaired loans. Loans not individually reviewed are evaluated as a group using reserve factor percentages based on historic loss experience and the qualitative factors described above. In determining the appropriate level of the general pooled allowance, management makes estimates based on internal risk ratings, which take into account such factors as debt service coverage, loan-to-value ratios and external factors. Estimates are periodically measured against actual loss experience.

As changes in the Company’s operating environment occur and as recent loss experience fluctuates, the factors for each category of loan based on type and risk rating will change to reflect current circumstances and the quality of the loan portfolio. Given that the components of the allowance are based partially on historical losses and on risk rating changes in response to recent events, required reserves may trail the emergence of any unforeseen deterioration in credit quality.

Although the Company maintains its allowance for loan losses at levels considered adequate to provide for the inherent risk of loss in its loan portfolio, if economic conditions differ substantially from the assumptions used in making the evaluations or loan performance deteriorates further from current levels, there can be no assurance that future losses will not exceed estimated amounts or that additional provisions for loan losses will not be required in future periods. Accordingly, the current state of the national economy and local economies of the areas in which the loans are concentrated and their slow recovery from a severe recession could result in an increase in loan delinquencies, foreclosures or repossessions resulting in increased charge-off amounts and the need for additional loan loss allowances in future periods. In addition, the Company’s determination as to the amount of its allowance for loan losses is subject to review by the Bank’s primary regulator, the Office of the Comptroller of the Currency (the “OCC”), as part of its examination process, which may result in the establishment of an additional allowance based upon the judgment of the OCC after a review of the information available at the time of the OCC examination.

Accounting for Income Taxes. The Company accounts for income taxes in accordance with Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) 740, *Income Taxes* (“FASB ASC 740”). FASB ASC 740 requires the recording of deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expenses will not be required in future periods. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the consolidated statements of operations. Assessment of uncertain tax positions under FASB ASC 740 requires careful consideration of the technical merits of a position based on management’s analysis of tax regulations and interpretations. Significant judgment may be involved in applying the requirements of FASB ASC 740.

Management expects that the Company’s adherence to FASB ASC 740 may result in increased volatility in quarterly and annual effective income tax rates, as FASB ASC 740 requires that any change in judgment or change in measurement of a tax position taken in a prior period be recognized as a discrete event in the period in which it occurs. Factors that could impact management’s judgment include changes in income, tax laws and regulations, and tax planning strategies.

Fair Value Measurement. The Company accounts for fair value measurement in accordance with FASB ASC 820, *Fair Value Measurements and Disclosures* ("FASB ASC 820"). FASB ASC 820 establishes a framework for measuring fair value. FASB ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, emphasizing that fair value is a market-based measurement and not an entity-specific measurement. FASB ASC 820 clarifies the application of fair value measurement in a market that is not active. FASB ASC 820 also includes additional factors for determining whether there has been a significant decrease in market activity, affirms the objective of fair value when a market is not active, eliminates the presumption that all transactions are not orderly unless proven otherwise, and requires an entity to disclose inputs and valuation techniques, and changes therein, used to measure fair value. FASB ASC 820 addresses the valuation techniques used to measure fair value. These valuation techniques include the market approach, income approach and cost approach. The market approach uses prices or relevant information generated by market transactions involving identical or comparable assets or liabilities. The income approach involves converting future amounts to a single present amount. The measurement is valued based on current market expectations about those future amounts. The cost approach is based on the amount that currently would be required to replace the service capacity of the asset.

FASB ASC 820 establishes a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the instrument's fair value measurement. The three levels within the fair value hierarchy are described as follows:

- Level 1 —Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 — Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Company measures financial assets and liabilities at fair value in accordance with FASB ASC 820. These measurements involve various valuation techniques and models, which involve inputs that are observable, when available, and include the following significant financial instruments: investment securities available for sale and derivative financial instruments. The following is a summary of valuation techniques utilized by the Company for its significant financial assets and liabilities which are measured at fair value on a recurring basis.

Investment securities available-for-sale. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated using quoted prices of securities with similar characteristics or discounted cash flows based on observable market inputs and are classified within Level 2 of the fair value hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Level 3 market value measurements include an internally developed discounted cash flow model combined with using market data points of similar securities with comparable credit ratings in addition to market yield curves with similar maturities in determining the discount rate. In addition, significant estimates and unobservable inputs are required in the determination of Level 3 market value measurements. If actual results differ significantly from the estimates and inputs applied, it could have a material effect on the Company's consolidated financial statements.

Derivative financial instruments. The Company's derivative financial instruments are not exchange-traded and therefore are valued utilizing models that use as their basis readily observable market parameters, specifically the London Interbank Offered Rate ("LIBOR") swap curve, and are classified within Level 2 of the valuation hierarchy.

Residential mortgage loans held-for-sale. Effective July 1, 2012, the Company's residential mortgage loans held-for-sale were recorded at fair value utilizing Level 2 measurements. This fair value measurement is determined based upon third party quotes obtained on similar loans.

The Company adopted the fair value option on these loans which allows the Company to record the mortgage loans held-for-sale portfolio at fair market value as opposed to the lower of cost or market. The Company economically hedges its residential loans held for sale portfolio with forward sale agreements which are reported at fair value. A lower of cost or market accounting treatment would not allow the Company to record the excess of the fair market value over book value but would require the Company to record the corresponding reduction in value on the hedges. Both the loans and related hedges are carried at fair value which reduces earnings volatility as the amounts more closely offset, particularly in environments when interest rates are declining. For loans held-for-sale for which the fair value option has been elected, the aggregate fair value exceeded the aggregate principal balance by $2.1 million as of December 31, 2012.

Interest rate lock commitments on residential mortgages. The Company enters into interest rate lock commitments on its residential mortgage loans originated for sale. The determination of the fair value of interest rate lock commitments is based on agreed upon pricing with the respective investor on each loan and includes a pull through percentage. The pull through percentage represents an estimate of loans in the pipeline to be delivered to an investor versus the total loans committed for delivery. Significant changes in this input could result in a significantly higher or lower fair value measurement. As the pull through percentage is a significant unobservable input, this is deemed a Level 3 valuation input. The pull through percentage, which is based upon historical experience, was 70% as of December 31, 2012.

In addition, certain assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The Company measures impaired loans, commercial loans held-for-sale, SBA servicing assets, restricted equity investments and loans or bank properties transferred into other real estate owned at fair value on a non-recurring basis.

Valuation techniques and models utilized for measuring financial assets and liabilities are reviewed and validated by the Company at least quarterly.

Goodwill. Goodwill is the excess of the fair value of liabilities assumed over the fair value of tangible and identifiable intangible assets acquired in a business combination. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company tests goodwill for impairment annually. The Company elected not to apply the qualitative evaluation option permitted under Accounting Standards Update 2011-8, *Intangibles – Goodwill and Other (Topic 35): Testing Goodwill for Impairment*, issued in September 2011. Therefore, the Company utilizes the two-step goodwill impairment test outlined in FASB ASC 350, *Intangibles – Goodwill and Other*. Significant judgment is applied when goodwill is assessed for impairment. Step one, which is used to identify potential impairment, compares the fair value of the reporting unit with its carrying amount, including goodwill. As defined in FASB ASC 280, *Segment Reporting*, a reporting unit is an operating segment or one level below an operating segment. The Company has one reportable operating segment, “Community Banking”, as defined in Note 2 of the Notes to Consolidated Financial Statements. If the fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is considered not impaired and step two is therefore unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step is performed to measure the amount of the impairment loss, if any. An implied loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value.

The Company performed a goodwill impairment analysis at December 31, 2012. In performing step one of the impairment analysis, the Company estimated the fair value of the Company through the consideration of its quoted market valuation, market earnings multiples of peer companies and market earnings multiples of peer companies adjusted to include a market observed control premium (i.e., its acquisition value relative to its peers). The considerations above are sensitive to both the fluctuation of the Company’s stock price and those of peer companies. The step one impairment test completed at December 31, 2012 indicated that the Company’s fair value was above its carrying value, and therefore the Company did not need to perform a step two analysis. As a result, the Company’s goodwill balance was not considered impaired at December 31, 2012.

However, given the continued turmoil in the capital markets and with bank stocks in general, it is possible that our assumptions and conclusions regarding the valuation of our Company could change adversely in the future and could result in impairment of the Company’s goodwill. While any charge resulting from a partial or full impairment of goodwill would be a non-cash charge and have no impact on the Company’s regulatory capital, the charge could have a material adverse impact on our financial position and results of operations. For more information on goodwill, see Notes 2 and 10 of the Notes to Consolidated Financial Statements.

RECENT ACCOUNTING PRINCIPLES

In February 2013, the FASB issued Accounting Standards Update (“ASU”) 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.* The amendments in this update aim to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The Company is currently evaluating the impact of the adoption of this accounting standards update on its financial statements.

In July 2012, the FASB issued ASU 2012-02, *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. This amendment provides an entity with the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Subtopic 350-30. This amendment is effective for public entities for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The guidance will have no impact on the Company as it does not have any indefinite-lived intangible assets.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities ("ASU 2011-11").* This amendment results in common offsetting requirements and disclosure requirements in GAAP and International Financial Reporting Standards ("IFRS"). This guidance is not intended to change, but enhance, the application requirements in FASB ASC 210, *Balance Sheet ("FASB ASC 210")*. This guidance is effective for public entities during interim and annual periods beginning after January 1, 2013. This guidance amends only the disclosure requirements and not the application of the accounting standard. In January 2013, the FASB issued Accounting Standards Update ("ASU") 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The amendments in this update clarify that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with FASB ASC 815, *Derivatives and Hedging* ("FASB ASC 815"), including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with FASB ASC 210 or FASB ASC 815 or subject to an enforceable master netting arrangement or similar agreement. This guidance is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The Company is currently evaluating the impact of the adoption of these accounting standards updates on its financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. Subsequently in December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This guidance eliminates the presentation option of presenting the component of other comprehensive income as part of the statement of changes in stockholders' equity. In addition, the updates to comprehensive income guidance require all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or two separate but consecutive statements. The Company elected to adopt the two statement approach. In this two statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income and the total of comprehensive income. These changes apply to both annual and interim financial statements. The Company adopted the new accounting guidance effective January 1, 2012, and applied it retrospectively to fiscal years 2011 and 2010. The adoption added the consolidated statements of comprehensive loss but did not impact the Company's results of operations, financial position, or cash flows.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, to achieve common fair value measurement and disclosure requirements between U.S. GAAP and international accounting principles. While the overall guidance is consistent with U.S. GAAP, the amendment includes additional fair value disclosure requirements. The amendments in the guidance are effective for interim and annual periods beginning after December 15, 2011. The adoption of this amendment did not have a material effect on the Company's financial statements; however, the adoption did result in expanded fair value disclosures in Note 24.

RESULTS OF OPERATIONS

The following discussion focuses on the major components of the Company's operations and presents an overview of the significant changes in the results of operations during the past three fiscal years. This discussion should be reviewed in conjunction with the consolidated financial statements and notes thereto presented elsewhere in this Annual Report. All earnings per share amounts are presented assuming dilution.

Net Interest Income. Net interest income is the most significant component of the Company's income from operations. Net interest income is the difference between interest earned on total interest-earning assets (primarily loans and investment securities), on a fully taxable equivalent basis, where appropriate, and interest paid on total interest-bearing liabilities (primarily deposits and borrowed funds). Fully taxable equivalent basis represents income on total interest-earning assets that is either tax-exempt or taxed at a reduced rate, adjusted to give effect to the prevailing incremental federal tax rate, and adjusted for nondeductible carrying costs and state income taxes, where applicable. Yield calculations, where appropriate, include these adjustments. Net interest income depends on the volume and interest rate earned on interest-earning assets, and the volume and interest rate paid on interest-bearing liabilities.

The Company’s net interest margin and interest rate spread in 2012 were 3.43% and 3.27%, respectively, as compared to 3.50% and 3.30%, respectively, for 2011 and 3.50% and 3.28%, respectively, for 2010. The margin decrease from 2011 is due primarily to the decline in the yield on interest-bearing assets of 23 basis points, which was partially offset by a decline of 20 basis points in costs of interest-bearing liabilities. The margin impact of the decline in yield on interest-bearing assets of 31 basis points in 2011 from 2010 was almost directly offset by a decline of 33 basis points in costs of interest-bearing liabilities.

Net interest income (on a tax-equivalent basis) decreased $6.2 million, or 5.9%, to $98.7 million for 2012 compared to $104.9 million for 2011. Net interest income (on a tax-equivalent basis) decreased $7.9 million, or 7.0%, to $104.9 million for 2011 compared to $112.8 million for 2010.

Table 1 provides detail regarding the Company’s average daily balances with corresponding interest income (on a tax-equivalent basis) and interest expense, as well as yield and cost information for the years ended December 31, 2012, 2011 and 2010. Average balances are derived from daily balances. Table 2 further provides certain information regarding changes in interest income and interest expense of the Company for the years ended December 31, 2012, 2011 and 2010.

TABLE 1: STATEMENTS OF AVERAGE BALANCES, INCOME OR EXPENSE, YIELD OR COST

Years Ended December 31,	2012			2011			2010		
	Average Balance	Income/ Expense	Yield/ Cost	Average Balance	Income/ Expense	Yield/ Cost	Average Balance	Income/ Expense	Yield/ Cost
Interest-earning assets:									
Loans receivable (1), (2):									
Commercial and industrial	**$1,814,626**	**$ 82,165**	**4.53%**	$1,954,701	$ 92,107	4.71%	$2,245,118	$105,210	4.69%
Home equity	**216,218**	**8,738**	**4.04**	232,278	9,774	4.21	251,599	11,714	4.66
Second mortgage	**37,021**	**2,128**	**5.75**	48,998	2,863	5.84	62,349	3,889	6.24
Residential real estate	**207,553**	**8,199**	**3.95**	87,858	4,547	5.18	79,547	4,415	5.55
Other	**35,636**	**2,477**	**6.95**	51,041	3,502	6.86	60,874	4,163	6.84
Total loans receivable	**2,311,054**	**103,707**	**4.49**	2,374,876	112,793	4.75	2,699,487	129,391	4.79
Investment securities (3)	**537,710**	**12,529**	**2.33**	505,006	14,940	2.96	452,365	17,846	3.95
Interest-earning deposits with banks	**28,646**	**68**	**0.24**	117,830	288	0.24	69,803	166	0.24
Total interest-earning assets	**2,877,410**	**116,304**	**4.04**	2,997,712	128,021	4.27	3,221,655	147,403	4.58
Non-interest-earning assets:									
Cash and due from banks	**73,000**			72,455			47,393		
Bank properties and equipment, net	**52,781**			54,589			52,944		
Goodwill and intangible assets, net	**43,280**			46,961			95,010		
Other assets	**108,299**			114,158			150,558		
Total non-interest-earning assets	**277,360**			288,163			345,905		
Total assets	**$3,154,770**			$3,285,875			$3,567,560		
Interest-bearing liabilities:									
Interest-bearing deposit accounts:									
Interest-bearing demand deposits	**$1,225,609**	**$ 4,778**	**0.39%**	$1,317,816	$ 7,024	0.53%	$1,312,871	$ 10,692	0.81%
Savings deposits	**263,307**	**900**	**0.34**	271,970	1,412	0.52	295,121	2,283	0.77
Time deposits	**643,822**	**7,876**	**1.22**	675,464	10,301	1.53	899,038	15,805	1.76
Total interest-bearing deposit accounts	2,132,738	13,554	0.64	2,265,250	18,737	0.83	2,507,030	28,780	1.15
Short-term borrowings:									
Federal funds purchased	**5,437**	**20**	**0.37**	36	—	—	16,907	89	0.53
Repurchase agreements with customers	**5,157**	**7**	**0.14**	6,681	7	0.10	16,069	29	0.18
Long-term borrowings:									
FHLBNY advances (4)	**37,038**	**898**	**2.42**	18,316	884	4.83	22,710	1,076	4.74
Obligation under capital lease	**7,737**	**513**	**6.63**	7,988	527	6.60	8,212	550	6.70
Junior subordinated debentures	**92,786**	**2,594**	**2.80**	92,786	2,997	3.23	92,786	4,117	4.44
Total borrowings	**148,155**	**4,032**	**2.72**	125,807	4,415	3.51	156,684	5,861	3.74
Total interest-bearing liabilities	**2,280,893**	**17,586**	**0.77**	2,391,057	23,152	0.97	2,663,714	34,641	1.30
Non-interest-bearing liabilities:									
Non-interest-bearing demand deposits	**499,435**			509,678			481,757		
Other liabilities	**80,777**			86,013			96,420		
Total non-interest-bearing liabilities	**580,212**			595,691			578,177		
Total liabilities	**2,861,105**			2,986,748			3,241,891		
Shareholders’ equity	**293,665**			299,127			325,669		
Total liabilities and shareholders’ equity	**$3,154,770**			$3,285,875			$3,567,560		
Net interest income (5)		**$ 98,718**			$104,869			$112,762	
Interest rate spread			**3.27%**			3.30%			3.28%
Net interest margin (6)			**3.43%**			3.50%			3.50%
Ratio of average interest-earning assets to average interest- bearing liabilities			**126.15%**			125.37%			120.95%

(1) Average balances include non-accrual loans (see "Non-Performing and Problem Assets").
(2) Loan fees are included in interest income and the amount is not material for this analysis.
(3) Interest earned on non-taxable investment securities is shown on a tax equivalent basis assuming a 35% marginal federal tax rate for all periods. The fully taxable equivalent adjustment for the years ended December 31, 2012, 2011 and 2010 was $870 thousand, $1.3 million and $1.8 million, respectively.
(4) Amounts include Advances from the Federal Home Loan Bank of New York ("FHLBNY") and Securities sold under agreements to repurchase – FHLBNY.
(5) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
(6) Net interest margin represents net interest income as a percentage of average interest-earning assets.

TABLE 2: RATE-VOLUME VARIANCE ANALYSIS (1)

Years Ended December 31,	2012 vs. 2011			2011 vs. 2010		
	Increase (Decrease) Due To			Increase (Decrease) Due To		
	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Loans receivable:						
Commercial and industrial	**$(6,458)**	$**(3,484)**	**$ (9,942)**	$(13,680)	$ 577	$(13,103)
Home equity	**(656)**	**(380)**	**(1,036)**	(860)	(1,080)	(1,940)
Second mortgage	**(691)**	**(44)**	**(735)**	(792)	(234)	(1,026)
Residential real estate	**3,568**	**84**	**3,652**	442	(310)	132
Other	**(1,004)**	**(21)**	**(1,025)**	(674)	13	(661)
Total loans receivable	**(5,241)**	**(3,845)**	**(9,086)**	(15,564)	(1,034)	(16,598)
Investment securities	**(193)**	**(2,218)**	**(2,411)**	1,908	(4,814)	(2,906)
Interest-earning deposits with banks	**(217)**	**(3)**	**(220)**	117	5	122
Total interest-earning assets	**(5,651)**	**(6,066)**	**(11,717)**	(13,539)	(5,843)	(19,382)
Interest expense:						
Interest-bearing deposit accounts:						
Interest-bearing demand deposits	**(470)**	**(1,776)**	**(2,246)**	40	(3,708)	(3,668)
Savings deposits	**(44)**	**(468)**	**(512)**	(167)	(704)	(871)
Time deposits	**(459)**	**(1,966)**	**(2,425)**	(3,587)	(1,917)	(5,504)
Total interest-bearing deposit accounts	**(973)**	**(4,210)**	**(5,183)**	(3,714)	(6,329)	(10,043)
Short-term borrowings:						
Federal funds purchased	**20**	**—**	**20**	(44)	(45)	(89)
Repurchase agreements with customers	**—**	**—**	**—**	(17)	(5)	(22)
Long-term borrowings:						
FHLBNY advances (2)	**157**	**(143)**	**14**	82	(274)	(192)
Obligation under capital lease	**(13)**	**(1)**	**(14)**	(15)	(8)	(23)
Junior subordinated debentures	**(2)**	**(401)**	**(403)**	—	(1,120)	(1,120)
Total borrowings	**162**	**(545)**	**(383)**	6	(1,452)	(1,446)
Total interest-bearing liabilities	**(811)**	**(4,755)**	**(5,566)**	(3,708)	(7,781)	(11,489)
Net change in net interest income	**$(4,840)**	**$(1,311)**	**$ (6,151)**	$ (9,831)	$ 1,938	$ (7,893)

(1) For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in average volume multiplied by the prior year rate) and (ii) changes in rate (changes in rate multiplied by the prior year average volume). The combined effect of changes in both volume and rate has been allocated to volume or rate changes in proportion to the absolute dollar amounts of the change in each.
(2) Amounts include Advances from the FHLBNY and Securities sold under agreements to repurchase – FHLBNY.

Interest income (on a tax-equivalent basis) decreased $11.7 million, or 9.2%, to $116.3 million for 2012 compared to $128.0 million in 2011, primarily due to a decrease of 26 basis points in the yield on loans and a decrease of 63 basis points in yield on average investments, as well as a decrease of $63.8 million, or 2.7%, in average loan balances. The rate declines were due to the overall decline in market interest rates during 2012. Significant pressures on loan yields existed through 2012 due to the competitive lending environment.

Interest income (on a tax-equivalent basis) decreased $19.4 million, or 13.1%, to $128.0 million for 2011 compared to $147.4 million in 2010, primarily due to a decrease of $324.6 million, or 12.0% in average loan balances as well as a decrease of four basis points in the yield on loans and a decrease of 99 basis points in yield on average investments. These declines were due to the overall decline in market interest rates during 2011. Interest income on loans decreased $16.6 million as average loans receivable declined $324.6 million, or 12.0%, over the prior year. Interest income on investments decreased $2.9 million even as average investments increased $52.6 million, or 11.6%, over the prior year. During 2011, the Company sold $102.2 million in higher yielding available-for-sale securities.

Interest expense decreased $5.6 million, or 24.0%, to $17.6 million for 2012 compared to $23.2 million in 2011, primarily due to a decrease in the cost of interest-bearing deposits of $5.2 million, or 19 basis points. The Company continued to lower interest rates on its deposit products throughout 2012.

Interest expense decreased $11.5 million, or 33.2%, to $23.2 million for 2011 compared to $34.6 million in 2010, primarily due to a decrease in the cost of interest-bearing deposits of $10.0 million, or 32 basis points.

Provision for Loan Losses. The Company recorded a provision for loan losses of $57.2 million during 2012, as compared to $74.3 million during 2011 and $101.5 million during 2010. The Company's total loans held-for-investment before allowance for loan losses were $2.27 billion at December 31, 2012, as compared to $2.29 billion at December 31, 2011. The ratio of allowance for loan losses to loans held-for-investment was 2.02% at December 31, 2012 compared to 1.82% at December 31, 2011. Net charge-offs were $52.4 million, or 2.26% of average loans outstanding, for the year ended December 31, 2012 as compared to $114.7 million, or 4.83% of average loans outstanding, and $79.8 million, or 2.95% of average loans outstanding, for the years ended December 31, 2011 and 2010, respectively. Total gross charge-offs in 2012 were $55.6 million, of which $51.3 million related to the commercial portfolio. During 2012, the Company signed a definitive agreement to sell $45.8 million of loans, having a book balance of $38.1 million to a third party investor and the related loans were marked to fair value and moved to loans held-for-sale. The resulting charge-offs totaled $13.1 million. Excluding charge-offs related to the loan sale, commercial charge-offs were largely driven by charge-offs of $23.2 million taken on 10 relationships. The Company's provision levels remained elevated during the year as delinquency levels and credit trends were still in the process of stabilizing in 2012.

The charge-offs in 2011 included $69.4 million in losses recorded on the sale of $159.8 million in book balance of criticized and classified commercial real estate loans during May 2011. Excluding the charge-offs related to the loan sale, total commercial charge-offs were $43.2 million in 2011. Charge-offs, excluding the loan sale, were primarily driven by three commercial relationships for $25.0 million.

At least quarterly, management performs an analysis to identify the inherent risk of loss in the Company's loan portfolio. This analysis includes a qualitative evaluation of concentrations of credit, past loss experience, current economic conditions, amount and composition of the loan portfolio (including loans being specifically monitored by management), estimated fair value of underlying collateral, delinquencies, and other factors. Additionally, management updates the migration analysis and historic loss experience on a quarterly basis.

Non-Interest Income. Non-interest income increased $16.0 million, or 118.7%, to $29.5 million for 2012 as compared to $13.5 million for 2011. The primary drivers of this change were a $7.2 million increase in gains on the sale of residential mortgage loans and a decrease of $10.3 million in derivative credit evaluation adjustment charges as compared to the prior year. The increase in gains on the sale of mortgage loans resulted from the expansion of the Company's mortgage operations which began in the first quarter of 2012. Derivative credit valuation adjustments were higher in 2011 compared to 2012 due to swap termination costs associated with the May 2011 commercial loan sale.

Non-interest income decreased $2.0 million, or 13.2%, to $13.5 million for 2011 as compared to $15.5 million for 2010. The primary drivers of this change were a $3.1 million decrease in gains on the sale of available-for-sale securities and a decrease of $717 thousand in service charges on deposit accounts as compared to the prior year; partially offset by a decrease of $1.1 million in impairment losses on available-for-sale securities and an increase of $890 thousand in bank-owned life insurance income over the same period from a death benefit recorded in 2011.

Non-Interest Expense. Non-interest expense increased $10.4 million, or 9.4%, to $120.6 million for 2012 as compared to $110.2 million for 2011. The primary driver of this increase was the increase in salaries and employee benefits of $10.0 million, or 19.0%, from the prior year primarily due to the expansion of the Company's mortgage operations. In addition, there was an increase of $1.3 million in provision for unfunded commitments as this reserve was reduced by $1.1 million in 2011 due to a reduction in unfunded commitments and mortgage recourse reserves of $775 thousand were recorded in 2012 as compared to $0 in 2011. Partially offsetting these increases was a decrease in problem loan costs of $2.7 million, or 31.9% from 2011 to 2012 due to loan sale related expenses in 2011.

Non-interest expense decreased $90.8 million, or 45.2%, to $110.2 million for 2011 as compared to $201.1 million for 2010. The primary driver of this decrease was the prior year goodwill impairment charge of $89.7 million. Salaries and employee benefits decreased $2.7 million, or 4.9%, from the prior year primarily due to staffing reductions that occurred towards the end of 2010. Problem loan costs increased $3.2 million, or 61.6% from 2010 to 2011 due to loan sale related expenses as well as credit deterioration in the commercial real estate loan portfolio. Other expense decreased by $2.8 million, or 33.1%, for the same period due to positive derivative credit valuation adjustments recorded in 2011.

Income Tax Expense. Income tax expense decreased $44 thousand from $10 thousand for the year ended December 31, 2011 to a tax benefit position of $34 thousand for 2012. As the Company remained in a cumulative loss position at December 31, 2012, a full deferred tax valuation allowance is still considered appropriate. As such, the Company recorded no federal income tax expense in 2012. The tax benefit in 2012 relates to a prior period federal refund owed to the Company.

Income tax expense decreased $9.3 million from $9.3 million for the year ended December 31, 2010 to income tax expense of $10 thousand for 2011. As the Company remained in a cumulative loss position at December 31, 2011, a full deferred tax valuation allowance is considered appropriate. As such, the Company recorded no federal income tax expense in 2011.

LIQUIDITY AND CAPITAL RESOURCES

The liquidity of the Company is the ability to maintain cash flows that are adequate to fund operations and meet its other obligations on a timely and cost-effective basis in various market conditions. The ability of the Company to meet its current financial obligations is a function of balance sheet structure, the ability to liquidate assets and the availability of alternative sources of funds. To meet the needs of the clients and manage the risk of the Company, the Company engages in liquidity planning and management.

The major source of the Company's funding is deposits, which management believes will be sufficient to meet the Company's daily and long-term operating liquidity needs. The ability of the Company to retain and attract new deposits is dependent upon the variety and effectiveness of its customer account products, customer service and convenience, and rates paid to customers. The Company also obtains funds from the repayment and maturities of loans, maturities or calls of investment securities, as well as from a variety of wholesale funding sources including, but not limited to, brokered deposits, federal funds purchased, FHLBNY advances, securities sold under agreements to repurchase, and other secured and unsecured borrowings. Additional liquidity can be obtained from loan sales or participations. In a continued effort to balance deposit growth and net interest margin, especially in the current interest rate environment and with highly competitive local deposit pricing, the Company continually evaluates these other funding sources for funding cost efficiencies. During the year, the Company aggressively lowered interest rates on deposits while managing overall funding and liquidity. As a result of this planned reduction in deposit rates, the Company experienced an overall decline in its deposit balances. Core deposits, which exclude all certificates of deposit, decreased $19.1 million to $2.02 billion, or 74.3% of total deposits, at December 31, 2012, as compared to $2.03 billion, or 76.3% of total deposits, at December 31, 2011. The Company has additional secured borrowing capacity with the FRB of approximately $174.4 million and the FHLBNY of approximately $202.5 million. At December 31, 2012, $0 and $61.4 million of the Company's secured borrowing capacity through the FRB and the FHLBNY was utilized, respectively. The Company has additional unsecured borrowing capacity through lines of credit with other financial institutions of approximately $55.0 million. Management continues to monitor the Company's liquidity and has taken measures to increase its borrowing capacity by providing additional collateral through the pledging of loans. As of December 31, 2012, the Company had a par value of $364.4 million and $180.7 million in loans and securities, respectively, pledged as collateral on secured borrowings.

The Company's primary uses of funds are the origination of loans, the funding of the Company's maturing certificates of deposit, deposit withdrawals, the repayment of borrowings and general operating expenses. Certificates of deposit scheduled to mature during the 12 months ending December 31, 2013 total $437.0 million, or approximately 62.6% of total certificates of deposit. The Company continues to operate with a core deposit relationship strategy that values a long-term stable customer relationship. This strategy employs a pricing strategy that rewards customers that establish core accounts and maintain a certain minimum threshold account balance. Based on market conditions and other liquidity considerations, the Company may also avail itself to the secondary borrowings discussed above.

Total loans receivable increased $83.4 million, or 3.6%, during 2012. The Company anticipates that deposits, cash and cash equivalents on hand, the cash flow from assets, as well as other sources of funds will provide adequate liquidity for the Company's future operating, investing and financing needs.

Management currently operates under a capital plan for the Company and the Bank that is expected to allow the Company and the Bank to grow capital internally at levels sufficient for achieving its internal growth projections while managing its operating and financial risks. The principal components of the capital plan are to generate additional capital through retained earnings from internal growth, access the capital markets for external sources of capital, such as common equity and capital securities, when necessary or appropriate, redeem existing capital instruments and refinance such instruments at lower rates when conditions permit, and maintain sufficient capital for safe and sound operations. The Company continues to assess its plan for contingency capital needs, and when appropriate, the Company's Board of Directors may consider various capital raising alternatives. As part of its assessment, the Company performs stress tests on select balance sheet components, deemed to have inherent risk given relevant economic and regulatory conditions, in an effort to gauge potential exposure on its capital position.

On July 7, 2010, the Company entered into securities purchase agreements with WLR SBI Acquisition Co, LLC, an affiliate of WL Ross & Co. LLC ("WL Ross"), members and affiliates of the Bank's founding Brown Family (the "Brown Family"), certain affiliates of Siguler Guff & Company, LP (the "Siguler Guff Shareholders") and certain other institutional and accredited investors (the "Other Investors"). On September 22, 2010, the Company completed the issuance and sale of 4,672,750 shares of its common stock and 88,009 shares of its Mandatorily Convertible Cumulative Non-Voting Perpetual Stock, Series B (the "Series B Preferred Stock") for net proceeds of $98.5 million. At the Company's Annual Meeting of Shareholders held on November 1, 2010, its shareholders approved an amendment to our Amended and Restated Certificate of Incorporation allowing for the conversion of the 88,009 shares of Series B Preferred Stock into 22,002,250 shares of common stock at a conversion price of $4.00 per share.

On March 22, 2011, the Company completed a public offering of 28,750,000 shares of common stock at a public offering price of $3.00 per share, which included the full exercise of the over-allotment option granted to the underwriters to purchase an additional 3,750,000 shares of common stock. After deducting the underwriting discount and offering expenses payable by the Company, the net proceeds were $81.4 million. The Company's three largest shareholders, WL Ross, Siguler Guff, and the Brown Family, along with certain officers and directors, purchased an aggregate of 10,193,224 shares in the offering. WL Ross and the Siguler Guff Shareholders maintained their percentage interest in the Company in the offering. Pursuant to the terms of the securities purchase agreements entered into between WL Ross, the Siguler Guff Shareholders, the Brown Family and the Company in connection with the private placement of Company securities in July 2010, each of these investors was entitled to purchase shares in the offering at $2.85 per share which represented the public offering price less the underwriting discount of $0.15 per share paid to the underwriters on the other shares sold.

On April 11, 2011, the Company issued and sold in a private placement transaction an additional 3,802,131 shares at $2.85 per share totaling $10.8 million in additional stock proceeds pursuant to the exercise of gross-up rights contained in the previously executed securities purchase agreements with the three investors noted above. The gross-up rights were triggered by the underwriters' exercise of the over-allotment option in the public offering. On August 8, 2011, the Company issued in a private placement approximately 2,378,232 additional shares at $2.85 per share totaling $6.8 million in stock proceeds pursuant to the exercise of gross-up rights. The transactions were triggered pursuant to the gross-up rights issued to Anchorage Capital Group, LLC ("Anchorage"), in connection with its purchase of shares in the public offering.

At December 31, 2012, WL Ross beneficially owned approximately 24.7% of our outstanding common stock, the Brown Family beneficially owned approximately 18.1% of our outstanding common stock and the Siguler Guff Shareholders and Anchorage each beneficially owned approximately 9.8% of our outstanding common stock. None of the Other Investors beneficially owned more than 2% of our common stock.

The Company is subject to regulatory capital requirements adopted by the FRB for bank holding companies. The Bank is also subject to similar capital requirements adopted by the OCC. Under the requirements, the federal bank regulatory agencies have established quantitative measures to ensure that minimum thresholds for Total Capital, Tier 1 Capital and Leverage (Tier 1 Capital divided by average assets) ratios are maintained. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets and certain off-balance sheet items as calculated under regulatory practices. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the federal bank regulators about components, risk weightings and other factors. The Company's and the Bank's risk-based capital ratios have been computed in accordance with regulatory practices. The Company and the Bank were in compliance with these regulatory capital requirements of the FRB and the OCC as of December 31, 2012. As discussed below and elsewhere herein, additional capital requirements have been imposed on the Bank by the OCC, which the Bank was also in full compliance with as of December 31, 2012.

On April 15, 2010, the Bank entered into an Agreement with the OCC (the "OCC Agreement") which contained requirements to develop and implement a profitability and capital plan that provides for the maintenance of adequate capital to support the Bank's risk profile in the current economic environment. The capital plan was also required to contain a dividend policy allowing dividends only if the Bank is in compliance with the capital plan, and obtains prior approval from the OCC. During the second quarter of 2010, the Company delivered its profit and capital plans to the OCC. The Company continues to maintain and update appropriate capital and profit plan in accordance with the OCC Agreement.

The Bank also agreed to: (a) implement a program to protect the Bank's interest in criticized or classified assets, (b) review and revise the Bank's loan review program; (c) implement a program for the maintenance of an adequate allowance for loan losses; and (d) revise the Bank's credit administration policies. During the second quarter of 2010, the Company revised and implemented changes to policies and procedures pursuant to the OCC Agreement. As noted earlier in this section, the Bank also agreed that its brokered deposits will not exceed 3.5% of its total liabilities unless approved by the OCC. Effective October 18, 2012, the OCC approved an increase of this limit to 6.0%. Management does not expect this restriction will limit its access to liquidity as the Bank does not rely on brokered deposits as a major source of funding. At December 31, 2012, the Bank's brokered deposits represented 4.0% of its total liabilities.

The Bank is also subject to individual minimum capital ratios established by the OCC requiring the Bank to continue to maintain a Leverage ratio at least equal to 8.50% of adjusted total assets, to continue to maintain a Tier 1 Capital ratio at least equal to 9.50% of risk-weighted assets and to achieve, by June 30, 2010, and thereafter maintain, a Total Capital ratio at least equal to 11.50% of risk-weighted assets. At December 31, 2012, the Bank exceeded all of the three capital ratio requirements established by the OCC as its Leverage ratio was 9.24%, its Tier 1 Capital ratio was 11.76%, and its Total Capital ratio was 13.02%.

Management is working towards taking all of the necessary actions for the Bank to become fully compliant with all requirements of the OCC Agreement.

TABLE 3: REGULATORY CAPITAL LEVELS

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions (1)	
December 31, 2012	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets):						
Sun Bancorp, Inc.	$340,111	13.72%	$198,340	8.00%	N/A	
Sun National Bank	322,041	13.02	197,964	8.00	$247,455	10.00%
Tier I Capital (to Risk-Weighted Assets) (1)						
Sun Bancorp, Inc.	293,008	11.82	99,170	4.00	N/A	
Sun National Bank	290,922	11.76	98,982	4.00	148,473	6.00
Leverage Ratio:						
Sun Bancorp, Inc.	293,008	9.30	126,080	4.00	N/A	
Sun National Bank	290,922	9.24	125,902	4.00	157,377	5.00

(1) Not applicable to bank holding companies.

The Company's ratio of tangible equity to tangible assets, which is a non-GAAP financial measure of risk, was 6.95% at December 31, 2012, compared with 8.41% at December 31, 2011. Tangible equity and tangible assets are calculated by subtracting identifiable intangible assets and goodwill from shareholders' equity and total assets, respectively, and may be used by investors to assist them in understanding how much loss, exclusive of intangible assets and goodwill, can be absorbed before shareholders' equity is depleted. The Company's and Bank's regulators also exclude intangible assets and goodwill from shareholders' equity when assessing capital adequacy of each.

The Company's capital securities are deconsolidated in accordance with GAAP and qualify as Tier 1 capital under federal regulatory guidelines. These instruments are subject to a 25% capital limitation under risk-based capital guidelines developed by the FRB. In March 2005, the FRB amended its risk-based capital standards to expressly allow the continued limited inclusion of outstanding and prospective issuances of capital securities in a bank holding company's Tier 1 capital, subject to tightened quantitative limits. The FRB's amended rule was to become effective March 31, 2009, and would have limited capital securities and other restricted core capital elements to 25% of all core capital elements, net of goodwill less any associated deferred tax liability. On March 16, 2009, the FRB extended for two years the ability for bank holding companies to include restricted core capital elements as Tier 1 capital up to 25% of all core capital elements, including goodwill. The portion that exceeds the 25% capital limitation qualifies as Tier 2, or supplementary capital of the Company. At December 31, 2012, the $74.1 million in capital securities qualify as Tier 1.

The ability of the Bank to pay dividends to the Company is controlled by certain regulatory restrictions. Generally, dividends declared in a given year by a national bank are limited to its net profit, as defined by regulatory agencies, for that year, combined with its retained net income for the preceding two years, less any required transfer to surplus or to fund for the retirement of any preferred stock. In addition, a national bank may not pay any dividends in an amount greater than its undivided profits and a national bank may not declare any dividends if such declaration would leave the bank inadequately capitalized. Therefore, the ability of the Bank to declare dividends will depend on its future net income and capital requirements. Also, banking regulators have indicated that national banks should generally pay dividends only out of current operating earnings. Further, per the OCC Agreement, a dividend may only be declared if it is in accordance with the approved capital plan, the Bank remains in compliance with the capital plan following the payment of the dividend and the dividend is approved by the OCC. As a result of these restrictions, the amount available for payment of dividends to the Company by the Bank totaled $0 at December 31, 2012.

The Bank’s deposits are insured to applicable limits by the Federal Deposit Insurance Corporation (“FDIC”). As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) which was signed into law on July 21, 2010, the maximum deposit insurance limit is $250 thousand.

In addition, the Dodd-Frank Act amended the Federal Deposit Insurance Act to provide for full deposit insurance coverage for noninterest-bearing transaction accounts for a two year period beginning December 31, 2010. This applies to all insured depository institutions with no opt in or opt out requirements. This amendment expired on December 31, 2012.

In May 2009, the FDIC imposed a special assessment equal to five basis points of assets, less Tier 1 capital, as of June 30, 2009, payable on September 30, 2009, and reserved the right to impose additional special assessments. In November 2009, instead of imposing additional special assessments, the FDIC amended the assessment regulations to require all insured depository institutions to prepay their estimated risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 on December 30, 2009. For purposes of estimating the future assessments, each institution’s base assessment rate in effect on September 30, 2009 was used, assuming a 5% annual growth rate in the assessment base and a three basis point increase in the assessment rate in 2011 and 2012. The prepaid assessment will be applied against actual quarterly assessments until exhausted. Any funds remaining after June 30, 2013 will be returned to the institution. If the prepayment impairs an institution’s liquidity or otherwise creates significant hardship, it was able to apply for an exemption. Requiring this prepaid assessment does not preclude the FDIC from changing assessment rates or from further revising the risk-based assessment system. On December 30, 2009, the Company paid the FDIC prepaid assessment of $18.3 million which was to be recognized as expense for a three-year period from that date. At December 31, 2012, the remaining balance of the FDIC prepaid assessment was $2.6 million, with $3.9 million being recognized in expense during 2012.

Under federal law, deposits and certain claims for administrative expenses and employee compensation against an insured depository institution are afforded a priority over other general unsecured claims against such an institution, including federal funds and letters of credit, in the liquidation or other resolution of such an institution by any receiver appointed by regulatory authorities. Such priority creditors would include the FDIC.

See Note 23 of the Notes to Consolidated Financial Statements for additional information regarding regulatory matters.

Asset and Liability Management. Interest rate, credit and operational risks are among the most significant market risks impacting the performance of the Company. The Company has an Asset Liability Committee (“ALCO”), composed of senior management representatives from a variety of areas within the Company. ALCO, which meets at least quarterly, devises strategies and tactics to maintain the net interest income of the Company within acceptable ranges over a variety of interest rate scenarios. Should the Company’s risk modeling indicate an undesired exposure to changes in interest rates, there are a number of remedial options available, including changing the investment portfolio characteristics, and changing loan and deposit pricing strategies. Two of the tools used in monitoring the Company’s sensitivity to interest rate changes are gap analysis and net interest income simulation.

Gap Analysis. Banks are concerned with the extent to which they are able to match maturities or re-pricing characteristics of interest-earning assets and interest-bearing liabilities. Such matching is facilitated by examining the extent to which such assets and liabilities are interest-rate sensitive and by monitoring the bank’s interest rate sensitivity gap. Gap analysis measures the volume of interest-earning assets that will mature or re-price within a specific time period, compared to the interest-bearing liabilities maturing or re-pricing within that same time period. On a monthly basis, the Company and the Bank monitor their gap, primarily cumulative through both six month and one year maturities.

Table 4 provides the maturity and re-pricing characteristics of the Company’s interest-earning assets and interest-bearing liabilities at December 31, 2012. All amounts are categorized by their actual maturity or re-pricing date with the exception of interest-bearing demand deposits and savings deposits. As a result of prior experience during periods of rate volatility and management’s estimate of future rate sensitivities, the Company allocates the interest-bearing demand deposits and savings deposits into categories noted below, based on the estimated duration of those deposits.

TABLE 4: INTEREST RATE SENSITIVITY SCHEDULE

December 31, 2012	Maturity/Re-pricing Time Periods 0-3 Months	4-12 Months	1-5 Years	Over 5 Years	Total
Interest-earning assets:					
FHLB interest- bearing deposits	$ 699	$ —	$ —	$ —	$ 699
Loans receivable	1,246,490	335,655	583,283	120,581	2,286,009
Investment securities	105,435	97,611	147,431	108,637	459,114
Federal funds sold	91,601	—	—	—	91,601
Total interest-earning assets	1,444,225	433,266	730,714	229,218	2,837,423
Interest-bearing liabilities:					
Interest-bearing & non-interest demand deposits	582,090	161,961	363,242	110,557	1,217,850
Savings deposits	74,231	32,751	87,548	69,624	264,154
Time certificates	138,417	299,070	259,774	625	697,886
Federal Home Loan Bank Advances	334	70	430	60,582	61,416
Securities sold under agreements to repurchase	1,968	—	—	—	1,968
Guaranteed interest in Company's subordinated debt	92,779	(20)	(104)	(419)	92,236
Other Borrowings	68	210	1,472	5,859	7,609
Total interest-bearing liabilities	889,887	494,042	712,362	246,828	2,343,119
Periodic gap	$ 554,338	$ (60,776)	$ 18,352	$ (17,610)	$ 494,304
Cumulative gap	$ 554,338	$ 493,562	$511,914	$ 494,304	
Cumulative gap as a % of total assets	17.2%	15.3%	15.9%	15.3%	

At December 31, 2012, the Company's gap analysis showed an asset-sensitive position with total interest-bearing assets maturing or re-pricing within one year, exceeding interest-earning liabilities maturing or re-pricing during the same time period by $493.6 million, representing a positive one-year gap ratio of 15.3%. All amounts are categorized by their actual maturity, anticipated call or re-pricing date with the exception of interest-bearing demand deposits and savings deposits. Though the rates on interest-bearing demand and savings deposits generally trend with open market rates, they often do not fully adjust to open market rates and frequently adjust with a time lag. As a result of prior experience during periods of rate volatility and management's estimate of future rate sensitivities, the Company allocates the interest-bearing demand deposits and savings deposits based on an estimated decay rate for those deposits.

Net Interest Income Simulation. Due to the inherent limitations of gap analysis, the Company also uses simulation models to measure the impact of changing interest rates on its operations. The simulation model attempts to capture the cash flow and re-pricing characteristics of the current assets and liabilities on the Company's balance sheet. Assumptions regarding such things as prepayments, rate change behaviors, level and composition of new balance sheet activity, and new product lines are incorporated into the simulation model. Net interest income is simulated over a 12-month horizon under a variety of linear yield curve shifts, subject to certain limits agreed to by ALCO.

Net interest income simulation analysis, at December 31, 2012, shows a position that is slightly asset sensitive as rates increase. The net income simulation results are impacted by an expected continuation of deposit pricing competition which may limit deposit pricing flexibility in both increasing and decreasing rate environments, floating-rate loan floors initially limiting loan rate increases and a relatively short liability maturity structure including retail certificates of deposit.

Actual results may differ from the simulated results due to such factors as the timing, magnitude and frequency of interest rate changes, changes in market conditions, management strategies and differences in actual versus forecasted balance sheet composition and activity. Table 5 provides the Company's estimated earnings sensitivity profile versus the most likely rate forecast as of December 31, 2012. The Company anticipates that strong deposit pricing competition will continue to limit deposit pricing flexibility in an increasing and a decreasing rate environment.

TABLE 5: SENSITIVITY PROFILE

Change in Interest Rates (Basis Points)	Percentage Change in Net Interest Income Year 1
+200	2.5%
+100	0.8%
-100	-1.8%
-200	-4.1%

Derivative Financial Instruments. The Company utilizes certain derivative financial instruments to enhance its ability to manage interest rate risk that exists as part of its ongoing business operations. In general, the derivative transactions entered into by the Company fall into one of two types: a fair value hedge of a specific fixed-rate loan agreement and an economic hedge of a derivative offering to a Bank customer. Derivative financial instruments involve, to varying degrees, interest rate, market and credit risk. The Company manages these risks as part of its asset and liability management process, and through credit policies and procedures. The Company seeks to minimize counterparty credit risk by establishing credit limits and collateral agreements. The Company does not use derivative financial instruments for trading purposes. For more information on the Company's financial derivative instruments, please see Note 19 of the Notes to Consolidated Financial Statements.

Disclosures about Contractual Obligations and Commercial Commitments. Purchase obligations include significant contractual cash obligations. Table 6 provides the Company's contractual cash obligations at December 31, 2012. Included in Table 6 are the minimum contractual obligations under legally enforceable contracts with contract terms that are both fixed and determinable. The majority of these amounts are primarily for services, including core processing systems and telecommunications maintenance.

TABLE 6: CONTRACTUAL OBLIGATIONS

		Payments Due by Period			
December 31, 2012	Total	Less Than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years
Time deposits (1)	$697,886	$437,006	$166,827	$ 93,428	$ 625
Long-term debt	154,841	3,928	7,256	7,262	136,394
Leases	57,447	4,953	9,610	9,063	33,822
Purchase obligations (off-balance sheet)	15,489	5,401	5,969	2,871	1,248
Total contractual cash obligations	$925,663	$451,288	$189,663	$112,624	$172,088

(1) Amount represents the book value of time deposits, including brokered time deposits.

The Company maintains a reserve for unfunded loan commitments and letters of credit, which is reported in other liabilities in the Consolidated Statements of Financial Condition, consistent with FASB ASC 825, *Financial Instruments*. As of the balance sheet date, the Company records estimated losses inherent with unfunded loan commitments in accordance with FASB ASC 450, *Contingencies*, and estimated future obligations under letters of credit in accordance with FASB ASC 460, *Guarantees* . The methodology used to determine the adequacy of this reserve is integrated in the Company's process for establishing the allowance for loan losses and considers the probability of future losses and obligations that may be incurred under these off-balance sheet agreements. The reserve for unfunded loan commitments and letters of credit at December 31, 2012 and December 31, 2011 was $613 thousand and $381 thousand, respectively. Management believes this reserve level is sufficient to absorb estimated probable losses related to these commitments.

Table 7 provides the Company's off balance sheet commitments (see Note 18 of the Notes to Consolidated Financial Statements for additional information) at December 31, 2012.

TABLE 7: OFF BALANCE SHEET COMMITMENTS

		Amount of Commitment Expiration Per Period			
December 31, 2012	Unfunded Commitments	Less Than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years
Lines of credit	$ 543,594	$277,208	$24,295	$6,595	$235,496
Commercial standby letters of credit	40,541	40,232	309	—	—
Construction funding	101,083	26,039	75,044	—	—
Other commitments	157,219	157,219	—	—	—
Total off balance sheet commitments	$ 842,438	$500,698	$99,648	$6,595	$235,496

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. In the event of a draw by the beneficiary that complies with the terms of the letter of credit, the Company would be required to honor the commitment. The Company takes various forms of collateral, such as real estate assets and customer business assets, to secure the commitment. Additionally, all letters of credit are supported by indemnification agreements executed by the customer. The maximum undiscounted exposure related to these commitments at December 31, 2012 was $40.5 million and the portion of the exposure not covered by collateral was approximately $666 thousand. We believe that the utilization rate of these letters of credit will continue to be substantially less than the amount of these commitments, as has been our experience to date.

Impact of Inflation and Changing Prices. The consolidated financial statements of the Company and notes thereto, presented elsewhere herein, have been prepared in accordance with GAAP, which requires the measurement of financial condition and operating results without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of the Company's operations. Nearly all the assets and liabilities of the Company are monetary. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

FINANCIAL CONDITION

The Company's assets were $3.22 billion at December 31, 2012 compared to $3.18 billion at December 31, 2011. Gross loans receivable and loans held-for-sale increased $82.8 million, or 3.6%, to $2.40 billion at December 31, 2012 as compared to $2.31 billion at December 31, 2011. The investment portfolio decreased $70.7 million, or 13.3%, to $462.0 million at December 31, 2012 from $532.7 million at December 31, 2011. Deposits increased 1.7% to $2.71 billion at December 31, 2012 as compared to $2.67 billion at December 31, 2011. Excluding junior subordinated debentures, borrowings increased $39.7 million, or 127.0%, to $71.0 million at December 31, 2012.

Loans. Gross loans held-for-investment decreased $15.0 million from the prior year end to $2.28 billion at December 31, 2012 as the Company transferred $33.5 million of book balance loans to loans held-for-sale as of December 31, 2012. The Company's home equity portfolio, which includes second mortgages, decreased $27.3 million, in comparison to the prior year end. The Company continues to see competition for loans across all products and market segments. During 2012, competitive pressures have increased as interest rates fell to historical lows and loan activity has increased as the economy improves.

The trend of the Company's lending continues to reflect the geographic and borrower diversification of the commercial loan portfolio. As the Company's marketplace has expanded within the State of New Jersey, commercial lending activities have grown, especially in the central and northern parts of the state. The recent recession which impacted all aspects of the national and regional economy and the slow pace of recovery have created increased stress in our loan portfolios and have had an adverse effect on the Company's financial condition and results of operation. At December 31, 2012 and 2011, the Company did not have more than 10% of its total loans outstanding concentrated in any one industry category, including, but not limited to, the hospitality, entertainment and leisure industries, and general office space. The loan categories are based upon borrowers engaged in similar activities who would be similarly impacted by economic or other conditions.

Table 8 provides selected data relating to the composition of the Company's loan portfolio by type of loan and type of collateral at December 31, 2012, 2011, 2010, 2009 and 2008.

TABLE 8: SUMMARY OF LOAN PORTFOLIO

December 31,	2012		2011		2010		2009		2008	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Type of Loan:										
Commercial and industrial	**$1,725,567**	**77.37%**	$1,878,026	83.49%	$2,103,492	85.74%	$2,249,365	84.64%	$2,234,202	82.67%
Home equity	**207,720**	**9.31**	224,517	9.98	239,729	9.77	258,592	9.73	274,360	10.15
Second mortgage	**30,842**	**1.38**	41,470	1.84	53,912	2.20	68,592	2.58	84,388	3.12
Residential real estate	**273,413**	**12.26**	100,438	4.47	79,074	3.22	75,322	2.83	67,473	2.50
Other	**38,618**	**1.74**	46,671	2.07	58,963	2.40	65,776	2.47	79,402	2.94
Less: Loan loss allowance	**(45,873)**	**(2.06)**	(41,667)	(1.85)	(81,713)	(3.33)	(59,953)	(2.25)	(37,309)	(1.38)
Net loans receivable	**$2,230,287**	**100.00%**	$2,249,455	100.00%	$2,453,457	100.00%	$2,657,694	100.00%	$2,702,516	100.00%
Type of Collateral:										
Residential real estate:										
1-4 family	**$ 543,439**	**24.37%**	$ 429,106	18.88%	$ 426,488	17.38%	$ 460,106	17.31%	$ 494,828	18.31%
Other	**19,425**	**0.87**	15,127	0.67	19,835	0.81	22,992	0.87	24,692	0.91
Construction and land development:										
1-4 family	**6,438**	**0.29**	15,807	0.70	28,816	1.17	43,803	1.65	64,646	2.39
Other	**50,753**	**2.28**	82,116	3.61	147,909	6.03	187,624	7.06	153,205	5.67
Commercial real estate	**1,096,982**	**49.19**	1,226,349	53.96	1,385,210	56.46	1,503,301	56.56	1,495,398	55.34
Commercial business loans	**522,202**	**23.41**	500,301	22.01	466,870	19.03	425,541	16.01	434,097	16.06
Consumer	**30,536**	**1.37**	37,087	1.63	43,835	1.79	50,827	1.91	56,312	2.08
Other	**6,385**	**0.28**	8,421	0.37	16,207	0.66	23,453	0.88	16,647	0.62
Less: Loan loss allowance	**(45,873)**	**(2.06)**	(41,667)	(1.83)	(81,713)	(3.33)	(59,953)	(2.25)	(37,309)	(1.38)
Net loans receivable	**$2,230,287**	**100.00%**	$2,272,647	100.00%	$2,453,457	100.00%	$2,657,694	100.00%	$2,702,516	100.00%

Many of the Company's commercial and industrial loans have a real estate component as part of the collateral securing the accommodation. Additionally, the Company makes commercial real estate loans for the acquisition, refinance, improvement and construction of real property. Loans secured by owner occupied properties are dependent upon the successful operation of the borrower's business. If the operating company experiences difficulties in terms of sales volume and/or profitability, the borrower's ability to repay the loan may be impaired. Loans secured by properties where repayment is dependent upon payment of rent by third-party tenants or the sale of the property may be impacted by loss of tenants, lower lease rates needed to attract new tenants or the inability to sell a completed project in a timely fashion and at a profit. At December 31, 2012, commercial and industrial loans secured by commercial real estate properties totaled $1.11 billion of which $527.8 million, or 47.4%, were classified as owner occupied and $584.9 million, or 52.6%, were classified as non-owner occupied. Management considers these loans to be well diversified across multiple industries.

The Company's home equity loan portfolio, including second mortgages, represents 10.7% of total loans outstanding at December 31, 2012. The home equity loan portfolio decreased $27.3 million, or 10.3%, from December 31, 2011. Usage of home equity lines of credit has remained constant, at approximately 48.4% over the past year with approximately 25.4% of the overall home equity loan portfolio balance being in a first lien position. At December 31, 2012, residential real estate loans represent 12.3% of total loans outstanding and is the largest component of the Company's non-commercial portfolio. The residential loan portfolio increased $173.0 million, or 172.2%, from December 31, 2011. This increase is due to the Company's strategy implemented in 2011 to increase its held-for-investment jumbo residential mortgage portfolio.

Table 9 provides the estimated maturity of the Company's loan portfolio at December 31, 2012. The table does not include potential prepayments or scheduled principal payments. Adjustable-rate mortgage loans are shown based on contractual maturities.

TABLE 9: ESTIMATED MATURITY OF LOAN PORTFOLIO

December 31, 2012	Due Within 1 Year	Due After 1 Through 5 Years	Due After 5 Years	Allowance for Loan Loss	Total
Commercial and industrial	$354,373	$1,002,974	$368,220	$ 33,197	$1,692,370
Home equity (1)	308	6,579	231,675	2,734	235,828
Residential real estate	1,576	388	271,449	3,333	270,080
Other	5,944	4,576	28,098	6,609	32,009
Total	$362,201	$1,014,517	$899,442	$ 45,873	$2,230,287

(1) Amount includes both home equity and second mortgages.

Table 10 provides the dollar amount of all loans due one year or more after December 31, 2012, which have pre-determined interest rates and which have floating or adjustable interest rates.

TABLE 10: LOANS GREATER THAN 12 MONTHS

December 31, 2012	Fixed-Rates	Floating or Adjustable Rates	Total
Commercial and industrial	$461,017	$ 910,177	$1,371,194
Home equity (1)	31,307	206,947	238,254
Residential real estate	172,585	99,252	271,837
Other	29,412	3,262	32,674
Total	$694,321	$1,219,638	$1,913,959

(1) Amount includes both home equity and second mortgages.

See Notes 5 and 6 of the Notes to Consolidated Financial Statements for additional information on loans.

Non-Performing and Problem Assets

Loan Delinquencies. The Company's collection procedures provide for a late charge assessment after a commercial loan is 10 days past due, or a residential mortgage loan is 15 days past due. The Company contacts the borrower and payment is requested. If the delinquency continues, subsequent efforts are made to contact the borrower. If the loan continues to be delinquent for 90 days or more, the Company usually declares the loan to be in default and payment in full is demanded. The Company will initiate collection and foreclosure proceedings and steps will be taken to liquidate any collateral taken as security for the loan unless other repayment arrangements are made. Delinquent loans are reviewed on a case-by-case basis in accordance with the lending policy.

Interest accruals are generally discontinued when a loan becomes 90 days past due or when collection of principal or interest is considered doubtful. When interest accruals are discontinued, interest credited to income in the current year is reversed, and interest accrued in the prior year is charged to the allowance for loan losses. Generally, commercial loans and commercial real estate loans are charged-off no later than 180 days delinquent, unless the loan is well secured and in the process of collection or other extenuating circumstances support collection. Residential real estate loans are typically placed on non-accrual at the time the loan is 90 days delinquent. Other consumer loans are typically charged-off at 180 days delinquent. In all cases, loans must be placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

Non-Performing Assets. Total non-performing assets decreased $9.6 million from $112.7 million at December 31, 2011 to $103.1 million at December 31, 2012. This decrease was primarily a result of a decrease in non-accrual loans of $63.7 million due to the May 2011 loan sale. Commercial non-accrual loans were $53.3 million at December 31, 2012. Interest income that would have been recorded on non-accrual loans as of December 31, 2012, under the original terms of such loans, would have totaled approximately $7.7 million for 2012. The ratio of non-performing assets to net loans decreased to 4.62% at December 31, 2012 compared to 4.96% at December 31, 2011.

Table 11 provides a summary of non-performing assets at December 31, 2012, 2011, 2010, 2009 and 2008.

TABLE 11: SUMMARY OF NON-PERFORMING ASSETS

December 31,	2012	2011	2010	2009	2008
Non-performing loans:					
Loans accounted for on a non-accrual basis:					
Commercial and industrial	**$ 53,315**	$ 81,041	$148,517	$ 73,596	$37,528
Commercial and industrial, held-for-sale	**10,224**	—	—	—	—
Home equity lines of credit	**3,714**	3,620	4,616	4,737	1,682
Home equity term loans	**1,226**	1,246	1,134	938	130
Residential real estate	**5,747**	2,522	4,243	7,443	2,225
Other	**658**	1,227	916	1,168	668
Total non-accruing loans	**74,884**	89,656	159,426	87,882	42,233
TDR, non-accruing	**18,244**	17,875	11,796	—	—
TDR, non-accruing, held-for-sale	**2,499**	—	—	—	—
Accruing loans that are contractually past due 90 days or more:					
Commercial and industrial	**—**	138	1,167	6,457	4,014
Home equity lines of credit	**—**	—	379	—	286
Home equity term loans	**—**	—	—	891	—
Residential real estate	**—**	—	72	49	162
Other	**—**	16	936	561	125
Total loans 90-days past due	**—**	154	2,554	7,958	4,587
Total non-performing loans	**95,627**	107,685	173,776	95,840	46,820
Real estate owned	**7,473**	5,020	3,913	9,527	1,962
Total non-performing assets	**$103,100**	$112,705	$177,689	$105,367	$48,782
Total non-performing loans to net loans receivable	**4.29%**	4.74%	7.08%	3.61%	1.73%
Total non-performing loans to total assets	**2.97%**	3.38%	5.08%	2.68%	1.29%
Total non-performing assets to net loans receivable	**4.62%**	4.96%	7.24%	3.96%	1.81%
Total non-performing assets to total assets	**3.20%**	3.54%	5.20%	2.94%	1.35%
Total allowance for loan losses to total non-performing loans	**47.97%**	38.69%	47.02%	62.56%	79.69%

Potential Problem Loans. At December 31, 2012, there were 18 loan relationships aggregating $9.2 million for which known information exists as to the potential inability of the borrowers to comply with present loan repayment terms and have therefore caused management to place them on its internally monitored loan list. The classification of these loans, however, does not imply that management expects losses, but that it believes a higher level of scrutiny is prudent under the circumstances. These loans were not classified as non-accrual and were not considered non-performing. Depending upon the state of the economy, future events and their impact on these borrowers, these loans and others not currently so identified could be classified as non-performing assets in the future. At December 31, 2012, these loans were current and well collateralized.

Real Estate Owned. Real estate acquired by the Company as a result of foreclosure or deed in lieu and bank property that is not in use is classified as real estate owned until such time as it is sold. The property acquired through foreclosure or deed in lieu is carried at the lower of the related loan balance or fair value of the property based on a current appraisal less estimated cost to dispose. Losses arising from foreclosure are charged against the allowance for loan losses. Bank property is carried at the lower of cost or fair value less estimated cost to dispose. Costs to maintain real estate owned and any subsequent gains or losses are included in the Company's results of operations. Table 12 provides a summary of real estate owned at December 31, 2012 and 2011.

TABLE 12: SUMMARY OF REAL ESTATE OWNED

December 31,	2012	2011
Commercial properties	**$5,382**	$1,777
Residential properties	**696**	1,683
Bank properties	**1,395**	1,560
Total	**$7,473**	$5,020

Table 13 provides a summary of real estate owned activity for the year ended December 31, 2012.

TABLE 13: SUMMARY OF REAL ESTATE OWNED ACTIVITY

	Underlying Property			
At or for year-ended December 31, 2012	Commercial	Residential	Bank	Total
Balance, beginning of year	$ 1,777	$ 1,683	$1,560	$ 5,020
Transfers into real estate owned	6,000	315	1,365	7,680
Transfers into operations	—	—	—	—
Sale of real estate owned	(1,956)	(1,153)	(797)	(3,906)
Write down of real estate owned	(439)	(149)	(733)	(1,321)
Balance, end of year	$ 5,382	$ 696	$1,395	$ 7,473

Real estate owned increased $2.5 million to $7.5 million at December 31, 2012 as compared to December 31, 2011. During 2012, the Company transferred $7.7 million in book value of loans into real estate owned, including 23 commercial properties aggregating $6.0 million, three bank properties totaling $1.4 million, and four residential properties for $315 thousand. In 2012, the Company recorded $1.4 million of write-downs of real estate owned, including $149 thousand on the carrying value of four residential properties, $733 thousand on the carrying value of six bank properties, and $439 thousand on the carrying value of six commercial properties. There were 11 commercial properties, two bank properties, and six residential properties, with carrying amounts of $2.0 million, $797 thousand and $1.2 million, respectively, sold during the year ended December 31, 2012 resulting in a net gain of $345 thousand, which is included in real estate owned expense, net in the consolidated statements of operations. The Company recognized a reduction of carrying value of $3.9 million on these sales. See Note 9 of the Notes to Consolidated Financial Statements for additional information on real estate owned.

Allowances for Losses on Loans. The Company's allowance for losses on loans was $45.9 million, or 2.02% of gross loans held-for-investment, at December 31, 2012 compared to $41.7 million, or 1.82% of gross loans held-for-investment, at December 31, 2011. The provision for loan losses was $57.2 million for 2012, $74.3 million for 2011 and $101.5 million for 2010. The decrease in the provision for loan losses is due to the impact of the prior year loan sale as well as a decrease in non-accrual loans and criticized and classified loans and stabilizing delinquencies. Net charge-offs were $53.0 million for the year ended December 31, 2012 as compared to $114.7 million for the year ended December 31, 2011. The decrease in net charge-offs during 2012 was primarily due to $69.4 million of losses recorded on the sale of commercial real estate loans in the prior year. For the credit related charge-offs, management has been monitoring the performance, economic climate and future cash flow potential of these relationships for some time and strongly believes all of these borrowers have been profoundly impacted by the severity of the recession and the seemingly prolonged return to stable economic conditions. During 2012, the Company signed a definitive agreement to sell $45.8 million of loans having a book balance of $35.1 million to a third party investor and the related loans were moved to loans held-for-sale and recorded at lower of cost or market. The resulting charge-offs totaled $13.1 million. Excluding charge-offs related to the loan sale, the remaining net charge-offs in 2012 are primarily due to 10 commercial relationships totaling $23.2 million. The decrease in 2012 net charge-offs resulted in a decrease in net charge-offs to average outstanding loans to 2.29% for 2012 as compared to 4.83% for 2011 and 2.95% for 2010. Non-performing loans also decreased $12.1 million to $95.6 million at December 31, 2012 as compared to $107.7 million at December 31, 2011 as a result of problem loan resolution strategies implemented in 2012. During 2012, the Company entered into three troubled debt restructuring agreements ("TDR"), which were on non-accrual status and had a carrying amount of $9.1 million at December 31, 2012.

Table 14 provides information with respect to changes in the Company's allowance for loan losses for the years ended December 31, 2012, 2011, 2010, 2009, and 2008.

TABLE 14: ALLOWANCE FOR LOAN LOSSES

At or for the Years Ended December 31,	2012	2011	2010	2009	2008
Allowance for loan losses, beginning of year	**$ 41,667**	**$ 81,713**	$ 59,953	$ 37,309	$ 27,002
Charge-offs:					
Commercial and industrial	**(51,265)**	**(112,108)**	(74,014)	(19,898)	(6,520)
Home equity	**(2,222)**	**(3,038)**	(3,435)	(1,795)	(1,012)
Second mortgage	**(267)**	**(299)**	(761)	(81)	(81)
Residential real estate	**(249)**	**(1,064)**	(1,085)	(360)	(346)
Other	**(1,610)**	**(1,303)**	(1,507)	(2,614)	(2,769)
Total charge-offs	**(55,613)**	**(117,812)**	(80,802)	(24,748)	(10,728)
Recoveries:					
Commercial and industrial	**1,950**	**2,459**	482	334	619
Home equity	**422**	**60**	60	67	24
Second mortgage	**28**	**28**	26	4	1
Residential real estate	**14**	**43**	199	5	5
Other	**190**	**523**	277	316	386
Total recoveries	**2,604**	**3,113**	1,044	726	1,035
Net charge-offs	**(53,009)**	**(114,699)**	(79,758)	(24,022)	(9,693)
Provision for loan losses	57,215	74,266	101,518	46,666	20,000
Reserves transferred	**—**	**387**	—	—	—
Allowance for loan losses, end of year	**$ 45,873**	**$ 41,667**	$ 81,713	$ 59,953	$ 37,309
Net loans charged-off as a percent of average loans outstanding	2.29%	4.83%	2.95%	0.88%	0.37%
Allowance for loan losses as a percent of total gross loans outstanding	2.02%	1.80%	3.22%	2.21%	1.36%

Table 15 provides the allocation of the Company's allowance for loan losses by loan category and the percent of loans in each category to loans receivable at December 31, 2012, 2011, 2010, 2009, and 2008. The portion of the allowance for loan losses allocated to each loan category does not represent the total available for future losses that may occur within the loan category since the allowance for loan losses is a valuation reserve applicable to the entire loan portfolio.

TABLE 15: ALLOCATION OF ALLOWANCE FOR LOAN LOSSES

December 31,	2012		2011		2010		2009		2008	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Allowance for loan losses:										
Commercial and industrial	$ 33,197	72.37%	$ 34,227	82.14%	$ 76,759	82.97%	$ 55,359	82.77%	$ 33,342	81.55%
Residential real estate	3,333	7.27	903	2.17	661	3.12	494	2.77	375	2.46
Home equity (1)	2,734	5.96	2,566	6.16	3,084	11.58	3,034	12.04	2,738	13.09
Other	6,609	14.41	3,971	9.53	1,209	2.33	1,066	2.42	854	2.90
Total allowance for loan losses	$ 45,873	100.0%	$ 41,667	100.0%	$ 81,713	100.0%	$ 59,953	100.00%	$ 37,309	100.00%

(1) Amount includes both home equity and second mortgages.

See Note 6 of the Notes to Consolidated Financial Statements for additional information on the allowance for loan losses.

Investment Securities. Investment securities available for sale and held to maturity decreased $72.8 million, or 14.1%, from $516.9 million at December 31, 2011 to $444.1 million at December 31, 2012. For the year ended December 31, 2012, the Company's investment impairment review did not identify any credit losses. During 2011, the Company realized OTTI charges of $250 thousand on a single issuer trust preferred security with a par value of $5.0 million. The cumulative OTTI on the single issuer trust preferred security is $1.2 million. The estimated average life of the investment portfolio at December 31, 2012 was 3.3 years with an estimated modified duration of 2.5 years. The reinvestment strategy for 2013 is expected to maintain the average life, duration and portfolio size at approximately the same levels as December 31, 2012.

The Company's investment policy is established by senior management and approved by the Board of Directors. It is based on asset and liability management goals, and is designed to provide a portfolio of high quality investments that optimizes interest income within acceptable limits of risk and liquidity.

Table 16 provides the estimated fair value and amortized cost of the Company's portfolio of investment securities at December 31, 2012, 2011, and 2010. For all debt securities classified as available for sale, the carrying value is the estimated fair value.

TABLE 16: SUMMARY OF INVESTMENT SECURITIES

December 31,	2012			2011			2010		
	Amortized Cost	Net Unrealized Gains (Losses)	Estimated Fair Value	Amortized Cost	Net Unrealized Gains (Losses)	Estimated Fair Value	Amortized Cost	Net Unrealized Gains (Losses)	Estimated Fair Value
Available for sale:									
U.S. Treasury obligations	$ 9,998	$ 13	$ 10,011	$ 11,999	$ 80	$ 12,079	$ 47,017	$ 2	$ 47,019
U.S. Government agencies	4,966	(17)	4,949	—	—	—	—	—	—
U.S. Government agency mortgage-backed securities	348,854	6,124	354,978	423,269	5,635	428,904	329,973	(1,486)	328,487
Other mortgage-backed securities	287	(1)	286	323	(27)	296	7,472	(1,335)	6,137
State and municipal obligations	36,848	3,322	40,170	45,424	3,361	48,785	82,744	(347)	82,397
Trust preferred securities	12,622	(6,740)	5,882	12,619	(7,711)	4,908	12,867	(7,225)	5,642
Corporate Bonds	24,449	993	25,442	19,689	(281)	19,408	—	—	—
Other	1,464	—	1,464	1,165	—	1,165	3,182	—	3,182
Total available for sale investment securities	$ 439,488	$ 3,694	$ 443,182	$ 514,488	$ 1,057	$ 515,545	$ 483,255	$ (10,391)	$ 472,864
Held to maturity:									
U.S. Government agency mortgage-backed securities	$ 662	$ 48	$ 710	$ 1,344	$ 69	$ 1,413	$ 2,887	$ 116	$ 3,003
Other mortgage-backed securities	250	—	250	—	—	—	152	—	152
Total held to maturity investment securities	$ 912	$ 48	$ 960	$ 1,344	$ 69	$ 1,413	$ 3,039	$ 166	$ 3,155

Table 17 provides the gross unrealized losses and fair value at December 31, 2012, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position.

TABLE 17: ANALYSIS OF GROSS UNREALIZED LOSSES BY INVESTMENT CATEGORY

	Less than 12 Months		12 Months or Longer		Total	
December 31, 2012	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
U.S. Government agencies	$ 4,949	$ (17)	$ —	$ —	$ 4,949	$ (17)
U.S. Government agency mortgage-backed securities	69,145	(980)	—	—	69,145	(980)
Other mortgage-backed securities	286	(1)	—	—	286	(1)
Trust preferred securities	—	—	5,882	(6,740)	5,882	(6,740)
Total	$74,380	$ (998)	$ 5,882	$ (6,740)	$80,262	$ (7,738)

The Company determines whether the unrealized losses are temporary in accordance with FASB ASC 325, *Investments-Other*.- and FASB ASC 320, *Investments-Debt and Equity Securities*. The evaluation is based upon factors such as the creditworthiness of the underlying borrowers, performance of the underlying collateral, if applicable, and the level of credit support in the security structure. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost, and near-term prospects of the issuer.

For the year ended December 31, 2012, the Company reviewed its unrealized losses on securities to determine whether such losses were considered to be OTTI. As previously discussed, this review indicated no such unrealized losses were due to deterioration in credit of the underlying securities.

U.S. Government Agencies. At December 31, 2012, the gross unrealized loss in the category of less than 12 months of $17 thousand consisted of one agency security with an estimated fair value of $4.9 million issued and guaranteed by a U.S. Government sponsored agency. The Company monitors key credit metrics such as delinquencies, defaults, cumulative losses and credit support levels to determine if an OTTI exists. As of December 31, 2012, management concluded that an OTTI did not exist on the aforementioned security based upon its assessment. Management also concluded that it does not intend to sell the security, and that it is not more likely than not it will be required to sell the security, before their recovery, which may be maturity, and management expects to recover the entire amortized cost basis of this security.

U.S. Government Agency Mortgage-Backed Securities – At December 31, 2012, the gross unrealized loss in the category of less than 12 months of $980 thousand consisted of nine mortgage-backed securities with an estimated fair value of $69.1 million issued and guaranteed by a U.S. Government sponsored agency. The Company monitors key credit metrics such as delinquencies, defaults, cumulative losses and credit support levels to determine if an OTTI exists. As of December 31, 2012, management concluded that an OTTI did not exist on any of the aforementioned securities based upon its assessment. Management also concluded that it does not intend to sell the securities and that it is not more likely than not it will be required to sell the securities before their recovery, which may be maturity, and management expects to recover the entire amortized cost basis of these securities.

Other Mortgage-Backed Securities – At December 31, 2012, the gross unrealized loss in the category of 12 months or longer of $1 thousand consisted of one non-agency mortgage-backed security with an estimated fair value of $286 thousand. This security was rated “AA” by at least one nationally recognized rating agency. The Company monitors key credit metrics such as delinquencies, defaults, cumulative losses and credit support levels to determine if an OTTI exists. As of December 31, 2012, management concluded that an OTTI did not exist on the this security and believes the unrealized loss is due to increases in market interest rates since the time the underlying security was purchased.

Trust Preferred Securities – At December 31, 2012, the gross unrealized loss in the category of 12 months or longer of $6.7 million consisted of two trust preferred securities. The trust preferred securities are comprised of one non-rated single issuer security with an amortized cost of $3.8 million and an estimated fair value of $1.9 million, and one non-investment grade rated pooled security with an amortized cost of $8.8 million and estimated fair value of $3.9 million. The non-investment grade pooled security is a senior position in the capital structure with approximately 1.93 times principal coverage as of the last reporting date.

In August 2009, the issuer of the single issuer trust preferred security elected to defer its normal quarterly dividend payment. As contractually permitted, the issuer may defer dividend payments up to five years with accumulated dividends, and interest on those deferred dividends, payable upon the resumption of its scheduled dividend payments. The issuer is currently operating under an agreement with its regulators. The agreement stipulates the issuer must receive permission from its regulators prior to resuming its scheduled dividend payments.

During the year ended December 31, 2012, the Company did not record a credit related OTTI charge related to this deferring single issuer trust preferred security. Based on the Company’s most recent evaluation, the Company does not expect the issuer to default on the security based primarily on the issuer’s subsidiary bank reporting that it meets the minimum regulatory requirements to be considered a “well capitalized” institution. The Company recognizes the length of time the issue has been in deferral, the difficult economic environment and some weakened performance measures, while recently improving, increases the probability that a full recovery of principal and anticipated dividends may not be realized. However, the Company concluded that an additional impairment charge was not warranted at December 31, 2012.

Expected maturities of individual securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Table 18 provides an estimated maturity summary with the carrying values and weighted average yields on the Company’s portfolio of investment securities at December 31, 2012. The investment securities are presented in the table based on current prepayment assumptions. Yields on tax-exempt obligations have been calculated on a tax-equivalent basis.

TABLE 18: MATURITY DISTRIBUTION OF INVESTMENT SECURITIES

December 31, 2012	1 Year or Less Carrying Value	1 Year or Less Yield	1 to 5 Years Carrying Value	1 to 5 Years Yield	5 to 10 Years Carrying Value	5 to 10 Years Yield	More than 10 Years Carrying Value	More than 10 Years Yield	Total Carrying Value	Total Yield
Available for sale:										
U.S. Treasury obligations	$ 10,011	0.78%	$ —	— %	$ —	— %	$ —	— %	$ 10,011	0.78%
U.S. Government agencies	—	—	—	—	4,949	2.08	—	—	4,949	2.08
U.S. Government agency mortgage-backed securities	—	—	9,320	1.41	21,668	2.57	323,990	1.81	354,978	1.84
Other mortgage-backed securities	—	—	—	—	—	—	286	2.82	286	2.82
State and municipal obligations	225	5.23	—	—	8,786	4.19	31,159	4.23	40,170	4.23
Corporate bonds	—	—	25,442	2.20	—	—	—	—	25,442	2.20
Trust preferred securities	—	—	—	—	—	—	5,882	1.24	5,882	1.24
Other securities	1,216	0.01	248	1.00	—	—	—	—	1,464	0.18
Total available for sale investment securities	$ 11,452	0.78%	$ 35,010	1.98%	$ 35,403	2.90%	$ 361,317	2.01%	$ 443,182	2.05%
Held to maturity:										
U.S. Government agency mortgage-backed securities	$ —	— %	$ —	0%	$ 662	3.82%	$ —	— %	$ 662	3.82%
Other mortgage-backed securities	—	—	250	0.89	—	—	—	—	250	0.89
Total held to maturity investment securities	$ —	— %	$ 250	0.89%	$ 662	3.82%	$ —	— %	$ 912	3.01%

See Note 4 of the Notes to Consolidated Financial Statements for additional information on investment securities.

Restricted Equity Investments. During 2012, restricted equity investments increased $2.1 million to $17.9 million at December 31, 2012 from $15.8 million at December 31, 2011. The Company, through the Bank, is a member of the Federal Reserve, the Federal Home Loan Bank of New York ("FHLBNY") and Atlantic Central Bankers Bank, and is required to maintain an investment in the capital stock of each. The FRB, FHLBNY and the Atlantic Central Bankers Bank stock are restricted in that they can only be redeemed by the issuer at par value. These securities are carried at cost and the Company did not identify any events or changes in circumstances that may have had an adverse effect on the value of the investment in accordance with FASB ASC 942, *Financial Services—Depository and Lending*. As of December 31, 2012, management does not believe that an OTTI of these holdings exists and expects to recover the entire cost of these securities.

Bank Owned Life Insurance. During 2012, bank owned life insurance ("BOLI") increased $2.0 million to $76.9 million at December 31, 2012. Of the $76.9 million BOLI cash surrender value, the Company had $25.4 million invested in a general account and $51.5 million in a separate account at December 31, 2012. The BOLI separate account is invested in a mortgage-backed securities fund, which is managed by an independent investment firm. Pricing volatility of these underlying investments may have an impact on investment income; however, these fluctuations would be partially mitigated by a stable value wrap agreement which is a component of the separate account. While generally protected by the stable value wrap, significant declines in fair value may result in charges in future periods for values outside the wrap coverage.

Cash and Cash Equivalents. Cash and cash equivalents increased $49.8 million to $169.6 million at December 31, 2012 from $119.8 million at December 31, 2011. This increase is primarily due to the decrease of $70.7 million in investment securities in 2012 and the increase of $45.2 million in deposits partially offset by an increase of $83.3 million in gross loans receivable during the same period.

Goodwill. The goodwill balance was $38.2 million at December 31, 2012 and 2011. See the Critical Accounting Policies, Judgments and Estimates section for additional detail.

Deferred Taxes, net. Deferred taxes, net, increased $1.1 million from $432 thousand at December 31, 2011 to $1.5 million at December 31, 2012 due to an increase in unrealized gains on investment securities.

Deposits. Deposits at December 31, 2012 totaled $2.7 billion, an increase of $45.2 million, or 1.7%, from December 31, 2011. Core deposits, which exclude all certificates of deposit, decreased $19.1 million to $2.02 billion, or 74.3% of total deposits, at December 31, 2012 as compared to $2.03 billion, or 76.3% of total deposits, at December 31, 2011.

Table 19 provides a summary of deposits at December 31, 2012, 2011, and 2010.

TABLE 19: SUMMARY OF DEPOSITS

December 31,	2012	2011	2010
Demand deposits	**$1,751,183**	$1,772,386	$1,862,940
Savings deposits	**264,155**	262,044	279,086
Time deposits under $100,000	**323,768**	376,369	480,993
Time deposits $100,000 or more	**256,725**	177,747	228,121
Brokered time deposits	**117,393**	79,431	89,320
Total	**$2,713,224**	$2,667,977	$2,940,460

Consumer and commercial deposits are attracted principally from within the Company's primary market area through a wide complement of deposit products that include checking, savings, money market, certificates of deposits and individual retirement accounts. The Company continues to operate with a core deposit relationship strategy that values the importance of building a long-term stable relationship with each and every customer. The relationship pricing strategy rewards customers that establish core accounts and maintain a certain minimum threshold account balance. Management regularly meets to evaluate internal cost of funds, to analyze the competition, to review the Company's cash flow requirements for lending and liquidity, and executes any appropriate pricing changes when necessary.

Table 20 provides the distribution of total deposits between core and non-core at December 31, 2012, 2011, and 2010.

TABLE 20: DISTRIBUTION OF DEPOSITS

December 31,	2012		2011		2010	
	Amount	%	Amount	%	Amount	%
Core deposits	$2,015,338	74.28%	$2,034,430	76.3%	$2,142,026	72.8%
Non-core deposits	697,886	25.72	633,547	23.7	798,434	27.2
Total deposits	$2,713,224	100.0%	$2,667,977	100.0%	$2,940,460	100.0%

Table 21 provides a summary of certificates of deposit of $100,000 or more by remaining maturity at December 31, 2012.

TABLE 21: CERTIFICATES OF DEPOSIT OF $100,000 OR MORE

December 31, 2012	Amount
Three months or less	**$ 48,681**
Over three through six months	**38,031**
Over six through twelve months	**70,761**
Over twelve months	**99,252**
Total	**$256,725**

See Note 11 of the Notes to Consolidated Financial Statements for additional information on deposits.

Borrowings. Borrowed funds, excluding debentures held by trusts, increased $40.0 million to $63.4 million at December 31, 2012, from $23.4 million at December 31, 2011.

Table 22 provides the maximum month end amount of borrowings by type during the years ended December 31, 2012 and 2011.

TABLE 22: SUMMARY OF MAXIMUM MONTH END BORROWINGS

Years Ended December 31,	2012	2011
FHLBNY advances	**$ 2,625**	$ 3,895
FHLBNY repurchase agreements	**45,000**	15,000
FHLBNY overnight line of credit	**37,000**	—
Repurchase agreements with customers	**7,278**	8,249

Table 23 provides information regarding FHLBNY advances and FHLBNY repurchase agreements, interest rates, approximate weighted average amounts outstanding and their approximate weighted average rates at or for the years ended December 31, 2012, 2011, and 2010.

TABLE 23: SUMMARY OF FHLBNY BORROWINGS

At or for the Years Ended December 31,	2012	2011	2010
FHLBNY term amortizing advances outstanding at year end	**$ 1,415**	$ 2,733	$ 3,999
Weighted average interest rate at year end	**5.43%**	4.75%	4.51%
Approximate average amount outstanding during the year	**$ 2,023**	$ 3,317	$ 4,561
Approximate weighted average rate during the year	**5.00%**	4.62%	4.45%
FHLBNY term non-amortizing advances outstanding at year end	**$60,000**	$ —	$ —
Weighted average interest rate at year end	**2.02%**	— %	— %
Approximate average amount outstanding during the year	**$16,250**	$ —	$ 2,500
Approximate weighted average rate during the year	**1.99**	— %	5.80%
FHLBNY repurchase agreements outstanding at year end	**$ —**	$15,000	$15,000
Weighted average interest rate at year end	**— %**	4.84%	4.84%
Approximate average amount outstanding during the year	**$18,333**	$15,000	$15,000
Approximate weighted average rate during the year	**2.30%**	4.91%	4.91%

Table 24 provides information regarding securities sold under agreements to repurchase with customers, interest rates, approximate average amounts outstanding and their approximate weighted average rates at December 31, 2012, 2011, and 2010.

TABLE 24: SUMMARY OF SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE WITH CUSTOMERS

At or for the Years Ended December 31,	2012	2011	2010
Balance at year end	$1,968	$5,668	$ 6,307
Weighted average interest rate at year end	0.17%	0.08%	0.21%
Approximate average amount outstanding during the year	$4,859	$6,659	$15,243
Approximate weighted average rate during the year	0.15%	0.10%	0.19%

Deposits are the primary source of funds for the Company's lending activities, investment activities and general business purposes. Should the need arise, the Company has the ability to access lines of credit from various sources including the FRB, the FHLBNY and various other correspondent banks. In addition, on an overnight basis, the Company has the ability to sell securities under agreements to repurchase.

See Notes 12 and 13 of the Notes to Consolidated Financial Statements for additional information on borrowings.

Junior Subordinated Debentures Held by Trusts that Issued Capital Debt. Table 25 provides a summary of the outstanding capital securities issued by each Issuer Trust and the junior subordinated debenture issued by the Company to each Issuer Trust as of December 31, 2012.

TABLE 25: SUMMARY OF CAPITAL SECURITIES AND JUNIOR SUBORDINATED DEBENTURES

December 31, 2012	Capital Securities			Junior Subordinated Debentures		
Issuer Trust	Issuance Date	Stated Value	Distribution Rate	Principal Amount	Maturity	Redeemable Beginning
Sun Capital Trust V	December 18, 2003	$ 15,000	3-mo LIBOR plus 2.80%	$ 15,464	December 30, 2033	December 30, 2008
Sun Capital Trust VI	December 19, 2003	25,000	3-mo LIBOR plus 2.80%	25,774	January 23, 2034	January 23, 2009
Sun Statutory Trust VII	January 17, 2006	30,000	3-mo LIBOR plus 1.35%	30,928	March 15, 2036	March 15, 2011
Sun Capital Trust VII	April 19, 2007	10,000	6.428% Fixed	10,310	June 30, 2037	June 30, 2012
Sun Capital Trust VIII	July 5, 2007	10,000	3-mo LIBOR plus 1.39%	10,310	October 1, 2037	October 1, 2012
		$ 90,000		$ 92,786		

On January 23, 2009 and December 30, 2008, the capital securities of Sun Capital Trust VI and Sun Capital Trust V, respectively, became eligible for redemption. As a result of the current interest environment, the Company has elected not to call these securities; however, the Company maintains the right to call these securities in the future on the respective payment anniversary dates.

The Company has customarily relied on dividend payments from the Bank to fund junior subordinated debenture interest obligations. The amount available for payment of dividends to the Company by the Bank was $0 as of December 31, 2012 and no dividends may be paid by the Bank without OCC approval. Per the OCC Agreement, a dividend may only be declared if it is in accordance with the approved capital plan, the Bank remains in compliance with the capital plan following the payment of the dividend and the dividend is approved by the OCC. The Company believes it is capable of funding its junior subordinated debenture interest obligations through available cash balances maintained at the bank holding company for the period of time necessary until earnings are expected to support a dividend from the Bank. See Note 23 of the Notes to Consolidated Financial Statements for additional information on dividend limitations.

Other Liabilities. Other liabilities totaled $82.9 million at December 31, 2012 and $82.4 million at December 31, 2011. Derivative liabilities are the primary component of other liabilities. See Note 19 of the Notes to Consolidated Financial Statements for additional information on derivative instruments.

FORWARD-LOOKING STATEMENTS

The Company may from time to time make written or oral "forward-looking statements," including statements contained in the company's filings with the securities and exchange commission, in its reports to shareholders and in other communications by the Company, which are made in good faith by the company pursuant to the "safe harbor" provisions of the private securities litigation reform act of 1995. Forward-looking statements often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook," or similar expressions or future or conditional verbs such as "may," "will," "should," "would," "could."

- statements and assumptions relating to financial performance;
- statements relating to the anticipated effects on results of operations or financial condition from recent or future developments or events;
- statements relating to our business and growth strategies and our regulatory capital levels;
- statements relating to potential sales of our criticized and classified assets; and
- any other statements, projections or assumptions that are not historical facts.

Actual future results may differ materially from our forward-looking statements, and we qualify all forward-looking statements by various risks and uncertainties we face, some of which are beyond our control, as well as the assumptions underlying the statements, including, among others, the following factors:

- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- market volatility;
- the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs;
- the overall quality of the composition of our loan and securities portfolios;
- the market for criticized and classified assets that we may sell;
- legislative and regulatory changes, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and impending regulations, changes in banking, securities and tax laws and regulations and their application by our regulators and changes in the scope and cost of FDIC insurance and other coverages;
- the effects of, and changes in, monetary and fiscal policies and laws, including interest rate policies of the FRB;
- inflation, interest rate, market and monetary fluctuations;
- fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas;
- the effect of and our compliance with the terms of the OCC Agreement as well as compliance with the individual minimum capital ratios established for the Bank by the OCC;
- the results of examinations of us by the Federal Reserve and of the Bank by the OCC, including the possibility that the OCC may, among other things, require the Bank to increase its allowance for loan losses or to write-down assets;
- our ability to control operating costs and expenses;
- our ability to manage delinquency rates;
- our ability to retain key members of our senior management team;
- the costs of litigation, including settlements and judgments;
- the increased competitive pressures among financial services companies;
- the timely development of and acceptance of new products and services and the perceived overall value of these products and services by businesses and consumers, including the features, pricing and quality compared to our competitors' products and services;
- technological changes;
- acquisitions;
- changes in consumer and business spending, borrowing and saving habits and demand for financial services in our market area;
- adverse changes in securities markets;
- the inability of key third-party providers to perform their obligations to us;
- changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies, the Financial Accounting Standards Board;
- war or terrorist activities;
- other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services and the other risks described elsewhere herein or in the documents incorporated by reference herein and our other filings with the Securities and Exchange Commission ("SEC"); and

- our success at managing the risks involved in the foregoing.

The development of any or all of these factors could have an adverse impact on our financial position and results of operations.

Any forward-looking statements are based upon management's beliefs and assumptions at the time they are made. We undertake no obligation to publicly update or revise any forward-looking statements included or incorporated by reference herein or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise, unless otherwise required to do so by law or regulation. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed herein or in the documents incorporated by reference herein might not occur, and you should not put undue reliance on any forward-looking statements.

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NON-GAAP FINANCIAL MEASURES

This Annual Report on Form 10-K of the Company contains financial information by methods other than in accordance with Generally Accepted Accounting Principles in the United States of America ("GAAP"). Management uses these "non-GAAP" measures in their analysis of the Company's performance. Management believes that these non-GAAP financial measures provide a greater understanding of ongoing operations and enhance comparability of results with prior periods as well as demonstrating the effects of significant gains and charges in the current period. The Company believes that a meaningful analysis of its financial performance requires an understanding of the factors underlying that performance. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies. Management uses these measures to evaluate the underlying performance and efficiency of operations. Management believes these measures reflect core trends of the business. Reconciliations of these ratios to GAAP are presented below.

Tangible Equity to Tangible Assets Ratio:

Tangible equity and tangible assets are calculated by subtracting identifiable intangible assets and goodwill from shareholders' equity and total assets, respectively, and may be used by investors to assist them in understanding how much loss, exclusive of intangible assets and goodwill, can be absorbed before shareholders' equity is depleted. The Company's and the Bank's regulators also exclude intangible assets and goodwill from shareholders' equity when assessing capital adequacy of each.

The following table reconciles this non-GAAP performance measure to the GAAP performance measure for the periods indicated:

Years Ended December 31,	2012	2011	2010
Total assets	**$3,224,031**	$3,183,926	$3,417,546
Less: Intangible assets	**3,262**	6,947	10,631
Less: Goodwill	**38,188**	38,188	38,188
Tangible assets	**$3,182,581**	$3,138,791	$3,368,727
Total stockholders' equity	**$ 262,595**	$ 309,083	$ 268,242
Less: Intangible assets	**3,262**	6,947	10,631
Less Goodwill	**38,188**	38,188	38,188
Tangible stockholders' equity	**$ 221,145**	$ 263,948	$ 219,423
Total stockholders' equity to total assets ratio	**8.14%**	9.71%	7.85%
Tangible common equity to tangible assets ratio	**6.95%**	8.41%	6.51%

Tax Equivalent Net Interest Income:

Tax-equivalent net interest income is net interest income plus the taxes that would have been paid had tax-exempt securities been taxable. This number attempts to enhance the comparability of the performance of assets that have different tax liabilities.

The following table provides a reconciliation of tax equivalent net interest income to GAAP net interest income using a 35% tax rate:

Years Ended December 31,	2012	2011	2010
Net interest income, as presented	**$97,848**	$103,528	$110,962
Effect of tax-exempt income	**870**	1,341	1,800
Net interest income, tax equivalent	**$98,718**	$104,869	$112,762

Core Deposits:

Core deposits is calculated by excluding time deposits and brokered deposits from total deposits.

The following table provides a reconciliation of core deposits to GAAP total deposits:

Years Ended December 31,	2012	2011
Total deposits	**$2,713,224**	$2,667,977
Less: Time deposits	**580,493**	554,116
Less: Brokered deposits	**117,393**	79,431
Core deposits	**$2,015,338**	$2,034,430

MANAGEMENT’S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Securities Exchange Act of 1934 Rules 13(a)-15(f). The Company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Management, including the chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the Company’s internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because management’s assessment was also conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management’s assessment of the Company’s internal control over financial reporting also included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for Consolidated Reports of Condition and Income for Schedules RC, RI, RI-A. Based on our evaluation under the framework in Internal Control—Integrated Framework, we concluded that the Company’s internal control over financial reporting was effective as of December 31, 2012.

Deloitte & Touche LLP, an independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report and has issued a report on the effectiveness of our internal control over financial reporting. Their reports follow this statement.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Sun Bancorp, Inc.
Vineland, New Jersey

We have audited the internal control over financial reporting of Sun Bancorp, Inc. and subsidiaries (the "Company") as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income for Schedules RC, RI, RI-A. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2012 of the Company and our report dated March 18, 2013 expressed an unqualified opinion and includes an explanatory paragraph relating to the change in presentation of comprehensive income due to the Company's adoption of Accounting Standards Update 2011-05.

/s/ Deloitte & Touche LLP

Philadelphia, PA
March 18, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Sun Bancorp, Inc.
Vineland, New Jersey

We have audited the accompanying consolidated statements of financial condition of Sun Bancorp, Inc. and subsidiaries (the “Company”) as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Sun Bancorp, Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the Company changed its presentation of comprehensive income due to the adoption of Accounting Standards Update 2011-05.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 18, 2013 expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Philadelphia, PA
March 18, 2013

SUN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Dollars in thousands, except par value amounts)

December 31,	2012	2011
ASSETS		
Cash and due from banks	**$ 77,564**	$ 68,773
Interest-earning bank balances	**92,052**	51,049
Cash and cash equivalents	**169,616**	119,822
Investment securities available for sale (amortized cost of $439,488 and $514,488 at December 31, 2012 and 2011, respectively)	**443,182**	515,545
Investment securities held to maturity (estimated fair value of $960 and $1,413 at December 31, 2012 and 2011, respectively)	**912**	1,344
Loans receivable (net of allowance for loan losses of $45,873 and $41,667 at December 31, 2012 and 2011, respectively)	**2,230,287**	2,249,455
Loans held-for-sale, at lower of cost or market	**21,922**	23,192
Loans held-for-sale, at fair value	**99,013**	—
Restricted equity investments, at cost	**17,886**	15,826
Bank properties and equipment, net	**50,805**	54,756
Real estate owned, net	**7,473**	5,020
Accrued interest receivable	**8,054**	8,912
Goodwill	**38,188**	38,188
Intangible assets, net	**3,262**	6,947
Bank owned life insurance (BOLI)	**76,858**	74,871
Other assets	**56,573**	70,048
Total assets	**$3,224,031**	$3,183,926
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits	**$2,713,224**	2,667,977
Securities sold under agreements to repurchase – customers	**1,968**	5,668
Advances from the Federal Home Loan Bank of New York (FHLBNY)	**61,415**	2,733
Securities sold under agreements to repurchase – FHLBNY	**—**	15,000
Obligation under capital lease	**7,609**	7,868
Junior subordinated debentures	**92,786**	92,786
Deferred taxes, net	**1,509**	432
Other liabilities	**82,925**	82,379
Total liabilities	**2,961,436**	2,874,843
Commitments and contingencies (see Note 18)		
SHAREHOLDERS' EQUITY		
Preferred stock, $1 par value, 1,000,000 shares authorized, none issued	**—**	—
Common stock, $1 par value, 200,000,000 shares authorized; 88,290,735 shares issued and 86,184,012 shares outstanding at December 31, 2012; 87,825,038 shares issued and 85,718,315 shares outstanding at December 31, 2011	**88,301**	87,825
Additional paid-in capital	**506,537**	504,508
Retained deficit	**(308,011)**	(257,520)
Accumulated other comprehensive income	**2,186**	625
Deferred compensation plan trust	**(256)**	(193)
Treasury stock at cost, 2,106,723 shares at December 31, 2012 and 2011, respectively	**(26,162)**	(26,162)
Total shareholders' equity	**262,595**	309,083
Total liabilities and shareholders' equity	**$3,224,031**	$3,183,926

See Notes to Consolidated Financial Statements.

SUN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share amounts)

Years Ended December 31,	2012	2011	2010
INTEREST INCOME			
Interest and fees on loans	**$ 103,707**	$ 112,793	$ 129,391
Interest on taxable investment securities	**9,138**	10,507	11,993
Interest on non-taxable investment securities	**1,618**	2,487	3,344
Dividends on restricted equity investments	**970**	893	875
Total interest income	**115,433**	126,680	145,603
INTEREST EXPENSE			
Interest on deposits	**13,553**	18,737	28,780
Interest on funds borrowed	**1,438**	1,418	1,744
Interest on junior subordinated debentures	**2,594**	2,997	4,117
Total interest expense	**17,585**	23,152	34,641
Net interest income	**97,848**	103,528	110,962
PROVISION FOR LOAN LOSSES	**57,215**	74,266	101,518
Net interest income after provision for loan losses	**40,633**	29,262	9,444
NON-INTEREST INCOME			
Service charges on deposit accounts	**10,660**	10,889	11,572
Other service charges	**294**	330	364
Gain on sale of loans	**10,479**	3,247	3,560
Net gain on sale of investment securities	**234**	1,855	4,751
Investment products income	**2,296**	2,913	2,831
BOLI income	**1,986**	2,964	2,074
Net impairment losses on available for sale securities:			
Total impairment	**$ —**	$ (250)	$ (4,944)
Portion of loss recognized in other comprehensive income (before taxes)	**—**	—	3,615
Net impairment losses recognized in operations	**—**	(250)	(1,329)
Derivative credit adjustment	**(2,275)**	(12,538)	(12,214)
Other	**5,776**	4,058	3,903
Total non-interest income	**29,450**	13,468	15,512
NON-INTEREST EXPENSE			
Salaries and employee benefits	**62,500**	52,501	55,219
Occupancy expense	**13,011**	13,373	12,508
Equipment expense	**7,399**	7,342	6,783
Amortization of intangible assets	**3,685**	3,685	3,685
Data processing expense	**4,384**	4,352	4,359
Professional fees	**3,459**	3,271	2,724
Goodwill impairment	**—**	—	89,706
Insurance expense	**5,824**	6,186	7,696
Advertising expense	**2,809**	2,946	2,335
Problem loan expense	**5,681**	8,342	5,162
Real estate owned expense, net	**2,358**	1,186	801
Office supplies expense	**1,247**	1,307	1,501
Other	**8,251**	5,734	8,573
Total non-interest expense	**120,608**	110,225	201,052
LOSS BEFORE INCOME TAXES	**(50,525)**	(67,495)	(176,096)
INCOME TAX (BENEFIT) EXPENSE	**(34)**	10	9,322)
NET LOSS	**(50,491)**	(67,505)	(185,418)
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	**$ (50,491)**	$ (67,505)	$ (185,418)
Basic loss per common share	**$ (0.59)**	$ (0.88)	$ (6.56)
Diluted loss per common share	**$ (0.59)**	$ (0.88)	$ (6.56)
Weighted average common shares – basic	**85,938,714**	76,653,990	28,258,953
Weighted average common shares – diluted	**85,938,714**	76,653,990	28,258,953

See Notes to Consolidated Financial Statements.

SUN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Dollars in thousands)

	For the Year Ended December 31,		
	2012	**2011**	**2010**
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	**$(50,491)**	$(67,505)	(185,418)
Other Comprehensive Income, net of tax (See Note 2)			
Unrealized gains (losses) on securities:			
Unrealized holding gains (losses) gains arising during period	**$ 1,649**	$ 7,721	(1,765)
Less: reclassification adjustment for gains included in net income	**(88)**	(1,098)	(2,842)
Reclassification adjustment for net impairment loss recognized in earnings	**—**	148	808
Reclassification adjustment for portion of impairment loss recognized in other comprehensive loss	**—**	—	(2,198)
Other comprehensive income (loss)	**1,561**	6,771	(5,997)
COMPREHENSIVE LOSS	**$(48,930)**	$(60,734)	(191,415)

See Notes to Consolidated Financial Statements.

SUN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars in thousands)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive (Loss) Gain	Deferred Compensation Plan Trust	Treasury Stock	Total
BALANCE, JANUARY 1, 2010	$ —	$25,436	$362,189	$ (4,597)	$ (149)	$ (124)	$(26,162)	$ 356,593
Net loss	—	—	—	(185,418)	—	—	—	(185,418)
Other comprehensive loss	—	—	—	—	(5,997)	—	—	(5,997)
Issuance of preferred stock (See Note 21)	88,009	—	—	—	—		—	88,009
Redemption of preferred stock (See Note 21)	(88,009)	—	—	—	—		—	(88,009)
Issuance of common stock	—	26,983	81,074	—	—	(110)	—	107,947
Preferred and common stock issuance costs (See Note 21)	—	—	(7,495)	—	—	—	—	(7,495)
Stock-based compensation	—	45	2,567	—	—	—	—	2,612
BALANCE, DECEMBER 31, 2010	$ —	$52,464	$438,335	$(190,015)	$ (6,146)	$ (234)	$(26,162)	$ 268,242
Net loss	—	—	—	(67,505)	—	—	—	(67,505)
Other comprehensive income	—	—	—	—	6,771	—	—	6,771
Capital raise	—	34,930	64,621	—	—	—	—	99,551
Deferred cost of capital raise	—	—	(571)	—	—	—	—	(571)
Issuance of common stock	—	354	742	—	—	41	—	1,137
Stock based compensation	—	77	1,381	—	—	—	—	1,458
BALANCE, DECEMBER 31, 2011	$ —	$87,825	$504,508	$(257,520)	$ 625	$ (193)	$(26,162)	$ 309,083
Net loss	**—**	**—**	**—**	**(50,491)**	**—**	**—**	**—**	**(50,491)**
Other comprehensive income	**—**	**—**	**—**	**—**	**1,561**	**—**	**—**	**1,561**
Issuance of common stock	**—**	**396**	**794**	**—**	**—**	**(63)**	**—**	**1,127**
Stock based compensation	**—**	**80**	**1,235**	**—**	**—**	**—**	**—**	**1,315**
BALANCE, DECEMBER 31, 2012	**$ —**	**$88,301**	**$506,537**	**$(308,011)**	**$ 2,186**	**$ (256)**	**$(26,162)**	**$ 262,595**

See Notes to Consolidated Financial Statements.

SUN BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

Years Ended December 31,	2012	2011	2010
OPERATING ACTIVITIES			
Net (loss) income	**$ (50,491)**	$ (67,505)	$(185,418)
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	**57,215**	74,266	101,518
Increase (decrease) in reserve for unfunded commitments	**232**	(1,109)	525
Depreciation, amortization and accretion	**12,700**	11,978	11,574
Goodwill impairment	**—**	—	89,706
Impairment of bank properties and equipment and real estate owned	**1,736**	1,394	277
Impairment charge on available for sale securities	**—**	250	1,329
Net gain on sales and calls of investment securities	**(151)**	(1,901)	(4,673)
Loss (gain) on real estate owned	**345**	(26)	(18)
Purchase of trading securities	**—**	(41,371)	—
Proceeds from sale of trading securities	**—**	41,367	—
Increase in fair value of interest rate lock commitments	**(847)**	—	—
Gain on sale of loans	**(8,414)**	(3,247)	(3,560)
Increase in cash surrender value of BOLI	**(1,987)**	(2,199)	(2,074)
Deferred income taxes	**—**	—	20,342
Stock-based compensation	**1,315**	1,458	2,612
Shares contributed to employee benefit plans	**1,126**	1,096	644
Credit valuation adjustment	**54**	(2,042)	1,948
Change in fair value of residential mortgage loans held-for-sale	**(2,065)**	—	—
Mortgage loans originated for sale	**(471,185)**	(141,482)	(189,077)
Proceeds from the sale of mortgage loans	**405,842**	135,895	185,520
Change in assets and liabilities which provided (used) cash:			
Accrued interest receivable	**858**	1,092	2,231
Other assets	**4,378**	12,629	5,373
Other liabilities	**11,698**	11,872	(1,169)
Net cash (used in) provided by operating activities	**(37,641)**	32,415	37,610
INVESTING ACTIVITIES			
Purchases of investment securities available for sale	**(117,411)**	(248,524)	(465,629)
Purchases of investment securities held to maturity	**(250)**	—	—
Net (purchase) redemption of restricted equity securities	**(2,060)**	1,764	(2,091)
Proceeds from maturities, prepayments or calls of investment securities available for sale	**141,795**	151,002	246,278
Proceeds from maturities, prepayments or calls of investment securities held to maturity	**676**	1,693	3,911
Proceeds from sale of investment securities available for sale	**47,500**	63,001	175,381
Proceeds from the sale of commercial real estate loans	**—**	98,628	54,808
Net (increase) decrease in loans	**(67,475)**	12,447	51,794
Purchases of bank properties and equipment	**(3,869)**	(8,384)	(5,090)
Return of surrender value of BOLI	**—**	2,230	5,171
Proceeds from sale of real estate owned	**3,559**	1,597	8,049
Insurance proceeds from real estate owned	**—**	—	154
Net cash provided by investing activities	**2,465**	75,454	72,736
FINANCING ACTIVITIES			
Net increase (decrease) in deposits	**45,247**	(272,105)	31,192
Net repayments of federal funds purchased	**—**	—	(89,000)
Net repayments of securities sold under agreements to repurchase - customer	**(3,700)**	(639)	(12,370)
Repayments of short-term advances from FHLBNY	**(1,318)**	(1,266)	(11,216)
Borrowings of long-term advances from FHLBNY	**60,000**	—	—
Repayments under securities sold under agreements to repurchase - FHLB	**(15,000)**	—	—
Repayment of obligation under capital lease	**(259)**	(243)	(190)
Proceeds from the issuance of preferred stock (see Note 21)	**—**	—	88,009
Redemption of preferred stock	**—**	—	(88,009)
Preferred stock issuance costs	**—**	—	(7,495)
Common stock issuance costs	**—**	(571)	—
Proceeds from issuance of common stock	**—**	99,551	106,839
Net cash provided by (used in) financing activities	**84,970**	(175,273)	17,760
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**49,794**	(67,404)	128,106
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	**119,822**	187,226	59,120
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 169,616**	$ 119,822	$ 187,226
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Interest paid	**$ 21,137**	$ 25,048	$ 32,766
Income taxes paid	**—**	154	110
SUPPLEMENTAL DISCLOSURE OF NON-CASH ITEMS			

Transfer of real estate owned to bank property	**$ —**	$ —	$ 1,900
Transfer of loans or bank properties to real estate owned	**7,679**	3,344	4,625
Transfer of loans from held-for-sale to held-for-investment	**9,905**	6,374	2,985
Commitments to purchase investment securities	**—**	—	2,500

See Notes to Consolidated Financial Statements.

1. NATURE OF OPERATIONS

Sun Bancorp, Inc. (the "Company") is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company is the parent company of Sun National Bank (the "Bank"), a national bank and the Company's principal wholly owned subsidiary. The Bank's wholly owned subsidiaries are Sun Financial Services, L.L.C., and 2020 Properties, L.L.C. and 4040 Properties, L.L.C. The Bank's former subsidiary, Sun Home Loans, Inc., was merged into the Bank on September 16, 2011, pursuant to New Jersey Law.

The Company's principal business is to serve as a holding company for the Bank. The Bank is in the business of attracting customer deposits through its Community Banking Centers and investing these funds, together with borrowed funds and cash from operations, in loans, primarily commercial real estate, small business, residential mortgage and non-real estate loans, as well as mortgage-backed and investment securities. The principal business of Sun Financial Services, L.L.C. is to offer mutual funds, securities brokerage, annuities and investment advisory services through the Bank's Community Banking Centers. The principal business of 2020 Properties, L.L.C. and 4040 Properties, L.L.C. is to acquire and thereafter liquidate certain real estate and other assets in satisfaction of debts previously contracted by the Bank. The Company's various capital trusts, Sun Capital Trust V, Sun Capital Trust VI, Sun Capital Trust VII, Sun Statutory Trust VII and Sun Capital Trust VIII, collectively, the "Issuing Trusts," are presented on a deconsolidated basis. The Issuing Trusts, consisting of Delaware business trusts and one business trust operating in Connecticut, hold junior subordinated debentures issued by the Company.

Through the Bank, the Company provides commercial and consumer banking services. As of December 31, 2012, the Company had 62 locations throughout New Jersey.

The Company's outstanding common stock is traded on the NASDAQ Global Select Market under the symbol "SNBC". The Company is subject to the reporting requirements of the Securities and Exchange Commission ("SEC"). The Bank's primary federal regulator is the Office of the Comptroller of the Currency (the "OCC").

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation. The accounting and reporting policies conform to accounting principles generally accepted in the United States of America ("GAAP") and to general practices in the banking industry. The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. The significant estimates include the allowance for loan losses, goodwill, intangible assets, income taxes, stock-based compensation, and the fair value of financial instruments. Actual results may differ from these estimates under different assumptions or conditions.

Basis of Consolidation. The consolidated financial statements include, after all intercompany balances and transactions have been eliminated, the accounts of the Company, its principal wholly owned subsidiary, the Bank, and the Bank's wholly owned subsidiaries, Sun Financial Services, L.L.C., 2020 Properties, L.L.C., and 4040 Properties, L.L.C. In accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") 810, *Consolidation*, the Issuing Trusts are deconsolidated. See Note 14 of the Notes to Consolidated Financial Statements for additional information on the Company's participation in the Issuing Trusts.

Segment Information. In accordance with FASB ASC 280, *Segment Reporting* (FASB ASC 280), the Company has one reportable operating segment, "Community Banking." All of the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, lending is dependent upon the ability of the Company to fund itself with deposits and other borrowings, and manage interest rate and credit risk. Accordingly, all significant operating decisions are based upon analysis of the Company as one segment or unit.

Cash and Cash Equivalents. Cash and cash equivalents includes cash and amounts due from banks, interest-earning bank balances and federal funds sold, all of which have original maturity dates of 90 days or less.

Investment Securities. The Company's investment securities include both held-to-maturity and available-for-sale. The purchase and sale of the Company's investment securities are recorded based on trade date accounting. At December 31, 2012 and 2011, the Company had no unsettled transactions. The following provides further information on the Company's accounting for debt securities:

Held-to-Maturity - Investment securities that management has the positive intent and ability to hold until maturity are classified as held-to-maturity and carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the interest method over the estimated remaining term of the underlying security.

Available- for-Sale – Investment securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity, and changes in the availability and the yield of alternative investments, are classified as available-for-sale. These assets are carried at their estimated fair value. Fair values are based on quoted prices for identical assets in active markets, quoted prices for similar assets in markets that are either actively or not actively traded, or in some cases where there is limited activity or less transparency around inputs, internally developed discounted cash flow models. Unrealized gains and losses are excluded from earnings and are reported net of tax in accumulated other comprehensive income (loss) on the consolidated statements of financial condition until realized, including those recognized through the non-credit component of an other-than-temporary impairment ("OTTI") charge.

Trading – From time to time, the Company purchases debt securities principally for the purpose of selling in the near-term. Any trading security balances held as of the reporting date are classified as held-for-trading and accounted for at fair value. Realized and unrealized gains and losses on trading securities are included in other income on the consolidated statements of operations. Fair values of trading securities are based on quoted market prices, pricing models (utilizing indicators of general market conditions or other economic measurements), or management's estimates of amounts to be realized on settlement, assuming current market conditions and an orderly disposition over a reasonable period of time. The Company had no investment securities classified as trading at December 31, 2012 and 2011.

In accordance with FASB ASC 325-40, *Beneficial Interests in Securitized Financial Assets* (FASB ASC 325-40), and FASB ASC 320, *Investment – Debt and Equity Securities* (FASB ASC 320), the Company evaluates its securities portfolio for OTTI throughout the year. Each investment, which has a fair value less than the book value, is reviewed on a quarterly basis by management. Management considers, at a minimum, whether the following factors exist that, both individually or in combination, could indicate that the decline is other-than-temporary: (a) the Company has the intent to sell the security; (b) it is more likely than not that it will be required to sell the security before recovery; and (c) the Company does not expect to recover the entire amortized cost basis of the security. Among the factors that are considered in determining the Company's intent is a review of capital adequacy, interest rate risk profile and liquidity at the Company. An impairment charge is recorded against individual securities if the review described above concludes that the decline in value is other-than-temporary. During 2012, it was determined there were no other-than-temporarily impaired investments. As a result, the Company did not record credit related OTTI charges through earnings during the year ended December 31, 2012 as compared to $250 thousand for the year ended December 31, 2011 and $1.3 million for the year ended December 31, 2010.

Loans Held-for-Sale. The Company had $120.9 million and $23.2 million of loans held-for-sale at December 31, 2012 and 2011, respectively. The balance at December 31, 2012 includes $99.0 million of residential mortgages originated with the intent to sell which are recorded at fair value and $21.9 million of commercial real estate loans, recorded at lower of cost or market. Effective July 1, 2012, the Company elected the fair value option under FASB ASC 825, *The Fair Value Option for Financial Instruments,* ("FASB ASC 825"), on its residential mortgage loans held-for-sale portfolio. This election resulted in a positive market value adjustment of $2.1 million, which was recognized in gain on sale of loans on the consolidated statements of operations for the twelve months ended December 31, 2012. At December 31, 2011, loans held-for-sale were carried at the lower of cost or estimated fair value, on an aggregate basis.

Deferred Loan Fees. Loan fees on loans held-for-investment, net of certain direct loan origination costs, are deferred and the balance is amortized to income as a yield adjustment over the life of the loan using the interest method. Loan fees on loans held-for-sale, net of certain direct loan origination costs, are deferred until the related loans are sold and are included in the determination of the gains or losses upon sale, which are reported in gain on sale of loans in the consolidated statements of operations.

Allowance for Loan Losses. The allowance for loan losses is determined by management based upon past experience, evaluation of estimated loss and impairment in the loan portfolio, current economic conditions and other pertinent factors. The allowance for loan losses is maintained at a level that management considers adequate to provide for estimated losses and impairment based upon an evaluation of known and inherent risk in the loan portfolio. Loan impairment is evaluated based on the fair value of collateral. While management uses the best information available to make such evaluations, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluations.

The provision for loan losses is based upon historical loan loss experience, a series of qualitative factors and an evaluation of estimated losses in the current commercial loan portfolio, including the evaluation of impaired loans under FASB ASC 310, *Receivables* (“FASB ASC 310”). Values assigned to the qualitative factors and those developed from historic loss experience provide a dynamic basis for the calculation of reserve factors for both pass-rated loans (general pooled allowance) and those criticized and classified loans that continue to perform. A loan is considered to be impaired when, based upon current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan. An insignificant delay or insignificant shortfall in amount of payments does not necessarily result in the loan being identified as impaired. For this purpose, delays less than 90 days are considered to be insignificant. Impairment losses are included in the provision for loan losses. Loans not individually reviewed are evaluated as a group using reserve factor percentages based on historic loss experience qualitative factors. Included in these qualitative factors are:

- Levels of past due, classified and non-accrual loans, troubled debt restructurings and modifications
- Nature and volume of loans
- Changes in lending policies and procedures, underwriting standards, collections, charge-offs and recoveries, and for commercial loans, the level of loans being approved with exceptions to policy
- Experience, ability and depth of management and staff
- National and local economic and business conditions, including various market segments
- Quality of the Company’s loan review system and degree of Board oversight
- Concentrations of credit by industry, geography and collateral type, with a specific emphasis on real estate, and changes in levels of such concentrations
- Effect of external factors, including the deterioration of collateral values, on the level of estimated credit losses in the current portfolio

Commercial loans, including commercial real estate loans, are placed on non-accrual at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. Generally, commercial loans and commercial real estate loans are charged-off no later than 180 days delinquent unless the loan is well secured and in the process of collection, or other extenuating circumstances support collection. Residential real estate loans are typically placed on non-accrual at the time the loan is 90 days delinquent. Other consumer loans are typically charged-off at 180 days delinquent. In all cases, loans must be placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

Restricted Equity Securities. Certain securities are classified as restricted equity securities because ownership is restricted and there is not an established market for their resale. These securities are carried at cost and are evaluated for impairment on a quarterly basis.

Bank Properties and Equipment. Land is carried at cost. Bank properties and equipment are stated at cost, less accumulated depreciation. Depreciation, which is recorded in equipment expense on the consolidated statements of operations, is computed by the straight-line method based on the estimated useful lives of the assets, generally as follows:

Asset Type	Estimated Useful Life
Buildings	40 years
Leasehold improvements	Lesser of the useful life or the remaining lease term, including renewals, if applicable
Equipment	Three to 10 years

Real Estate Owned. Real estate owned is comprised of property acquired through foreclosure, deed in lieu and bank property that is not in use. Property acquired through foreclosure is carried at the lower of cost or fair value of the property based on an appraisal less estimated disposal costs. Credit losses arising from foreclosure transactions are charged against the allowance for loan losses. Bank properties are carried at the lower of cost or fair value less estimated disposal cost. Costs to maintain real estate owned and any subsequent gains or losses are included in real estate owned expense, net on the Company’s consolidated statements of operations.

Goodwill and Intangible Assets. Goodwill is the excess of the fair value of liabilities assumed over the fair value of tangible and identifiable intangible assets acquired in a business combination. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company tests goodwill for impairment annually as of December 31. The Company elected to not apply the qualitative evaluation option permitted under Accounting Standards Update (“ASU”) 2011-8, *Intangibles – Goodwill and Other (Topic 35): Testing Goodwill for Impairment* issued in September 2011. Therefore, the Company utilizes the two-step goodwill impairment test outlined in FASB ASC 350, *Intangibles – Goodwill and Other (“FASB ASC 350”)*. Step one, which is used to identify potential impairment, compares the fair value of the reporting unit with its carrying amount, including goodwill. A reporting unit is an operating segment, or one level below an operating segment, as defined in FASB ASC 280. If the fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is not considered impaired and step two is therefore unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step is performed to measure the amount of the impairment loss, if any. At December 31, 2012, the Company performed its annual goodwill impairment test, and step one of the analysis indicated that the Company's fair value was greater than its carrying value; therefore, the Company's goodwill was not impaired at December 31, 2012.

Intangible assets, net on the consolidated statements of financial condition, consist of core deposit intangibles, net of accumulated amortization from the Bank's previous acquisitions. Core deposit intangibles are amortized using the straight-line method based on the characteristics of the particular deposit type and are evaluated annually for impairment. See Note 10 for further details on goodwill and intangible assets.

Bank Owned Life Insurance ("BOLI"). The Company has purchased life insurance policies on certain key employees. These policies are recorded at their cash surrender value, or the amount that can be realized in accordance with FASB ASC 325-30, *Investments in Insurance Contract*s. At December 31, 2012, the Company had $25.4 million invested in a general account and $51.5 million in a separate account, for a total BOLI cash surrender value of $76.9 million. The BOLI separate account is invested in a mortgage-backed securities fund, which is managed by an independent investment firm. Pricing volatility of these underlying instruments may have an impact on investment income; however, the fluctuations would be partially mitigated by a stable value wrap agreement which is a component of the separate account. Income from these policies and changes in the cash surrender value are recorded in BOLI income of the consolidated statements of operations.

Long-Lived Assets. Management evaluates the carrying amount of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Measurement of an impaired loss for long-lived assets and intangibles with definite lives would be based on the fair value of the asset. The Company recognized impairment losses of $37 thousand, $338 thousand and $123 thousand for the years ended December 31, 2012, 2011 and 2010, respectively, on long-lived assets. Impairment losses on long-lived assets are recorded in other expense in the Company's consolidated statements of operations.

Loan Servicing Assets. The Company originates certain Small Business Administration ("SBA") loans for sale to institutional investors. In accordance with FASB ASC 860, *Transfers and Servicing* ("FASB ASC 860"), the cost of loans sold is allocated between the servicing rights, the retained portion of the loan and the sold portion of the loan based on the relative fair values of each.

Loan servicing rights are amortized in proportion to, and over the period of, estimated net servicing income. In accordance with FASB ASC 860, the Company regularly evaluates the loan servicing asset for impairment. Because loans are sold individually and are not pooled, the Company does not stratify groups of loans based on risk characteristics for purposes of measuring impairment. The Company measures the loan servicing assets by estimating the present value of expected future cash flows for each servicing asset, based on their unique characteristics and market-based assumptions for prepayment speeds and records a valuation allowance for the amount by which the carrying amount of the servicing asset exceeds the fair value. The gross carrying value of the Company's loan servicing assets was $389 thousand and $429 thousand at December 31, 2012 and 2011, respectively. The fair value of the loan servicing rights is determined by valuation techniques. Valuation adjustments to the loan servicing assets for the years ended December 31, 2012, 2011 and 2010 were $95 thousand, of expense, $0 and $0, respectively. These adjustments are reflected in other income on the consolidated statements of operations. The valuation allowance for the loan servicing assets at December 31, 2012 and 2011 was $118 thousand and $23 thousand, respectively. The net carrying value of the loan servicing asset is included within other assets on the consolidated statements of financial condition.

Securities Sold Under Agreements to Repurchase. The Company enters into sales of securities under agreements to repurchase with its customers and the Federal Home Loan Bank of New York ("FHLBNY"). In accordance with FASB ASC 860, these agreements are treated as financings, and the obligations to repurchase securities sold are reflected as a liability in the consolidated statements of financial condition. Securities pledged as collateral under agreements to repurchase are reflected as assets in the accompanying consolidated statements of financial condition.

Accounting for Derivative Financial Instruments and Hedging Activities. The Company recognizes all derivative instruments at fair value as either assets or liabilities in other assets or other liabilities on the consolidated statements of financial condition. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current earnings.

The Company's derivative financial instruments are not exchange-traded and therefore are valued utilizing models that use as their basis readily observable market parameters, specifically the LIBOR swap curve, and are classified within Level 2 of the valuation hierarchy.

Accumulated Other Comprehensive Loss. The Company classifies items of accumulated other comprehensive loss by their nature and displays the accumulated balance of accumulated other comprehensive loss separately from retained earnings and additional paid-in capital in the equity section of the consolidated statements of financial condition. Amounts categorized as accumulated other comprehensive loss represent net unrealized gains or losses on investment securities available for sale, net of tax and the non-credit portion of any OTTI loss not recorded in earnings. Reclassifications are made to avoid double counting items which are displayed as part of net income for the period. These reclassifications for the years ended December 31, 2012, 2011, and 2010 are as follows:

DISCLOSURE OF RECLASSIFICATION AMOUNTS, NET OF TAX

Years Ended December 31,	2012			2011			2010		
	Pre-tax	Tax	After-tax	Pre-tax	Tax	After-tax	Pre-tax	Tax	After-tax
Unrealized holding gain (loss) on securities available for sale during the year	**$2,788**	**$(1,139)**	**$ 1,649**	$13,053	$(5,332)	$ 7,721	$(2,903)	$1,138	$(1,765)
Less:									
Reclassification adjustment for net gain included in net income	**(151)**	**63**	**(88)**	(1,855)	757	(1,098)	(4,673)	1,831	(2,842)
Reclassification adjustment for net impairment loss recognized in earnings (1)	—	—	—	250	(102)	148	1,329	(521)	808
Reclassification adjustment for portion of impairment loss recognized in other comprehensive loss	—	—	—	—	—	—	(3,615)	1,417	(2,198)
Net unrealized gain (loss) on securities available for sale	**$2,637**	**$(1,076)**	**$ 1,561**	$11,448	$(4,677)	$ 6,771	$(9,862)	$3,865	$(5,997)

(1) All amounts are included in non-interest income in the Consolidated statements of operations.

Treasury Stock. Stock held in treasury by the Company is accounted for using the cost method which treats stock held in treasury as a reduction to total shareholders' equity. At December 31, 2012 and 2011, the Company held 2,106,723 shares of treasury stock.

Stock-Based Compensation. The Company accounts for stock-based compensation issued to employees and non-employee directors, in accordance with the fair value recognition provisions of FASB ASC 718, *Compensation - Stock Compensation,* ("FASB ASC 718"). Under the fair value provisions of FASB ASC 718, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the appropriate vesting period using the straight-line method. However, consistent with FASB ASC 718, the amount of stock-based compensation cost recognized at any date must at least equal the portion of the grant date value of the award that is vested at that date and, as a result, it may be necessary to recognize the expense using a ratable method. Although the provisions of FASB ASC 718 should generally be applied to non-employees, FASB ASC 505-50, *Equity-Based Payments to Non-Employees*, is used in determining the measurement date of the compensation expense for non-employees.

Determining the fair value of stock-based awards at measurement date requires judgment, including estimating the expected term of the stock options and the expected volatility of the Company's stock. In addition, judgment is required in estimating the amount of stock-based awards that are expected to be forfeited. If actual results differ significantly from these estimates or different key assumptions were used, it could have a material effect on the Company's consolidated financial statements.

In accordance with FASB ASC 718, the fair value of the stock options granted is estimated on the date of grant using the Black-Scholes option pricing model which uses the assumptions noted in the table below. The expected term of a stock option is estimated using historical exercise behavior of employees at a particular level of management who were granted options with a comparable term. The stock options have historically been granted a 10 year term. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected volatility is based on the historical volatility of the Company's stock price.

Significant weighted average assumptions used to calculate the fair value of the option awards for the years ended December 31, 2012, 2011 and 2010 are as follows:

WEIGHTED AVERAGE ASSUMPTIONS USED IN BLACK-SCHOLES OPTION PRICING MODEL

Years Ended December 31,	2012	2011	2010
Fair value of options granted during the year	$1.52	$2.11	$2.75
Risk-free rate of return	0.98%	2.72%	3.05%
Expected term in months	61	78	111
Expected volatility	62%	47%	45%
Expected dividends (1)	$ —	$ —	$ —

(1) To date, the Company has not paid cash dividends on its common stock.

At December 31, 2012, the Company had five stock-based employee compensation plans, which are described more fully in Note 15.

Interest Income on Loans. Interest income on loans is credited to operations based upon the principal amount outstanding. Interest accruals are generally discontinued when a loan becomes 90 days past due, or when principal or interest is considered doubtful of collection. When interest accruals are discontinued unpaid, interest credited to income in the current year is reversed and unpaid interest accrued in the prior year is charged to the allowance for loan losses.

Income Taxes. The Company accounts for income taxes in accordance with FASB ASC 740, *Income Taxes* ("FASB ASC 740"). FASB ASC 740 requires the recording of deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expenses will not be required in future periods. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the consolidated statements of operations. Assessment of uncertain tax positions under FASB ASC 740 requires careful consideration of the technical merits of a position based on management's analysis of tax regulations and interpretations. Significant judgment is applied when addressing the requirements of FASB ASC 740. At December 31, 2012, the Company had a valuation allowance of $113.4 million against its gross deferred tax asset. As the Company remained in a cumulative loss position, a full deferred tax valuation allowance is still appropriate at December 31, 2012. See Note 20 for additional information on the Company's application of FASB ASC 740.

Loss Per Common Share. Basic loss per share is computed by dividing net loss available to common shareholders by the weighted average number of shares of common stock outstanding, net of any treasury shares, during the period. Diluted earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of shares of common stock outstanding, net of any treasury shares, after consideration of the potential dilutive effect of common stock equivalents, based upon the treasury stock method using an average market price of common shares sold during the period. Dilution is not considered when the Company is in a net loss position.

Recent Accounting Principles. In February 2013, the FASB issued Accounting Standards Update ("ASU") 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.* The amendments in this update aim to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The Company is currently evaluating the impact of the adoption of this accounting standards update on its financial statements.

In July 2012, the FASB issued ASU 2012-02, *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. This amendment provides an entity with the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Subtopic 350-30. This amendment is effective for public entities for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The guidance will have no impact on the Company as it does not have any indefinite-lived intangible assets.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities ("ASU 2011-11").* This amendment results in common offsetting requirements and disclosure requirements in GAAP and International Financial Reporting Standards ("IFRS"). This guidance is not intended to change, but enhance, the application requirements in FASB ASC 210, *Balance Sheet ("FASB ASC 210").* This guidance is effective for public entities during interim and annual periods beginning after January 1, 2013. This guidance amends only the disclosure requirements and not the application of the accounting standard. In January 2013, the FASB issued Accounting Standards Update ("ASU") 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The amendments in this update clarify that the scope of

ASU 2011-11 applies to derivatives accounted for in accordance with FASB ASC 815, *Derivatives and Hedging* ("FASB ASC 815"), including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with FASB ASC 210 or FASB ASC 815 or subject to an enforceable master netting arrangement or similar agreement. This guidance is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The Company is currently evaluating the impact of the adoption of these accounting standards updates on its financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. Subsequently in December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This guidance eliminates the presentation option of presenting the component of other comprehensive income as part of the statement of changes in stockholders' equity. In addition, the updates to comprehensive income guidance require all nonowner changes in stockholders' equity to be presented either in a single continuous statement of comprehensive income or two separate but consecutive statements. The Company elected to adopt the two statement approach. In this two statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income and the total of comprehensive income. These changes apply to both annual and interim financial statements. The Company adopted the new accounting guidance effective January 1, 2012, and applied it retrospectively to fiscal years 2011 and 2010. The adoption added the Condensed Consolidated Statements of Comprehensive Income but did not impact the Company's results of operations, financial position, or cash flows.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, to achieve common fair value measurement and disclosure requirements between U.S. GAAP and international accounting principles. While the overall guidance is consistent with U.S. GAAP, the amendment includes additional fair value disclosure requirements. The amendments in the guidance are effective for interim and annual periods beginning after December 15, 2011. The adoption of this amendment did not have a material effect on the Company's financial statements; however, the adoption did result in expanded fair value disclosures in Note 24.

3. BRANCH SALES AND CONSOLIDATIONS

During 2012, the Company consolidated three owned branch offices and one leased branch office into existing branch offices. As a result of these consolidations, the Company added the three owned branch offices to the real estate owned portfolio in the amount of $1.4 million, which included a loss on the transfer of $236 thousand. No branch sales or consolidations occurred in 2011. During the third quarter of 2010, the Company consolidated four owned branch offices and one leased branch office into existing branch offices. In 2010, as a result of these consolidations, the Company added the four owned branch offices to the real estate owned portfolio in the amount of $1.3 million, which included a loss on the transfer of $130 thousand.

4. INVESTMENT SECURITIES

The amortized cost of investment securities and the approximate fair value at December 31, 2012 and 2011 were as follows:

SUMMARY OF INVESTMENT SECURITIES

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2012				
Available for sale:				
U.S. Treasury obligations	**$ 9,998**	**$ 13**	**$ —**	**$ 10,011**
U.S. Government agencies	**4,966**	**—**	**(17)**	**4,949**
U.S. Government agency mortgage-backed securities	**348,854**	**7,104**	**(980)**	**354,978**
Other mortgage-backed securities	**287**	**—**	**(1)**	**286**
State and municipal obligations	**36,848**	**3,322**	**—**	**40,170**
Trust preferred securities	**12,622**	**—**	**(6,740)**	**5,882**
Corporate bonds	**24,449**	**993**	**—**	**25,442**
Other	**1,464**	**—**	**—**	**1,464**
Total available for sale	**439,488**	**11,432**	**(7,738)**	**443,182**
Held to maturity:				
U.S. Government agency mortgage-backed securities	**662**	**48**	**—**	**710**
Other mortgage-backed securities	**250**	**—**	**—**	**250**
Total held to maturity	**912**	**48**	**—**	**960**
Total investment securities	**$440,400**	**$ 11,480**	**$ (7,738)**	**$444,142**
December 31, 2011				
Available for sale:				
U.S. Treasury obligations	$ 11,999	$ 80	$ —	$ 12,079
U.S. Government agencies				
U.S. Government agency mortgage-backed securities	423,269	6,264	(629)	428,904
Other mortgage-backed securities	323	—	(27)	296
State and municipal obligations	45,424	3,373	(12)	48,785
Trust preferred securities	12,619	—	(7,711)	4,908
Corporate bonds	19,689	57	(338)	19,408

Other	1,165	—	—	1,165
Total available for sale	514,488	9,774	(8,717)	515,545
Held to maturity:				
U.S. Government agency mortgage-backed securities	1,344	69	—	1,413
Other mortgage-backed securities	—	—	—	—
Total held to maturity	1,344	69	—	1,413
Total investment securities	$515,832	$ 9,843	$ (8,717)	$516,958

During 2012, the Company had six securities called prior to maturity for $7.0 million of proceeds, resulting in gross realized gains and losses of $10 thousand and $93 thousand, respectively, eight available for sale securities were sold prior to maturity for gross proceeds of $47.5 million, which resulted in gross realized gains and losses of $475 thousand and $241 thousand, respectively and eight securities matured, generating $9.1 million of gross proceeds. During 2011, the Company had nine securities called prior to maturity for $27.0 million of proceeds, resulting in gross realized gains of $46 thousand, 22 available for sale securities were sold prior to maturity for gross proceeds of $61.4 million, which resulted in gross realized gains and losses of $1.9 million and $1.0 million, respectively, three trading securities were sold for gross proceeds of $42.2 million, resulting in gross realized gains of $880 thousand and 20 securities matured, generating $63.6 million of gross proceeds.

The following table provides the gross unrealized losses and fair value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position at December 31, 2012 and 2011:

GROSS UNREALIZED LOSSES BY INVESTMENT CATEGORY

	Less than 12 Months		12 Months or Longer		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
December 31, 2012						
U.S. Government agencies	$ 4,949	$ (17)	$ —	$ —	$ 4,949	$ (17)
U.S. Government agency mortgage-backed securities	69,145	(980)			69,145	(980)
Other mortgage-backed securities	286	(1)	—	—	286	(1)
Trust preferred securities	—	—	5,882	(6,740)	5,882	(6,740)
Total	$74,380	$ (998)	$ 5,882	$ (6,740)	$ 80,262	$ (7,738)
December 31, 2011						
U.S. Government agency mortgage-backed securities	$79,221	$ (627)	$ 7,224	$ (2)	$ 86,445	$ (629)
Other mortgage-backed securities	—	—	296	(27)	296	(27)
State and municipal obligations	—	—	233	(12)	233	(12)
Corporate bonds	14,231	(338)	—	—	14,231	(338)
Trust preferred securities	—	—	4,908	(7,711)	4,908	(7,711)
Total	$93,452	$ (965)	$12,661	$ (7,752)	$106,113	$ (8,717)

The Company determines whether unrealized losses are temporary in nature in accordance with FASB ASC 325-40, when applicable, and FASB ASC 320. The evaluation is based upon factors such as the creditworthiness of the underlying borrowers, performance of the underlying collateral, if applicable, and the level of credit support in the security structure. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost and near-term prospects of the issuer.

For the year ended December 31, 2012, the Company's investment impairment review did not identify any credit losses. For the year ended December 31, 2011, the Company's investment impairment review identified credit losses of $250 thousand on a single issuer trust preferred security for which the Company had previously recorded an OTTI charge in 2010. Application of the guidance did not have an impact on any other securities in an unrealized loss position at December 31, 2012 or 2011.

The following is a roll-forward for the years ended December 31, 2012 and 2011 of OTTI charges recognized in earnings as a result of credit losses on investments:

CUMULATIVE OTTI RECOGNIZED IN OPERATIONS

At or for the Year Ended December 31, 2012	Amount
Cumulative OTTI, beginning of year	**$10,203**
Additional increase as a result of net impairment losses recognized on investments	**—**
Decrease as a result of the sale of an investment with net impairment losses	**—**
Cumulative OTTI, end of year	**$10,203**

At or for the Year Ended December 31, 2011	Amount
Cumulative OTTI, beginning of year	**$10,683**
Additional increase as a result of net impairment losses recognized on investments	**250**
Decrease as a result of the sale of an investment with net impairment losses	**(730)**
Cumulative OTTI, end of year	**$10,203**

U.S. Government Agencies. At December 31, 2012, the gross unrealized loss in the category of less than 12 months of $17 thousand consisted of one agency security with an estimated fair value of $4.9 million issued and guaranteed by a U.S. Government sponsored agency. The Company monitors key credit metrics such as delinquencies, defaults, cumulative losses and credit support levels to determine if an OTTI exists. As of December 31, 2012, management concluded that an OTTI did not exist on the aforementioned security based upon its assessment. Management also concluded that it does not intend to sell the security, and that it is not more likely than not it will be required to sell the security, before its recovery, which may be maturity, and management expects to recover the entire amortized cost basis of this security.

U.S. Government Agency Mortgage-Backed Securities. At December 31, 2012, the gross unrealized loss in the category of less than 12 months of $980 thousand consisted of nine mortgage-backed securities with an estimated fair value of $69.1 million issued and guaranteed by a U.S. Government sponsored agency. The Company monitors key credit metrics such as delinquencies, defaults, cumulative losses and credit support levels to determine if an OTTI exists. As of December 31, 2012, management concluded that an OTTI did not exist on any of the aforementioned securities based upon its assessment. Management also concluded that it does not intend to sell the securities, and that it is not more likely than not it will be required to sell the securities, before their recovery, which may be maturity, and management expects to recover the entire amortized cost basis of these securities.

Other Mortgage-Backed Securities. At December 31, 2012, the gross unrealized loss in the category of less than 12 months of $1 thousand consisted of one non-agency mortgage-backed security with an estimated fair value of $286 thousand. This security was rated "AA" by at least one nationally recognized rating agency. The Company monitors key credit metrics such as delinquencies, defaults, cumulative losses and credit support levels to determine if an OTTI exists. As of December 31, 2012, management concluded that an OTTI did not exist on this security and believes the unrealized loss is due to increases in market interest rates since the time the underlying security was purchased. Management also concluded that it does not intend to sell the security, and that it is not more likely than not it will be required to sell the security, before its recovery, which may be maturity, and management expects to recover the entire amortized cost basis of this security.

Trust Preferred Securities. At December 31, 2012, the gross unrealized loss in the category of 12 months or longer of $6.7 million consisted of two trust preferred securities. The trust preferred securities are comprised of one non-rated single issuer security with an amortized cost of $3.8 million and an estimated fair value of $1.9 million, and one non-investment grade rated pooled security with an amortized cost of $8.8 million and estimated fair value of $3.9 million.

For the pooled security, the Company monitors each issuer in the collateral pool with respect to financial performance using data from the issuer's most recent regulatory reports as well as information on issuer deferrals and defaults. Also the security structure is monitored with respect to collateral coverage and current levels of subordination. Expected future cash flows are projected assuming additional defaults and deferrals based on the performance of the collateral pool. The non-investment grade pooled security is in a senior position in the capital structure. The security had a 1.93 times principal coverage. As of the most recent reporting date interest has been paid in accordance with the terms of the security. The Company reviews projected cash flow analysis for adverse changes in the present value of projected future cash flows that may result in an other-than-temporary credit impairment to be recognized through earnings. The most recent valuations assumed no recovery on any defaulted collateral, no recovery on any deferring collateral and additional 3.6% defaults or deferrals' every 3 years with no recovery rate. As of December 31, 2012, management concluded that an OTTI did not exist on the aforementioned security based upon its assessment. Management also concluded that it does not intend to sell the security, and that it is not more likely than not it will be required to sell the security, before their recovery, which may be maturity, and management expects to recover the entire amortized cost basis of this security.

The financial performance of the single issuer trust preferred security is monitored on a quarterly basis using data from the issuer's most recent regulatory reports to assess the probability of cash flow impairment. Expected future cash flows are projected incorporating the contractual cash flow of the security adjusted, if necessary, for potential changes in the amount or timing of cash flows due to the underlying creditworthiness of the issuer and covenants in the security.

In August 2009, the issuer of the single issuer trust preferred security elected to defer its normal quarterly dividend payment. As contractually permitted, the issuer may defer dividend payments up to five years with accumulated dividends, and interest on those deferred dividends, payable upon the resumption of its scheduled dividend payments. The issuer is currently operating under an agreement with its regulators. The agreement stipulates the issuer must receive permission from its regulators prior to resuming its scheduled dividend payments.

During the year ended December 31, 2012, the Company did not record a credit related OTTI charge related to this deferring single issuer trust preferred security. Based on the Company's most recent evaluation, the Company does not expect the issuer to default on the security based primarily on the issuer's subsidiary bank reporting that it meets the minimum regulatory requirements to be considered a "well-capitalized" institution. The Company recognizes that the length of time the issue has been in deferral, the difficult economic environment and some weakened performance measures, while recently improving, increases the probability that a full recovery of principal and anticipated dividends may not be realized. However, the Company concluded that an additional impairment charge is not warranted at December 31, 2012.

The amortized cost and estimated fair value of the investment securities, by contractual maturity, at December 31, 2012 is shown below. Actual maturities will differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

CONTRACTUAL MATURITIES OF INVESTMENT SECURITIES

	Available for Sale		Held to Maturity	
December 31, 2012	**Amortized Cost**	**Estimated Fair Value**	**Amortized Cost**	**Estimated Fair Value**
Due in one year or less	$ 11,437	$ 11,452	$ —	$ —
Due after one year through five years	24,697	25,691	250	250
Due after five years through ten years	12,971	13,735	—	—
Due after ten years	41,242	37,040	—	—
Total investment securities, excluding mortgage-backed securities	90,347	87,918	250	250
U.S. Government agency mortgage-backed securities	348,854	354,978	662	710
Other mortgage-backed securities	287	286	—	—
Total investment securities	$439,488	$443,182	$ 912	$ 960

At December 31, 2012, the Company had $127.0 million, amortized cost, and $132.0 million, estimated fair value, of investment securities pledged to secure public deposits. At December 31, 2012, the Company had $188.9 million, amortized cost, and $192.8 million, estimated fair value, of investment securities pledged as collateral on secured borrowings.

5. LOANS RECEIVABLE

The components of loans receivable, net were as follows:

Loan Components

December 31,	2012	2011
Commercial:		
Commercial and industrial	**$ 556,966**	$ 551,396
CRE owner occupied	**527,825**	604,361
CRE non-owner occupied	**584,857**	626,795
Land and development	**55,919**	95,474
Consumer:		
Home equity lines of credit	**207,720**	224,517
Home equity term loans	**30,842**	41,470
Residential real estate	**273,413**	100,438
Other	**38,618**	46,671
Total gross loans	**2,276,160**	2,291,122
Allowance for loan losses	**(45,873)**	(41,667)
Loans, net	**$2,230,287**	$2,249,455
Loans past due 90 days and accruing	**$ —**	$ 154
Troubled debt restructuring, accruing	**—**	—

Loans on Non-accrual Status

December 31,	2012	2011
Commercial		
Commercial and industrial	**$12,156**	$ 6,501
Commercial and industrial, held-for-sale	**1,114**	—
CRE owner occupied	**14,957**	32,579
CRE owner occupied, held-for-sale	**3,223**	—
CRE non-owner occupied	**5,305**	9,873
CRE non-owner occupied, held-for-sale	**5,298**	—
Land and development	**20,897**	32,088
Land and development, held-for-sale	**589**	—
Consumer:		
Home equity lines of credit	**3,714**	3,620
Home equity term loans	**1,226**	1,246
Residential real estate	**5,747**	2,522
Other	**658**	1,227
Total non-accrual loans	**$74,884**	$89,656
Troubled debt restructurings, non-accrual	**$18,244**	$17,875
Troubled debt restructurings, non-accrual, held-for-sale	**$ 2,499**	$ —

Many of the Company’s commercial and industrial loans have a real estate component as part of the collateral securing the accommodation. Additionally, the Company makes commercial real estate loans for the acquisition, refinance, improvement and construction of real property. Loans secured by owner-occupied properties are dependent upon the successful operation of the borrower’s business. If the operating company experiences difficulties in terms of sales volume and/or profitability, the borrower’s ability to repay the loan may be impaired. Loans secured by properties where repayment is dependent upon payment of rent by third-party tenants or the sale of the property may be impacted by loss of tenants, lower lease rates needed to attract new tenants or the inability to sell a completed project in a timely fashion and at a profit. At December 31, 2012, commercial and industrial loans secured by commercial real estate properties totaled $1.1 billion of which $527.8 million, or 47.44%, were classified as owner occupied and $584.9 million, or 52.56%, were classified as non-owner occupied.

As of December 31, 2012, the Company had $24.3 million outstanding on 19 residential construction, commercial construction and land development relationships whose agreements included interest reserves. As of December 31, 2011, the Company had $31.4 million outstanding on 18 residential construction, commercial construction and land development relationships whose agreements included interest reserves. The total amount available in those reserves to fund interest payments was $3.6 million and $956 thousand for the periods ended December 31, 2012 and December 31, 2011, respectively. There were no relationships with interest reserves which were on non-accrual status as of December 31, 2012. The Company had six residential construction relationships with interest reserves of $3.4 million on non-accrual status as of December 31, 2011. As these relationships were in technical default, no additional funding of the interest reserves could have been made. Construction projects are monitored throughout their lives by professional inspectors engaged by the Company. The budgets for loan advances and borrower equity injections are developed at underwriting time in conjunction with the review of the plans and specifications for the project being financed. Advances of the Company's funds are based on the prepared budgets and will not be made unless the project has been inspected by the Company's professional inspector who must certify that the work related to the advance is in place and properly complete. As it relates to construction project financing, the Company does not extend, renew or restructure terms unless its borrower posts cash collateral in an interest reserve.

Included in the Company's loan portfolio are modified commercial loans. Per FASB ASC 310-40, *Troubled Debt Restructuring,* a modification is one in which the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider, such as providing for a below market interest rate and/or forgiving principal or previously accrued interest; this modification may stem from an agreement or be imposed by law or a court, and may involve a multiple note structure. Generally, prior to the modification, the loans which are modified as a troubled debt restructuring ("TDR") are already classified as non-performing. These loans may only be returned to performing (i.e. accrual status) after considering the borrower's sustained repayment performance for a reasonable amount of time, generally six months; this sustained repayment performance may include the period of time just prior to the restructuring. During 2012, the Company entered into three TDR agreements. The Company granted a partial debt forgiveness on two of the agreements and permitted an advance on a defaulted relationship for the third TDR. As of December 31, 2012, the total carrying value of the TDR's was $9.1 million, of which $0 was performing.

There was a commitment to lend additional funds on two non-accrual TDRs at December 31, 2012 of $962 thousand. Interest income not recognized as a result of the above non-accrual loans was $7.7 million, $4.9 million and $5.4 million for the years ended December 31, 2012, 2011 and 2010, respectively. The amount of interest included in net income on these loans for the years ended December 31, 2012, 2011 and 2010 was $5.0 million, $3.8 million and $3.9 million, respectively.

Under approved lending decisions, the Company had commitments to lend additional funds totaling approximately $842.4 million and $423.4 million at December 31, 2012 and 2011, respectively. 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 may require 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. The Company evaluates each customer's creditworthiness on an individual basis. The type and amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower.

Most of the Company's business activity is with customers located within its local market area. Generally, commercial real estate, residential real estate and other assets are used to secure loans. The ultimate repayment of loans is dependent, to a certain degree, on the local economy and real estate market. As of December 31, 2012, the Company had $364.4 million in loans pledged as collateral on secured borrowings.

6. ALLOWANCE FOR LOAN LOSSES

An analysis of the change in the allowance for loan losses is as follows:

Allowance for Loan Losses and Recorded Investment in Financing Receivables

	For the Year Ended December 31, 2012				
	Commercial and industrial	Home Equity(1)	Residential Real Estate	Other	Total
Allowance for loan losses:					
Beginning balance	$ 34,227	$ 2,566	$ 903	$ 3,971	$ 41,667
Charge-offs	(51,265)	(2,489)	(249)	(1,610)	(55,613)
Recoveries	1,950	450	14	190	2,604
Net charge-offs	(49,315)	(2,039)	(235)	(1,420)	(53,009)
Provision for loan losses	48,285	2,207	2,665	4,058	57,215
Ending balance	$ 33,197	$ 2,734	$ 3,333	$ 6,609	$ 45,873
Ending balance: individually evaluated for impairment	$ 951	$ —	$ 98	$ —	$ 1,049
Ending balance: collectively evaluated for impairment	$ 32,246	$ 2,734	$ 3,235	$ 6,609	$ 44,824
Financing Receivables:					
Ending balance	$1,725,567	$ 238,562	$273,413	$38,618	$2,276,160
Ending balance: individually evaluated for impairment	$ 71,443	$ 4,756	$ 5,612	$ 631	$ 82,442
Ending balance: collectively evaluated for impairment	$1,654,124	$ 233,806	$267,801	$37,987	$2,193,718

(1) Amount includes both home equity lines of credit and term loans

	For the Year Ended December 31, 2011				
	Commercial and industrial	Home Equity(1)	Residential Real Estate	Other	Total
Allowance for loan losses:					
Beginning balance	$ 76,759	$ 2,883	$ 661	$ 1,410	$ 81,713
Charge-offs	(112,108)	(3,337)	(1,064)	(1,303)	(117,812)
Recoveries	2,459	88	43	523	3,113
Net charge-offs	(109,649)	(3,249)	(1,021)	(780)	(114,699)
Provision for loan losses	67,117	2,932	1,263	2,954	74,266
Reserves transferred	—	—	—	387	387
Ending balance	$ 34,227	$ 2,566	$ 903	$ 3,971	$ 41,667
Ending balance: individually evaluated for impairment	$ 5,429	$ —	$ 14	$ 47	$ 5,490
Ending balance: collectively evaluated for impairment	$ 28,798	$ 2,566	$ 889	$ 3,924	$ 36,177
Financing Receivables:					
Ending balance	$1,878,026	$ 265,987	$100,438	$46,671	$2,291,122
Ending balance: individually evaluated for impairment	$ 98,916	$ 4,595	$ 2,522	$ 97	$ 106,130
Ending balance: collectively evaluated for impairment	$1,779,110	$ 261,392	$ 97,916	$46,574	$2,184,992

(1) Amount includes both home equity lines of credit and term loans

At or for the Year Ended December 31,	2010
Balance, beginning of year	$ 59,953
Charge-offs	(80,802)
Recoveries	1,044
Net charge-offs	(79,758)
Provision for loan losses	101,518
Balance, end of year	$ 81,713

The allowance for loan losses was $45.9 million, $41.7 million and $81.7 million at December 31, 2012, 2011 and 2010, respectively. The ratio of allowance for loan losses to loans held-for-investment was 2.02%, 1.82% and 3.22% at December 31, 2012, 2011 and 2010, respectively.

The provision for loan losses charged to expense is based upon historical loan loss experience, a series of qualitative factors, and an evaluation of estimated losses in the current commercial loan portfolio, including the evaluation of impaired loans under FASB ASC 310. Values assigned to the qualitative factors and those developed from historic loss experience provide a dynamic basis for the calculation of reserve factors for both pass-rated loans (general pooled allowance) and those criticized and classified loans that continue to perform.

A loan is considered to be impaired when, based upon current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan. An insignificant delay or insignificant shortfall in amount of payments does not necessarily result in a loan being identified as impaired. For this purpose, delays less than 90 days are considered to be insignificant. Impairment losses are included in the provision for loan losses on the consolidated statements of operations. Impaired loans include accruing and non-accruing TDR loans. Loans not individually reviewed are evaluated as a group using reserve factor percentages based on historic loss experience and qualitative factors, which generally include consumer loans, residential real estate loans, and small business loans. In determining the appropriate level of the general pooled allowance, management makes estimates based on internal risk ratings, which take into account such factors as debt service coverage, loan-to-value ratios, management’s abilities, and certain external factors.

The following tables present the Company's components of impaired loans, segregated by class of loans. Commercial and consumer loans that were collectively evaluated for impairment are not included in the data that follows:

Impaired Loans
For the Year Ended December 31, 2012

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Accrued Interest Income Recognized	Cash Interest Income Recognized
With no related allowance:						
Commercial:						
Commercial & industrial	**$ 17,257**	**$ 19,260**	**$ —**	**$ 14,977**	**$ 53**	**$ 53**
Commercial & industrial, held for sale	**1,125**	**2,252**	**—**	**1,987**	**—**	**—**
CRE owner occupied	**22,586**	**44,110**	**—**	**25,521**	**86**	**86**
CRE owner occupied, held for sale	**5,596**	**17,091**	**—**	**11,384**	**—**	**—**
CRE non-owner occupied	**5,305**	**9,761**	**—**	**14,452**	**24**	**24**
CRE non-owner occupied, held for sale	**5,428**	**9,583**	**—**	**5,269**	**—**	**—**
Land and development	**20,649**	**33,607**	**—**	**27,353**	**22**	**22**
Land and development, held for sale	**589**	**2,124**	**—**	**1,255**	**—**	**—**
Consumer:						
Residential real estate	**5, 428**	**5,852**	**—**	**4,334**	**—**	**—**
Home Equity Lines of Credit	**3,582**	**4,610**	**—**	**2,942**	**9**	**9**
Home Equity Term Loans	**1,174**	**1,285**	**—**	**1,023**	**3**	**3**
Other	**631**	**1,489**	**—**	**231**	**—**	**—**
With an allowance recorded:						
Commercial:						
Commercial & industrial	**$ —**	**$ 939**	**$ —**	**$ 1,222**	**$ —**	**$ —**
CRE owner occupied	**4,649**	**8,779**	**649**	**6,029**	**—**	**—**
Land and development	**997**	**1,013**	**302**	**553**	**—**	**—**
Consumer:						
Residential Real Estate	**184**	**194**	**98**	**71**	**—**	**—**
Other	**—**	**—**	**—**	**4**	**—**	**—**
Total commercial	**$ 84,182**	**$148,519**	**$ 951**	**$110,002**	**$ 185**	**$ 185**
Total consumer	**$ 10,999**	**$ 13,430**	**$ 98**	**$ 8,605**	**$ 12**	**$ 12**

Impaired Loans
For the Year Ended December 31, 2011

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Accrued Interest Income Recognized	Cash Interest Income Recognized
With no related allowance:						
Commercial:						
Commercial & industrial	$ 9,401	$ 12,778	$ —	$ 9,180	$ 67	$ 67
CRE owner occupied	32,202	55,982	—	36,266	357	357
CRE non-owner occupied	7,308	8,584	—	15,299	36	36
Land and development	25,925	26,148	—	29,932	57	57
Consumer:						
Residential real estate	2,433	2,758	—	470	—	—
Home Equity Lines of Credit	3,398	4,402	—	637	—	—
Home Equity Term Loans	1,197	1,306	—	228	—	—
Other	50	50	—	2	—	—
With an allowance recorded:						
Commercial:						
Commercial & industrial	$ 4,955	$ 6,110	$ 262	$ 13,368	$ 337	$ 337
CRE owner occupied	9,706	14,449	2,448	18,929	212	212
CRE non-owner occupied	2,565	3,468	229	6,211	438	438
Land and development	6,854	7,063	2,490	7,937	—	—
Consumer:						
Residential Real Estate	89	164	14	45	—	—
Other	47	47	47	19	—	—
Total commercial	$ 98,916	$134,582	$ 5,429	$136,582	$ 1,504	$ 1,504
Total consumer	$ 7,214	$ 8,726	$ 61	$ 1,354	$ —	$ —

Impaired Loans
For the Year Ended December 31, 2010

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Accrued Interest Income Recognized	Cash Interest Income Recognized
With no related allowance:						
Commercial:						
Commercial & industrial	$ 8,650	$ 9,570	$ —	$ 5,387	$ 58	$ 58
CRE owner occupied	32,325	65,398	—	37,502	18	18
CRE non-owner occupied	24,047	33,445	—	9,398	—	—
Land and development	21,044	33,387	—	12,343	9	9
Consumer:						
Residential real estate	—	—	—	23	—	—
Other	—	—	—	644	—	—
With an allowance recorded:						
Commercial:						
Commercial & industrial	$ 26,938	$ 32,365	$ 6,109	$ 20,959	$ 454	$ 438
CRE owner occupied	20,365	25,099	4,800	22,463	433	420
CRE non-owner occupied	20,275	26,512	4,770	8,998	—	—
Land and development	27,085	28,460	5,401	9,209	29	29
Consumer:						
Other	—	—	—	323	—	—
Total commercial	$180,729	$254,236	$21,080	$126,259	$ 1,001	$ 972
Total consumer	$ —	$ —	$ —	$ 990	$ —	$ —

In accordance with FASB ASC 310, those impaired loans which are fully collateralized do not result in a specific allowance for loan losses. Included in impaired loans at December 31, 2012 were five TDR relationships (11 contracts), four of which were fully collateralized and one of which had specific reserves totaling $154 thousand. In addition, one of the TDRs at December 31, 2012 included a $6.5 million line of credit, of which $5.6 million was utilized and $939 thousand was available. One TDR included a commitment to lend additional funds of $23 thousand at December 31, 2012.

The following table presents an analysis of the Company’s TDR agreements entered into during the twelve months ended December 31, 2012:

Troubled Debt Restructuring as of December 31, 2012

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Loans held-for-investment			
CRE owner occupied	**1**	**$ 8,955**	**$ 8,382**
Land and development	**1**	**371**	**749**
CRE non-owner occupied	**1**	**265**	**—**

Troubled Debt Restructuring as of December 31, 2011

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and industrial	4	$ 8,277	$ 7,855
CRE owner occupied	6	19,363	9,329
Land and development	1	1,745	691

Troubled Debt Restructurings That Subsequently Defaulted
For the Year Ended December 31, 2012

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and industrial	**1**	**$ 3,257**	**$ 5,225**
CRE owner occupied (1)	**3**	**10,928**	**3,525**
Land and development	**1**	**371**	**749**

(1) One of the above contracts was charged off during the twelve months ended December 31, 2012. The recorded investment on this contract is now $139 thousand. The other contracts are displayed in the table above outstanding as of December 31, 2012.

Troubled Debt Restructurings That Subsequently Defaulted
For the Year Ended December 31, 2011

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and industrial (1)	5	$ 8,400	$ 7,978
CRE owner occupied	7	18,922	9,451

(1) One of the above contracts was charged off during the twelve months ended December 31, 2011. The recorded investment on this contract is now $0. The other contracts are displayed in the table above outstanding as of December 31, 2011.

The following tables present the Company's distribution of risk ratings loan portfolio, segregated by class, as of December 31, 2012 and 2011:

Credit Quality Indicators
As of December 31, 2012

Credit Risk by Internally Assigned Grade

	Commercial				Consumer			
	Commercial & industrial	CRE owner occupied	CRE non-owner occupied	Land and development	Home equity lines of credit	Home equity term loans	Residential real estate	Other
Grade:								
Pass	**$ 479,983**	**$456,576**	**$544,645**	**$ 32,791**	**$200,429**	**$29,561**	**$265,139**	**$37,561**
Special Mention	**36,233**	**19,955**	**24,885**	**—**	**—**	**—**	**—**	**—**
Substandard	**40,750**	**51,294**	**15,327**	**23,128**	**7,291**	**1,281**	**8,274**	**1,057**
Total	**$ 556,966**	**$527,825**	**$584,857**	**$ 55,919**	**$207,720**	**$30,842**	**$273,413**	**$38,618**

Credit Quality Indicators
As of December 31, 2011

Credit Risk by Internally Assigned Grade

	Commercial				Consumer			
	Commercial & industrial	CRE owner occupied	CRE non-owner occupied	Land and development	Home equity lines of credit	Home equity term loans	Residential real estate	Other
Grade:								
Pass	$ 501,605	$515,555	$567,295	$ 42,268	$218,066	$40,138	$ 94,681	$44,821
Special Mention	26,062	24,483	30,013	5,799	—	—	—	—
Substandard	23,729	64,323	29,487	47,407	6,451	1,332	5,757	1,850
Total	$ 551,396	$604,361	$626,795	$ 95,474	$224,517	$41,470	$100,438	$46,671

The Company's primary tool for assessing risk when evaluating a credit in terms of its underwriting, structure, documentation and eventual collectability is a risk rating system in which the loan is assigned a numeric value. Behind each numeric category is a defined set of characteristics reflective of the particular level of risk.

The risk rating system is based on a nine point grade using a two-digit scale. The upper five grades are for "pass" categories, while the lower four grades represent "criticized" categories which are equivalent to the guidelines utilized by the OCC.

The portfolio manager is responsible for assigning, maintaining, and documenting accurate risk ratings for all commercial loans and commercial real estate loans. The portfolio manager assigns a risk rating at the inception of the credit, reaffirms it at each renewal, extension, or modification, and adjusts the rating based on the performance of the credit. As part of the credit review process, a regional credit officer will review risk ratings for accuracy. The portfolio manager's risk rating will also be reviewed periodically by the loan review department and the Bank's regulators.

To calculate risk ratings in a consistent fashion, the Company uses a Risk Rating Form that provides for a numerical grade to be assigned to up to six characteristics of a credit including elements of its financial condition, abilities of management, position in the market, collateral support and the impact of changing conditions. When combined, an overall risk rating is provided. A separate set of risk rating elements are provided for credits associated with the financing of real estate projects.

The following tables present the Company's analysis of past due loans, segregated by class of loans, as of December 31, 2012 and 2011:

Aging of Receivables
For the Year Ended December 31, 2012

	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Total Past Due	Current	Total Financing Receivables	Loans 90 Days Past Due and Accruing
Commercial:							
Commercial & industrial	$ 3,192	$ 797	$ 2,350	$ 6,339	$ 550,627	$ 556,966	$ —
CRE owner occupied	5,828	223	10,811	16,862	510,963	527,825	—
CRE non-owner occupied	4,037	1	2,974	7,012	577,845	584,857	—
Land and development	3,823	—	12,139	15,962	39,957	55,919	—
Consumer:							
Home equity lines of credit	2,296	880	2,518	5,694	202,026	207,720	—
Home equity term loans	960	340	972	2,272	28,570	30,842	—
Residential real estate	8,387	328	5,288	14,003	259,410	273,413	—
Other	599	273	499	1,371	37,247	38,618	—
Total	$29,122	$ 2,842	$37,551	$ 69,515	$2,206,645	$2,276,160	$ —

Aging of Receivables
For the Year Ended December 31, 2011

	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Total Past Due	Current	Total Financing Receivables	Loans 90 Days Past Due and Accruing
Commercial:							
Commercial & industrial	$ 1,024	$ 4,600	$ 6,407	$ 12,031	$ 539,365	$ 551,396	$ —
CRE owner occupied	6,408	1,176	35,003	42,587	561,774	604,361	—
CRE non-owner occupied	2,187	4,981	8,398	15,566	611,229	626,795	—
Land and development	371	—	32,088	32,459	63,015	95,474	—
Consumer:							
Home equity lines of credit	2,001	1,016	3,182	6,199	218,318	224,517	138
Home equity term loans	687	145	1,200	2,032	39,438	41,470	—
Residential real estate	3,324	565	2,307	6,196	94,242	100,438	—
Other	891	227	902	2,020	44,651	46,671	16
Total	$16,893	$12,710	$89,487	$119,090	$2,172,032	$2,291,122	$ 154

7. RESTRICTED EQUITY INVESTMENTS

The Company, through the Bank, is a member of the FRB, the FHLBNY and Atlantic Central Bankers Bank, and is required to maintain an investment in the capital stock of each. These investments are restricted in that they can only be redeemed by the issuer at par value. These securities are carried at cost and the Company did not identify any events or changes in circumstances that may have had an adverse effect on the value of the investments in accordance with FASB ASC 942, *Financial Services – Depository and Lending*. As of December 31, 2012, management does not believe that an impairment of these holdings exists and expects to recover the entire cost of these securities.

The Company's restricted equity investments at December 31, 2012 and 2011 were as follows:

RESTRICTED EQUITY INVESTMENTS

December 31,	2012	2011
FRB stock	**$10,783**	$10,536
FHLBNY stock	**6,955**	5,142
Atlantic Central Bankers Bank stock	**148**	148
Total	**$17,886**	$15,826

8. BANK PROPERTIES AND EQUIPMENT

Bank properties and equipment consist of the following major classifications:

SUMMARY OF BANK PROPERTIES AND EQUIPMENT

December 31,	2012	2011
Land	**$ 8,998**	$ 9,193
Buildings	**30,617**	31,689
Capital lease	**8,630**	8,630
Leasehold improvements and equipment	**44,781**	42,899
Total bank properties and equipment	**93,026**	92,411
Accumulated depreciation	**(42,221)**	(37,655)
Bank properties and equipment, net	**$ 50,805**	$ 54,756

The Company recognized depreciation expense of $5.7 million, $6.3 million and $5.4 million for the years ended December 31, 2012, 2011 and 2010, respectively.

On occasion, the Company engages construction related services from companies affiliated with certain directors under separate agreements with the Company. The Company did not engage in any construction related services with related parties during 2012, 2011 or 2010.

9. REAL ESTATE OWNED

Real estate owned consisted of the following:

SUMMARY OF REAL ESTATE OWNED

December 31,	2012	2011
Commercial properties	**$5,382**	$1,777
Residential properties	**696**	1,683
Bank properties	**1,395**	1,560
Total	**$7,473**	$5,020

SUMMARY OF REAL ESTATE OWNED ACTIVITY

	Underlying Property			
At or for the year ended December 31, 2012	Commercial Properties	Residential Properties	Bank Properties	Total
Balance, beginning of year	$ 1,777	$ 1,683	$ 1,560	$ 5,020
Transfers into real estate owned	6,000	315	1,365	7,680
Transfers into operations	—	—	—	—
Sale of real estate owned	(1,956)	(1,153)	(797)	(3,906)
Write down of real estate owned	(439)	(149)	(733)	(1,321)
Balance, end of year	$ 5,382	$ 696	$ 1,395	$ 7,473

During 2012, the Company transferred $7.7 million in book value of loans into real estate owned, including 23 commercial properties aggregating $6.0 million, three bank properties totaling $1.3 million, and four residential properties for $315 thousand. In 2012, the Company recorded $1.4 million of write-downs of real estate owned, including $149 thousand on the carrying value of four residential properties, $733 thousand on the carrying value of six bank properties, and $439 thousand on the carrying value of six commercial properties. There were 11 commercial properties, two bank properties and six residential properties, with carrying amounts of $2.0 million, $797 thousand and $1.2 million, respectively, sold during the year ended December 31, 2012, which resulted in a net gain of $345 thousand, which is included in real estate owned expense, net in the consolidated statements of operations. At December 31, 2012, the Company maintained 29 properties in the real estate owned portfolio, six of which are former bank branches.

Expenses applicable to real estate owned include the following:

REAL ESTATE OWNED EXPENSES, NET

Years Ended December 31,	2012	2011	2010
Net (gain) loss on sales of real estate	**$ 345**	$ **(26)**	$ (18)
Write-down of real estate owned	**1,433**	**667**	383
Operating expenses, net of rental income	**580**	**545**	436
Total	**$2,358**	$**1,186**	$801

10. GOODWILL AND INTANGIBLE ASSETS

In accordance with FASB ASC 350, the Company tests goodwill for impairment annually at year end and the current year analysis was performed at December 31, 2012.

In performing step one of the impairment analysis as defined by FASB ASC 350, the market value assigned to the Company's stock was based upon an acquisition value relative to recent acquisition transactions by companies in the Company's geographic proximity and comparable size. The acquisition value is sensitive to both the fluctuation of the Company's stock price and the stock price and equity of peer companies. The analysis resulted in an estimated Company fair value above its carrying value, and therefore the Company was deemed to have no goodwill impairment during 2012. During the year ended December 31, 2011, the Company did not record a goodwill impairment charge. A goodwill impairment charge of $89.7 million was recorded in the year ended December 31, 2010. This was the total accumulated impairment of goodwill for the years ended December 31, 2012, 2011 and 2010.

The Company has a core deposit premium intangible asset that resulted from previous acquisitions. The carrying value of this asset was $3.3 million, and $6.9 million, at December 31, 2012 and 2011, respectively. The Company incurred amortization expense of $3.7 million, on its core deposit intangible during each of the years ended December 31, 2012, 2011 and 2010.

Information regarding the Company's expected amortization expense is as follows:

AMORTIZATION OF INTANGIBLE ASSETS

	Amount
Expected for Years Ended December 31,	
2013	2,708
2014	554
Thereafter	—
Total	$3,262

11. DEPOSITS

Deposits consist of the following major classifications:

SUMMARY OF DEPOSITS

December 31,	2012	2011
Interest-bearing demand deposits	**$1,215,548**	$1,244,590
Non-interest-bearing demand deposits	**535,635**	527,796
Savings deposits	**264,155**	262,044
Time deposits under $100,000	**323,768**	376,369
Time deposits $100,000 or more	**256,725**	177,747
Brokered time deposits	**117,393**	79,431
Total	**$2,713,224**	$2,667,977

A summary of time deposits by year of maturity is as follows:

MATURITIES OF TIME DEPOSITS (1)

Years Ended December 31,	Amount
2013	$437,006
2014	90,465
2015	76,362
2016	32,013
2017	61,415
Thereafter	625
Total	$697,886

(1) Amounts include brokered time deposits.

A summary of interest expense on deposits is as follows:

SUMMARY OF INTEREST EXPENSE

Years Ended December 31,	2012	2011	2010
Savings deposits	**$ 900**	$ 1,412	$ 2,283
Time deposits	**7,875**	10,301	15,805
Interest-bearing demand deposits	**4,778**	7,024	10,692
Total	**$13,553**	$18,737	$28,780

12. ADVANCES FROM THE FEDERAL HOME LOAN BANK OF NEW YORK

At December 31, 2012, the Company had fixed-rate advances from the FHLBNY of $61.4 million, which mature through 2022 with interest rates ranging from 1.60% to 5.87%. At December 31, 2011, the Company had fixed-rate advances from the FHLBNY of $2.7 million, which mature through 2018 with interest rates ranging from 3.78% to 5.87%. The weighted average interest rate at December 31, 2012 and 2011 was 2.10% and 4.62%, respectively. Interest expense on advances from the FHLBNY was $425 thousand, $153 thousand and $348 thousand for the years ended December 31, 2012, 2011 and 2010, respectively, and is included in interest on funds borrowed on the consolidated statements of operations.

The contractual maturities of the Company’s fixed-rate advances from the FHLBNY at December 31, 2012 are as follows:

CONTRACTUAL MATURITIES OF ADVANCES FROM THE FHLBNY

Years Ended December 31,	Amount
2013	$ 299
2014	—
2015	—
2016	—
2017	—
Thereafter	61,116
Total	$61,415

13. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Company has overnight repurchase agreements with customers, as well as term repurchase agreements with the FHLBNY. At December 31, 2012 and 2011, customer repurchase agreements were $2.0 million with an interest rate of 0.17% and $5.7 million with interest rate of 0.08%, respectively. Interest expense on customer repurchase agreements was $7 thousand, $7 thousand and $30 thousand for the years ended December 31, 2012, 2011 and 2010, respectively, and is included in interest on funds borrowed on the consolidated statements of operations. Collateral for customer repurchase agreements consisted of U.S. Treasury notes or securities issued or guaranteed by one of the U.S. Government sponsored agencies. The fair value of the collateral was approximately equal to the amounts outstanding.

At December 31, 2012, the Company did not have any FHLBNY repurchase agreements. At December 31, 2011, the Company had one FHLBNY repurchase agreement for $15.0 million with an interest rate of 4.84%. Interest expense on FHLBNY repurchase agreements was $472 thousand, $737 thousand and $737 thousand for the years ended December 31, 2012, 2011 and 2010, respectively, and is included in interest on funds borrowed on the consolidated statements of operations. Collateral for the FHLBNY repurchase agreements consists of securities issued or guaranteed by one of the U.S. Government sponsored agencies. The fair value of the collateral exceeded the amount outstanding at December 31, 2012, 2011 and 2010.

A summary of securities sold under agreements to repurchase, interest rates, approximate average amounts outstanding and their approximate weighted average rates at December 31, 2012, 2011 and 2010 is as follows:

SUMMARY OF REPURCHASE AGREEMENTS

At or for the Years Ended December 31,	2012	2011	2010
FHLBNY repurchase agreements outstanding at year end	**$ —**	$15,000	$15,000
Weighted average interest rate at year end	**— %**	4.84%	4.84%
Approximate average amount outstanding during the year	**$18,333**	$15,000	$15,000
Approximate weighted average rate during the year	**2.30%**	4.91%	4.91%
Repurchase agreements with customers outstanding at year end	**$ 1,968**	$ 5,668	$ 6,307
Weighted average interest rate at year end	**0.17%**	0.08%	0.21%
Approximate average amount outstanding during the year	**$ 4,859**	$ 6,659	$15,243
Approximate weighted average rate during the year	**0.15%**	0.10%	0.19%

The maximum month end amount of securities sold under agreements to repurchase for the years ended December 31, 2012 and 2011 is as follows:

SUMMARY OF MAXIMUM MONTH END REPURCHASE AGREEMENTS

December 31,	2012	2011
FHLBNY repurchase agreements	**$45,000**	$**15,000**
Repurchase agreements with customers	**$ 7,278**	$ **8,249**

14. JUNIOR SUBORDINATED DEBENTURES HELD BY TRUSTS THAT ISSUED CAPITAL DEBT

The Company has established Issuer Trusts that have issued guaranteed preferred beneficial interests in the Company's junior subordinated debentures. These Issuer Trusts are variable interest entities under FASB ASC 810-10, *Consolidation* ("FASB ASC 810-10").

In accordance with FASB ASC 810-10, all the Issuer Trusts outstanding at December 31, 2012 and 2011 are deconsolidated. The junior subordinated debentures issued by the Company to the Issuer Trusts at December 31, 2012 and 2011 of $92.8 million are reflected as junior subordinated debentures in the Company's consolidated statements of financial condition. The Company records interest expense on the corresponding debentures in its consolidated statements of operations. The Company also recorded the common capital securities issued by the Issuer Trusts in other assets in its consolidated statements of financial condition at December 31, 2012 and 2011.

The following is a summary of the outstanding capital securities issued by each Issuer Trust and the junior subordinated debentures issued by the Company to each Issuer Trust as of December 31, 2012.

SUMMARY OF CAPITAL SECURITIES AND JUNIOR SUBORDINATED DEBENTURES

December 31, 2012	Capital Securities			Junior Subordinated Debentures		
Issuer Trust	Issuance Date	Stated Value	Distribution Rate	Principal Amount	Maturity	Redeemable Beginning
Sun Capital Trust V	December 18, 2003	$15,000	3-mo LIBOR plus 2.80%	$15,464	December 30, 2033	December 30, 2008
Sun Capital Trust VI	December 19, 2003	25,000	3-mo LIBOR plus 2.80%	25,774	January 23, 2034	January 23, 2009
Sun Statutory Trust VII	January 17, 2006	30,000	3-mo LIBOR plus 1.35%	30,928	March 15, 2036	March 15, 2011
Sun Capital Trust VII	April 19, 2007	10,000	6.428% Fixed	10,310	June 30, 2037	June 30, 2012
Sun Capital Trust VIII	July 5, 2007	10,000	3-mo LIBOR plus 1.39%	10,310	October 1, 2037	October 1, 2012
		$90,000		$92,786		

On January 23, 2009 and December 30, 2008 the capital securities of Sun Capital Trust VI and Sun Capital Trust V, respectively, became eligible for redemption. As a result of the current interest environment, the Company has elected not to call these securities; however the Company maintains the right to call these securities in the future on the respective payment anniversary dates.

The Company's capital securities are deconsolidated in accordance with GAAP and qualify as Tier 1 capital under federal regulatory guidelines. These instruments are subject to a 25% capital limitation under risk-based capital guidelines developed by the FRB. In March 2005, the FRB amended its risk-based capital standards to expressly allow the continued limited inclusion of outstanding and prospective issuances of capital securities in a bank holding company's Tier 1 capital, subject to tightened quantitative limits. The FRB's amended rule was to become effective March 31, 2009, and would have limited capital securities and other restricted core capital elements to 25% of all core capital elements, net of goodwill, less any associated deferred tax liability. On March 16, 2009, the FRB extended for two years the ability of bank holding companies to include restricted core capital elements as Tier 1 capital up to 25% of all core capital elements, including goodwill. The portion that exceeds the 25% capital limitation qualifies as Tier 2, or supplementary capital of the Company. Management currently operates under a capital plan for the Company and the Bank that is expected to allow the Company and the Bank to maintain regulatory capital levels at or above the levels set for them.

The Issuer Trusts are wholly owned unconsolidated subsidiaries of the Company and have no independent operations. The obligations of Issuer Trusts are fully and unconditionally guaranteed by the Company. The debentures are unsecured and rank subordinate and junior in right of payment to all indebtedness, liabilities and obligations of the Company. Interest on the debentures is cumulative and payable in arrears. Proceeds from any redemption of debentures would cause a mandatory redemption of capital securities having an aggregate liquidation amount equal to the principal amount of debentures redeemed.

Sun Statutory Trust VII has a fixed rate of 6.24% for a period of five years from the date of issuance and beginning in year six a variable rate of London Interbank Offered Rate ("LIBOR") plus 1.35%. Sun Capital Trust VII has a fixed rate of 6.428% for a period of five years from the date of issuance and beginning in year six a variable rate of LIBOR plus 1.53%. Sun Capital Trust V, Sun Capital Trust VI, Sun Statutory Trust VII, Sun Capital Trust VII and Sun Capital Trust VIII do not have interest rate caps.

The Company has customarily relied on dividend payments from the Bank to fund junior subordinated debenture interest obligations. The amount available for payment of dividends to the Company by the Bank was $0 as of December 31, 2012 and no dividends may be paid by the Bank without OCC approval. Per the OCC Agreement, a dividend may only be declared if it is in accordance with the approved capital plan, the Bank remains in compliance with the capital plan following the payment of the dividend and the dividend is approved by the OCC. See Note 23 for additional information on dividend limitations.

15. STOCK-BASED INCENTIVE PLANS

In September 2010, the Board of Directors of the Company adopted a Stock-Based Incentive Plan (the "2010 Plan"). The purpose of the 2010 Plan, as is all of the Company's stock-based plans, is to attract and retain personnel for positions of substantial responsibility and to provide additional incentive to officers, employees, directors, and other persons providing services to the Company, or any present or future parent or subsidiary of the Company to promote the long-term interests of the Company and its shareholders. The 2010 Plan authorizes the issuance of 4,900,000 shares of common stock pursuant to awards that may be granted in the form of options to purchase common stock and awards of shares of common stock. The maximum number of stock awards may not exceed 1,400,000 shares. Under the 2010 Plan, options expire ten years after the date of grant, unless terminated earlier under the option terms. For both options and stock awards, a Committee of non-employee directors has the authority to determine the conditions upon which the options granted will vest. At December 31, 2012, there were 232,647 options and 588,136 awards granted under the 2010 Plan.

In September 2010, the Board of Directors of the Company adopted a Performance Equity Plan (the "2010 Performance Plan"). The 2010 Performance Plan authorizes the issuance of 2,700,000 shares of common stock pursuant to awards that may be granted in the form of options at an exercise price which is 110% of the fair market value of the Company's common stock on the date of grant. The purpose of the 2010 Performance Plan is to establish an effective link between incentive compensation and performance for officers and employees with the Company's stockholders by rewarding actions that result in building long-term shareholder value. Under the 2010 Performance Plan, options expire ten years after the date of grant, unless terminated earlier under the option terms. For options, a Committee of non-employee directors has the authority to determine the conditions upon which the options granted will vest. At December 31, 2012, there were no options or stock awards granted under the 2010 Performance Plan.

The 2004 Stock Plan, as amended in 2009, (the “2004 Plan”), authorizes the issuance of 2,500,425 shares of common stock pursuant to awards that may be granted in the form of options to purchase common stock and awards of shares of common stock. The maximum number of stock awards that may be granted over time may not exceed 761,101 shares. At December 31, 2012, the amount of shares of common stock available for future grants under the 2004 Plan, as amended, was 328,174 shares, of which 9,495 shares are available for issuance as stock awards. Under the 2004 Plan, options expire 10 years after the date of grant, unless terminated earlier under the option terms. For both options and stock awards, a Committee of non-employee directors has the authority to determine the conditions upon which the options granted will vest. Each director and advisory director of the Company received compensation in the form of stock awards which were immediately vested upon issuance. There were 0, 0, and 220,534 stock awards issued from the 2004 Plan for the years ended December 31, 2012, 2011 and 2010, respectively. The Company granted 0, 16,500 and 763,994 options for the years ended December 31, 2012, 2011 and 2010, respectively, under the 2004 Plan. These options were granted at the then fair market value of the Company’s stock. During 2012, there were no options granted under the 2004 Plan. During 2011, there were 16,500 options granted under the 2004 Plan which vested evenly over four years beginning two years after the date of grant. During 2010, there were 503,300 options granted under the 2004 Plan which vested 25% immediately and the remaining 75% evenly over three years, 94,657 options granted which vest evenly over five years, 75,000 options granted that vest 100% two years after the date of grant, 47,037 options granted which vested immediately, and 44,000 options granted which vest evenly over four years beginning two years after the date of grant. There are 1,411,150 options outstanding and 263,611 non-vested restricted stock awards under the 2004 Plan at December 31, 2012.

In January 2006, as a result of the Advantage Bank (“Advantage”) acquisition, the Company assumed stock options previously granted under the Advantage Plans. Upon merger, all stock options under the Advantage Plans became fully vested and were converted to stock options of the Company. The number of shares of common stock that may be purchased pursuant to any such option is equal to the number of shares covered by the option multiplied by the merger exchange ratio, with the exercise price of each converted option equal to the original exercise price divided by the merger exchange ratio. Stock options previously granted under the Advantage Plans are both incentive and non-qualified and expire from 2012 through 2014. There are 136 stock options outstanding under these plans at December 31, 2012. No additional stock options will be granted under these plans.

In July 2004, as a result of the acquisition of Community Bancorp of New Jersey (“Community”), the Company assumed stock options previously granted under the Community Plans. Upon merger, all stock options under the Community Plans became fully vested and were converted to stock options of the Company. The number of shares of common stock that could have been purchased pursuant to any such option equaled the number of shares covered by the option multiplied by the merger exchange ratio, with the exercise price of each converted option equal to the original exercise price divided by the merger exchange ratio. Stock options previously granted under the Community Plans were both incentive and non-qualified and any remaining options expired in 2012. There are no stock options outstanding under these plans at December 31, 2012. No additional stock options will be granted under these plans.

Options granted under the 2002 Stock Option Plan (the “2002 Plan”) may be either qualified incentive options or nonqualified options as determined by the Compensation Committee of the Board of Directors or the Board of Directors. The 2002 Plan authorizes the issuance of 1,108,089 shares of common stock. The grant of reload options is authorized under the 2002 Plan. The award of a reload option allows the optionee to receive the grant of an additional stock option, at the then current market price, in the event that such optionee exercises all or part of an option (an “original option”) by surrendering already owned shares of common stock in full or partial payment of the option price under such original option. The exercise of an additional option issued in accordance with the reload feature will reduce the total number of shares eligible for award under the Plan. Under the 2002 Plan, the nonqualified options expire ten years and ten days after the date of grant, unless terminated earlier under the option terms. The qualified incentive options expire 10 years after the date of grant, unless terminated earlier under the option terms. The vesting provision of the 2002 Plan generally allows 20% of options granted to employees to vest six months after the date of grant, and 20% for each of the next four anniversaries of the grant, subject to employment and other conditions. The vesting provision of the 2002 Plan generally allows options granted to directors to vest as of the date of grant. At December 31, 2012, there were no options outstanding with the reload feature under the 2002 Plan and no shares available for grant.

There are no equity compensation plans providing for the issuance of shares of the Company which were not approved by the shareholders.

Options outstanding under the 2002, 2004, 2010, Community Plans and Advantage Plans are as follows:

SUMMARY OF STOCK OPTIONS GRANTED AND OUTSTANDING

	Incentive	Nonqualified	Total
Stock options granted and outstanding:			
December 31, 2012 at prices ranging from $2.85 to $17.49 per share	**835,097**	**950,060**	**1,785,157**
December 31, 2011 at prices ranging from $3.09 to $17.49 per share	1,012,612	1,815,465	2,828,077
December 31, 2010 at prices ranging from $3.51 to $17.49 per share	846,377	1,353,234	2,199,611

Activity in the stock option plans for the years ended December 31, 2012, 2011 and 2010, respectively was as follows:

SUMMARY OF STOCK OPTION ACTIVITY

Years Ended December 31,	2012		2011		2010	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of year	**2,828,077**	**$ 7.94**	2,728,139	$ 8.29	2,199,611	$ 9.51
Granted	**232,647**	**2.92**	242,500	4.28	763,994	4.77
Exercised	**—**	**—**	—	—	—	—
Forfeited	**(74,776)**	**3.76**	(63,095)	4.84	(29,521)	8.16
Expired	**(1,200,791)**	**8.11**	(79,467)	11.39	(205,945)	8.27
Stock options outstanding, end of year	**1,785,157**	**$ 7.35**	2,828,077	$ 7.94	2,728,139	$ 8.29
Stock options exercisable, end of year	**1,178,775**	**$ 8.66**	2,037,549	$ 8.73	1,750,189	$ 9.37
Stock options vested or expected to vest (1)	**1,725,894**	**$ 7.44**	2,599,466	$ 7.98	2,584,682	$ 8.36

(1) Includes vested shares and nonvested shares after a forfeiture rate assumption, which is based upon historical data, is applied.

The weighted average grant date fair value per share of options granted during the years ended December 31, 2012, 2011 and 2010 were $1.52, $2.11 and $2.75, respectively. The aggregate intrinsic value of options outstanding at December 31, 2012, 2011 and 2010 was $132 thousand, $0, and $284 thousand, respectively.

No options were exercised during 2012, 2011 or 2010. The aggregate intrinsic value of options exercisable at December 31, 2012, 2011 and 2010 was $0.

A summary of the Company's nonvested options at December 31, 2012, 2011 and 2010, respectively, are presented in the following table:

SUMMARY OF NONVESTED STOCK OPTION ACTIVITY

Years Ended December 31,	2012		2011		2010	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested stock options outstanding, beginning of year	**790,528**	**$ 5.90**	977,950	$ 6.38	597,363	$ 15.31
Granted	**232,647**	**2.92**	242,500	4.28	763,994	4.77
Vested	**(342,017)**	**6.30**	(366,827)	6.29	(353,886)	17.82
Forfeited	**(74,776)**	**3.76**	(63,095)	4.84	(29,521)	8.16
Nonvested stock options outstanding, end of year	**606,382**	**$ 4.79**	790,528	$ 5.90	977,950	$ 6.38

At December 31, 2012, there was $923 thousand of total unrecognized compensation cost related to options granted under the stock option plans. That cost is expected to be recognized over a weighted average period of 2.6 years.

A summary of the Company's nonvested stock awards at December 31, 2012, 2011 and 2010, respectively, are presented in the following table:

SUMMARY OF NONVESTED STOCK AWARD ACTIVITY

Years Ended December 31,	2012		2011		2010	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested stock awards outstanding, beginning of year	**175,989**	**$ 6.07**	309,481	$ 6.16	182,297	$ 7.67
Issued	**588,136**	**2.88**	—	—	176,250	4.76
Vested	**(106,012)**	**5.57**	(110,973)	6.56	(48,066)	6.79
Forfeited	**(19,076)**	**3.21**	(19,689)	4.83	(1,000)	3.54
Nonvested stock awards outstanding, end of year	**639,037**	**$ 3.30**	178,819	$ 6.05	309,481	$ 6.16

During 2012, 2011 and 2010, the Company issued 588,136, 0 and 176,250 shares of stock awards, respectively, that were valued at $1.8 million, $0 and $839 thousand, respectively, at the time these awards were granted. The value of these shares is based upon the closing price of the Company's common stock on the date of grant. At December 31, 2012, there was $1.8 million of total unrecognized compensation cost related to these stock awards that is expected to be recognized over a weighted average period of 4.47 years. The total compensation expense recognized on stock awards which vested during 2012 was $469 thousand.

16. EMPLOYEE AND DIRECTOR STOCK PURCHASE PLANS

In 1997, the Company adopted an Employee Stock Purchase Plan ("ESPP") and a Directors Stock Purchase Plan ("DSPP") (collectively, the "Purchase Plans"). Under the ESPP and the DSPP, as amended and restated in 2009, 323,254 shares and 119,216 shares, respectively, were reserved for issuance. Under the terms of the Purchase Plans, the Company grants participants an option to purchase shares of Company common stock with an exercise price equal to 95% of market prices. Under the ESPP, employees are permitted, through payroll deduction, to purchase up to $25,000 of fair market value of the Company's common stock per year. Under the DSPP, directors are permitted to remit funds, on a regular basis, to purchase up to $25,000 of fair market value of the Company's common stock per year. Participants incur no brokerage commissions or service charges for purchases made under the Purchase Plans. For the years ended December 31, 2012, 2011 and 2010 there were 38,787 shares, 36,167 shares and 25,321 shares, respectively, purchased through the ESPP. For the years ended December 31, 2012, 2011 and 2010, there were 16,754 shares, 15,538 shares and 11,497 shares, respectively, purchased through the DSPP. At December 31, 2012, there were 103,069 and 1,324 shares remaining in the ESPP and DSPP, respectively.

17. BENEFITS

The Company has established a 401(k) Retirement Plan (the "401(k) Plan") for all qualified employees. Employees are eligible to participate in the 401(k) Plan following completion of 90 days of service and attaining age 21. The Company's match begins after one year of service. Vesting in the Company's match contribution accrues evenly over four years. Pursuant to the 401(k) Plan, employees can contribute up to 75% of their compensation to the maximum allowed by law. The Company will match 50% of the first 6% of the base contribution that an employee contributes. The Company match consists of a contribution of the Company's common stock, at market value. The Company's contribution to the 401(k) Plan was $670 thousand, $644 thousand and $641 thousand for the years ended December 31, 2012, 2011 and 2010, respectively.

In April 2009, the Company established the Directors' Deferred Fee Plan, a deferred stock compensation plan for members of its Board of Directors (the "Directors' Plan"). The Directors' Plan provides Directors with the opportunity to defer, for tax planning purposes, receipt of all or a portion of any Sun Bancorp, Inc. stock earned as compensation. The Directors' Plan balance as of December 31, 2012 and 2011 was $256 thousand and $193 thousand, respectively.

In September 2010, in an effort to facilitate the succession plan of the Company's Chairmanship, the Company established a Salary Continuation Plan (the "Salary Plan") to compensate the Chairman of the Company for advising the incoming Chairman and the Board of Directors, as well as reward him for his many years of service to the Company. Under the Salary Plan, for a period of three years, the Chairman will receive a monthly payment equal to his base salary in effect and due to him at retirement. At December 31, 2012, the Company had an accrued liability of $1.0 million in other liabilities on the consolidated statements of financial condition related to the Salary Plan.

18. COMMITMENTS AND CONTINGENT LIABILITIES

The Company, from time to time, may be a defendant in legal proceedings related to the conduct of its business. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such litigation and claims will not be material to the consolidated financial statements.

Letters of Credit. In the normal course of business, the Company has various commitments and contingent liabilities, such as customers' letters of credit (including standby letters of credit of $40.5 million and $51.9 million at December 31, 2012 and 2011, respectively), which are not reflected in the accompanying consolidated financial statements. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. In the judgment of management, the financial condition of the Company will not be affected materially by the final outcome of any letters of credit.

Reserve for Unfunded Commitments. The Company maintains a reserve for unfunded loan commitments and letters of credit which is reported in other liabilities in the consolidated statements of financial condition consistent with FASB ASC 825, *Financial Instruments*. As of December 31, 2012, the Company records estimated losses inherent with unfunded loan commitments in accordance with FASB ASC 450, *Contingencies*, and estimated future obligations under letters of credit in accordance with FASB ASC 460, *Guarantees*. The methodology used to determine the adequacy of this reserve is integrated in the Company's process for establishing the allowance for loan losses and considers the probability of future losses and obligations that may be incurred under these off-balance sheet agreements. The reserve for unfunded loan commitments and letters of credit as of December 31, 2012 and 2011 was $613 thousand and $381 thousand, respectively. Management believes this reserve level is sufficient to absorb estimated probable losses related to these commitments.

Reserve for residential mortgage loans sold with recourse. The Company maintains a reserve for residential mortgage loans sold with recourse to third-party purchasers which is reported in other liabilities in the consolidated statements of financial condition. As of December 31, 2012, the Company records estimated losses inherent with residential mortgage loans sold with recourse in accordance with FASB ASC 450, *Contingencies*. This reserve is determined based upon the probability of future losses which is calculated using historical Company and industry loss data. The reserve for residential mortgage loan recourse as of December 31, 2012 and 2011 was $325 thousand and $0, respectively. Management believes this reserve level is sufficient to address potential recourse exposure.

Leases. The following is a schedule of the Company's future minimum lease payments under capital leases as of December 31, 2012:

FUTURE MINIMUM LEASE PAYMENTS UNDER OBLIGATIONS UNDER CAPITAL LEASES

Years Ended December 31,	Amount
2013	$ 776
2014	776
2015	797
2016	839
2017	839
Thereafter	7,819
Total minimum lease payments	11,846
Less: Amount representing interest	4,237
Present value of minimum lease payment, net	$ 7,609

The following table shows future minimum payments under noncancelable operating leases with initial terms of one year or more at December 31, 2012. Future minimum receipts under sub-lease agreements are deemed not material.

FUTURE MINIMUM PAYMENTS UNDER NONCANCELABLE OPERATING LEASES

Years Ended December 31,	Amount
2013	$ 4,177
2014	4,110
2015	3,928
2016	3,855
2017	3,529
Thereafter	26,001
Total minimum lease payments	$45,600

Rental expense, which is included in occupancy expense on the Company's consolidated statements of operations for all leases was $4.8 million, $4.5 million and $4.5 million for the years ended December 31, 2012, 2011 and 2010, respectively.

19. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Derivative financial instruments involve, to varying degrees, interest rate, market and credit risk. The Company manages these risks as part of its asset and liability management process and through credit policies and procedures. The Company seeks to minimize counterparty credit risk by establishing credit limits and collateral agreements. The Company utilizes certain derivative financial instruments to enhance its ability to manage interest rate risk that exists as part of its ongoing business operations. In general, the derivative transactions entered into by the Company fall into one of two types: a fair value hedge of a specific fixed-rate loan agreement and an economic hedge of a derivative offering to a Bank customer. The Company does not use derivative financial instruments for trading purposes.

Fair Value Hedges - Interest Rate Swaps. The Company has entered into interest rate swap arrangements to exchange the periodic payments on fixed-rate commercial loan agreements for variable-rate payments based on the one-month London Interbank Offered Rate ("LIBOR") without the exchange of the underlying principal. The interest rate swaps are designated as fair value hedges under FASB ASC 815, *Derivatives and Hedging* ("FASB ASC 815"), and are executed for periods and terms that match the related underlying fixed-rate loan agreements. The Company applies the "shortcut" method of accounting under FASB ASC 815, which assumes there is no ineffectiveness as changes in the interest rate component of the swaps' fair value are expected to exactly offset the corresponding changes in the fair value of the underlying commercial loan agreements. Because the hedging arrangement is considered highly effective, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however, there may be fair value adjustments related to credit quality variations between counterparties, which may impact earnings as required by FASB ASC 820, *Fair Value Measurements and Disclosures* ("FASB ASC 820"). The fair value adjustments related to credit quality were not material as of December 31, 2012 and 2011.

The following tables provide information pertaining to interest rate swaps designated as fair value hedges under FASB ASC 815 at December 31, 2012 and 2011:

SUMMARY OF INTEREST RATE SWAPS DESIGNATED AS FAIR VALUE HEDGES

December 31,	2012		2011	
Balance Sheet Location	Notional	Fair Value	Notional	Fair Value
Other liabilities	**$30,545**	**$ (3,503)**	$33,663	$(4,489)

SUMMARY OF INTEREST RATE SWAPS COMPONENTS

December 31,	2012	2011
Weighted average pay rate	**6.85%**	6.83%
Weighted average receive rate	**2.22%**	2.27%
Weighted average maturity in years	**2.6**	3.4

Customer Derivatives – Interest Rate Swaps/Caps. The Company enters into interest rate swaps that allow our commercial loan customers to effectively convert a variable-rate commercial loan agreement to a fixed-rate commercial loan agreement. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to an interest rate swap agreement, which serves to effectively swap the customer's variable-rate loan into a fixed-rate loan. The Company then enters into a corresponding swap agreement with a third party in order to economically hedge its exposure on the variable and fixed components of the customer agreement. The interest rate swaps with both the customers and third parties are not designated as hedges under FASB ASC 815 and are marked to market through earnings. As the interest rate swaps are structured to offset each other, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however, there may be fair value adjustments related to credit quality variations between counterparties, which may impact earnings as required by FASB ASC 820. The Company recognized negative net derivative valuation adjustments of $2.3 million, $12.5 million and $12.2 million during the years ended December 31, 2012, 2011 and 2010, respectively. These balances included swap termination fees of $2.2 million, $14.6 million and $10.3 million during the years ended December 31, 2012, 2011 and 2010, respectively. These amounts are included in the derivative credit valuation adjustment in the consolidated statements of operations.

SUMMARY OF INTEREST RATE SWAPS NOT DESIGNATED AS HEDGING INSTRUMENTS

December 31,	2012		2011	
Balance Sheet Location	Notional	Fair Value	Notional	Fair Value
Other assets	**$358,753**	**$ 40,594**	**$400,311**	**$ 50,355**
Other liabilities	**358,753**	**(40,646)**	**400,311**	**(50,462)**

In addition, the Company has entered into an interest rate floor sale transaction with one commercial customer. The Company entered into a corresponding interest rate floor purchase transaction with a third party in order to offset its exposure on the variable and fixed components of the customer agreement. As the interest rate floors with both the customer and the third party are not designated as hedges under FASB ASC 815, the instruments are marked to market through earnings. As the interest rate floors are structured to offset each other, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however, there may be fair value adjustments related to credit quality variations between counterparties, which may impact earnings as required by FASB ASC 820. The combined notional amount of the two interest rate floors was $15.9 million and $16.6 million at December 31, 2012 and December 31, 2011, respectively.

The Company has an International Swaps and Derivatives Association agreement with a third party that requires a minimum dollar transfer amount upon a margin call. This requirement is dependent on certain specified credit measures. The amount of collateral posted with the third party at December 31, 2012 and 2011 was $54.6 million and $62.6 million, respectively. The amount of collateral posted with the third party is deemed to be sufficient to collateralize both the fair market value change as well as any additional amounts that may be required as a result of a change in the specified credit measures. The aggregate fair value of all derivative financial instruments in a liability position with credit measure contingencies and entered into with the third party was $44.1 million and $55.0 million at December 31, 2012 and 2011, respectively.

Interest rate lock commitments on residential mortgages. As a part of its normal residential mortgage operations, the Company will enter into an interest rate lock commitment with a potential borrower. The Company enters into a corresponding commitment to an investor to sell that loan at a specific price shortly after origination. In accordance with FASB ASC 820, adjustments are recorded through earnings to account for the net change in fair value of these transactions for both the held-for-sale pipeline and warehouse. For the year ended December 31, 2012, the Company recognized $638 thousand and $209 thousand in positive fair value adjustments on its held-for-sale pipeline and warehouse, respectively, which were included in other non-interest income on the consolidated statements of operations as an increase to income. In the year ended December 31, 2011, $0 in fair value adjustments were recorded. The interest rate lock commitment had notional amounts of $90.1 million and $98.5 million for the held-for-sale pipeline and warehouse, respectively as of December 31, 2012.

20. INCOME TAXES

The income tax (benefit) expense consists of the following:

SUMMARY OF INCOME TAX (BENEFIT) EXPENSE

Years Ended December 31,	2012	2011	2010
Current	**$ (34)**	$ 10	$(11,020)
Deferred	**—**	—	20,342
Income tax (benefit) provision	**$ (34)**	$ 10	$ 9,322

Items that gave rise to significant portions of the deferred tax accounts are as follows:

DETAILS OF DEFERRED TAX LIABILITY, NET

December 31,	2012	2011
Deferred tax asset:		
Allowance for loan losses	**$ 19,239**	$ 17,319
Goodwill amortization	**1,262**	3,263
Impairments realized on investment securities	**490**	490
Fixed assets	**2,596**	1,588
Net operating loss carry forwards	**85,466**	66,334
Alternative minimum tax credits	**2,010**	1,975
Other	**5,194**	3,804
Total deferred tax asset before valuation allowance	**116,257**	94,773
Less: valuation allowance	**(113,398)**	(91,416)
Deferred tax liability:		
Core deposit intangible amortization	**420**	1,203
Unrealized gain on investment securities	**1,509**	432
Deferred loan costs	**2,119**	1,817
Other	**320**	337
Total deferred tax liability	**4,368**	3,789
Net deferred tax (liability) asset	**$ (1,509)**	$ (432)

The Company has $199.2 million of federal net operating loss carryforwards at December 31, 2012 of which $38.8 million will expire in 2030, $113.5 million will expire in 2031, and $46.9 million will expire in 2032. The Company also has $268.9 million of state net operating loss carryforwards at December 31, 2012 of which $3.0 million expire in 2015, $37.4 million expire in 2029, $74.7 million expire in 2030, $110.2 million expire in 2031, and $43.7 million expire in 2032.

At December 31, 2012, the Company had a valuation allowance of $113.4 million against the net deferred tax asset as it is more likely than not that the full deferred tax asset will not be realized. Management considered all positive and negative evidence regarding the ultimate ability to fully realize the deferred tax assets, including past operating results and the forecast of future taxable income. In addition, the Company is a three-year cumulative loss company. The net deferred tax liability of $1.5 million relates to unrealized gains on investment securities.

The provision for income taxes differs from that computed at the statutory rate as follows:

RECONCILIATION OF FEDERAL STATUTORY INCOME TAX

Years Ended December 31,	2012		2011		2010	
	Amount	%	Amount	%	Amount	%
Loss before income taxes	**$(50,524)**		$(67,495)		$(176,096)	
Tax computed at statutory rate	**(17,683)**	**35.0%**	(23,624)	35.0%	(61,634)	35.0%
(Decrease) increase in charge resulting from:						
State taxes, net of federal benefit	**(3,040)**	**6.0**	(3,949)	5.9	(8,514)	4.8
Tax exempt interest (net)	**(638)**	**1.3**	(900)	1.3	(1,233)	0.7
BOLI	**(695)**	**1.4**	(1,037)	1.5	(726)	0.4
Nondeductible goodwill	**—**	**—**	—	—	18,980	(10.8)
Valuation allowance	**21,981**	**(43.5)**	29,524	(43.7)	61,892	(35.1)
Other, net	**41**	**(0.1)**	(4)	0.0	557	(0.3)
Total income tax (benefit) expense	**$ (34)**	**0.1%**	$ 10	0.0%	$ 9,322	(5.3)%

FASB ASC 740 clarifies the accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined in ASC 740 as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that has greater than 50% likelihood of being realized upon ultimate settlement. ASC 740 was applied to all existing tax positions upon initial adoption. There was no liability for uncertain tax positions and no known unrecognized tax benefits at December 31, 2012 or 2011.

The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the results of operations. As of December 31, 2012, the tax year ended December 31, 2011 was subject to examination by the Internal Revenue Service (the “IRS”) and to state examination. During 2012, the IRS completed its examination of the Company’s 2008 through 2010 tax returns, which did not result in any material change to the Company’s tax position. However, the federal statute remains open for 2009 and 2010.

21. SECURITIES PURCHASE AGREEMENTS

On July 7, 2010, the Company entered into securities purchase agreements with WLR SBI AcquisitionCo, LLC, an affiliate of WL Ross & Co. LLC ("WL Ross"), members and affiliates of the Bank's founding Brown Family (the "Brown Family"), certain affiliates of Siguler Guff & Company, LP (the "Siguler Guff Shareholders") and certain other institutional and accredited investors (the "Other Investors"). On September 22, 2010, the Company completed the issuance and sale of 4,672,750 shares of its common stock and 88,009 shares of its Mandatorily Convertible Cumulative Non-Voting Perpetual Stock, Series B (the "Series B Preferred Stock") for net proceeds of $98.5 million. At the Company's Annual Meeting of Shareholders held on November 1, 2010, its shareholders approved an amendment to our Amended and Restated Certificate of Incorporation allowing for the conversion of the 88,009 shares of Series B Preferred Stock into 22,002,250 shares of common stock at a conversion price of $4.00 per share.

On March 22, 2011, the Company completed a public offering of 28,750,000 shares of common stock at a public offering price of $3.00 per share, which included the full exercise of the over-allotment option granted to the underwriters to purchase an additional 3,750,000 shares of common stock. After deducting the underwriting discount and offering expenses payable by the Company, the net proceeds were $81.4 million. The Company's three largest shareholders, WL Ross, Siguler Guff, and the Brown Family, along with certain officers and directors, purchased an aggregate of 10,193,224 shares in the offering. WL Ross and the Siguler Guff Shareholders maintained their percentage interest in the Company in the offering. Pursuant to the terms of the securities purchase agreements entered into between WL Ross, the Siguler Guff Shareholders, the Brown Family and the Company in connection with the private placement of Company securities in July 2010, each of these investors was entitled to purchase shares in the offering at $2.85 per share which represented the public offering price less the underwriting discount of $0.15 per share paid to the underwriters on the other shares sold.

On April 11, 2011, the Company issued and sold in a private placement transaction an additional 3,802,131 shares at $2.85 per share totaling $10.8 million in additional stock proceeds pursuant to the exercise of gross-up rights contained in the previously executed security purchase agreements with the three investors noted above. The gross-up rights were triggered by the underwriters' exercise of the over-allotment option in the public offering. On August 8, 2011, the Company issued approximately 2,378,232 additional shares at $2.85 per share totaling $6.8 million in stock proceeds pursuant to the exercise of gross-up rights. The transactions were triggered pursuant to the gross-up rights issued to Anchorage Capital Group, LLC ("Anchorage"), in connection with its purchase of shares in the public offering.

22. LOSS PER COMMON SHARE

Basic earnings (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of shares of common stock outstanding, net of any treasury shares, during the period. Diluted earnings per share is calculated by dividing net income (loss) available to common shareholders by the weighted average number of shares of common stock outstanding, net of any treasury shares, after consideration of the potential dilutive effect of common stock equivalents, based upon the treasury stock method using an average market price for the period.

Loss per share was calculated as follows:

LOSS PER COMMON SHARE COMPUTATION

Years Ended December 31,	2012	2011	2010
Net loss	**$ (50,491)**	$ (67,505)	$ (185,418)
Net loss available to common shareholders	**$ (50,191)**	$ (67,505)	$ (185,418)
Average common shares outstanding	**85,938,714**	76,653,990	28,258,953
Net effect of dilutive stock options	**—**	—	—
Dilutive common shares outstanding	**85,738,714**	76,653,990	28,258,953
Loss per share – basic	**$ (0.59)**	$ (0.88)	$ (6.56)
Loss per share – diluted	**$ (0.59)**	$ (0.88)	$ (6.56)

23. REGULATORY MATTERS

The Company is subject to risk-based capital guidelines adopted by the FRB for bank holding companies. The Bank is also subject to similar capital requirements adopted by the OCC. Under the requirements the federal bank regulatory agencies have established quantitative measures to ensure that minimum thresholds for Total Capital, Tier 1 Capital and Leverage (Tier 1 Capital divided by average assets) ratios (set forth in the table below) are maintained. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets and certain off-balance sheet items as calculated under regulatory practices.

The Company's and Bank's capital amounts and classifications are also subject to qualitative judgments by the federal bank regulators about components, risk weightings and other factors. The Company's and the Bank's risk-based capital ratios have been computed in accordance with regulatory practices. The Company and the Bank were in compliance with these regulatory capital requirements of the FRB and the OCC as of December 31, 2012. As discussed below and elsewhere herein, additional capital requirements have been imposed on the Bank by the OCC, which the Bank was also in full compliance with as of December 31, 2012.

On April 15, 2010, the Bank entered into the OCC Agreement which contained requirements to develop and implement a profitability and capital plan that provides for the maintenance of adequate capital to support the Bank's risk profile in the current economic environment. The capital plan was also required to contain a dividend policy allowing dividends only if the Bank is in compliance with the capital plan, and obtains prior approval from the OCC. During the second quarter of 2010, the Company delivered its profit and capital plans to the OCC.

The Bank also agreed to: (a) implement a program to protect the Bank's interest in criticized or classified assets, (b) review and revise the Bank's loan review program; (c) implement a program for the maintenance of an adequate allowance for loan losses; and (d) revise the Bank's credit administration policies. During the second quarter of 2010, the Company revised and implemented changes to policies and procedures pursuant to the OCC Agreement. As noted earlier in this section, the Bank also agreed that its brokered deposits will not exceed 3.5% of its total liabilities unless approved by the OCC. Effective October 18, 2012, the OCC approved an increase of this limit to 6.0%. Management does not expect that this restriction will limit its access to liquidity as the Bank does not rely on brokered deposits as a major source of funding. As of December 31, 2012, the Bank's brokered deposits represented 4.0% of its total liabilities.

The Bank is also subject to individual minimum capital ratios established by the OCC requiring the Bank to continue to maintain a Leverage ratio at least equal to 8.50% of adjusted total assets, to continue to maintain a Tier 1 Capital ratio at least equal to 9.50% of risk-weighted assets and to maintain a Total Capital ratio at least equal to 11.50% of risk-weighted assets. At December 31, 2012, the Bank met all of the three capital ratios established by the OCC as its Leverage ratio was 9.24%, its Tier 1 Capital ratio was 11.76%, and its Total Capital ratio was 13.02%.

The following table provides both the Company's and the Bank's risk-based capital ratios as of December 31, 2012 and 2011.

REGULATORY CAPITAL LEVELS

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions(1)	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2012						
Total Capital (to Risk-Weighted Assets):						
Sun Bancorp, Inc.	$340,111	13.72%	$ 198,340	8.00%	N/A	
Sun National Bank	322,041	13.02	197,964	8.00	$ 247,455	10.00%
Tier 1 Capital (to Risk-Weighted Assets):						
Sun Bancorp, Inc.	293,008	11.82	99,170	4.00	N/A	
Sun National Bank	290,922	11.76	98,982	4.00	148,473	6.00
Leverage Ratio:						
Sun Bancorp, Inc.	293,008	9.30	126,080	4.00	N/A	
Sun National Bank	290,922	9.24	125,902	4.00	157,377	5.00
December 31, 2011						
Total Capital (to Risk-Weighted Assets):						
Sun Bancorp, Inc.	$385,034	15.22%	$ 202,415	8.00%	N/A	
Sun National Bank	338,240	13.39	202,120	8.00	$ 252,650	10.00%
Tier 1 Capital (to Risk-Weighted Assets):						
Sun Bancorp, Inc.	353,283	13.96	101,208	4.00	N/A	
Sun National Bank	306,534	12.13	101,060	4.00	151,590	6.00
Leverage Ratio:						
Sun Bancorp, Inc.	353,283	11.09	127,381	4.00	N/A	
Sun National Bank	306,534	9.64	127,240	4.00	159,050	5.00

(1) Not applicable for bank holding companies.

At December 31, 2012 and 2011, although the Company and the Bank exceeded the required ratios for classification as "well capitalized," due to the fact that it was subject to the OCC Agreement, it cannot be deemed "well capitalized."

The Bank's deposits are insured to applicable limits by the FDIC. Pursuant to the Dodd-Frank Act, the Federal Deposit Insurance Act was amended to increase the maximum deposit insurance amount from $100,000 to $250,000 and extended the unlimited deposit insurance coverage for noninterest-bearing transaction accounts until December 31, 2012, at which time the extension expired. Upon expiration, these types of deposits were only insured up to the same $250 thousand limit as other types of deposit accounts.

In November 2009, instead of imposing additional special assessments, the FDIC amended the assessment regulations to require all insured depository institutions to prepay their estimated risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012 on December 30, 2009. For purposes of estimating the future assessments, each institution's base assessment rate in effect on September 30, 2009 was used, assuming a five percent annual growth rate in the assessment base and a three basis point increase in the assessment rate in 2011 and 2010. The prepaid assessment will be applied against actual quarterly assessments until exhausted. Any funds remaining after June 30, 2013 will be returned to the institution. If the prepayment would impair an institution's liquidity or otherwise create significant hardship, it was able to apply for an exemption. Requiring this prepaid assessment did not preclude the FDIC from changing assessment rates or from further revising the risk-based assessment system. On December 31, 2009, the Company paid the FDIC prepaid assessment of $18.3 million, of which approximately $3.9 million applied to 2012. The remaining prepaid assessment of approximately $2.6 million at December 31, 2012 will be recognized as expense over the course of the respective periods covered.

The Company's capital securities are deconsolidated in accordance with GAAP and qualify as Tier 1 capital under federal regulatory guidelines. These instruments are subject to a 25% capital limitation under risk-based capital guidelines developed by the FRB. In March 2005, the FRB amended its risk-based capital standards to expressly allow the continued limited inclusion of outstanding and prospective issuances of capital securities in a bank holding company's Tier 1 capital, subject to tightened quantitative limits. The FRB's amended rule was to become effective March 31, 2009, and would have limited capital securities and other restricted core capital elements to 25% of all core capital elements, net of goodwill less any associated deferred tax liability. On March 16, 2009, the FRB extended for two years the ability for bank holding companies to include restricted core capital elements as Tier 1 capital up to 25% of all core capital elements, including goodwill. The portion that exceeds the 25% capital limitation qualifies as Tier 2, or supplementary capital of the Company. At December 31, 2012, the $74.1 million in capital securities qualified as Tier 1 capital.

The ability of the Bank to pay dividends to the Company is controlled by certain regulatory restrictions. Generally, dividends declared in a given year by a national bank are limited to its net profit, as defined by regulatory agencies, for that year, combined with its retained net income for the preceding two years, less any required transfer to surplus or to fund for the retirement of any preferred stock. In addition, a national bank may not pay any dividends in an amount greater than its undivided profits and a national bank may not declare any dividends if such declaration would leave the bank inadequately capitalized. Therefore, the ability of the Bank to declare dividends will depend on its future net income and capital requirements. Also, banking regulators have indicated that national banks should generally pay dividends only out of current operating earnings. Following this guidance, the amount available for payment of dividends to the Company by the Bank totaled $0 at December 31, 2012. Per the OCC Agreement, a dividend may only be declared if it is in accordance with the approved capital plan, the Bank remains in compliance with the capital plan following the payment of the dividend and the dividend is approved by the OCC.

24. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company accounts for fair value measurements in accordance with FASB ASC 820. FASB ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The definition of fair value retains the exchange price notion in earlier definitions of fair value. FASB ASC 820 clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability. The definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). FASB ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement and also clarifies the application of fair value measurement in a market that is not active.

FASB ASC 820 describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

FASB ASC 820 requires the Company to disclose the fair value of financial assets on both a recurring and non-recurring basis. Those assets and liabilities which will continue to be measured at fair value on a recurring basis are as follows:

SUMMARY OF RECURRING FAIR VALUE MEASUREMENTS

		Category Used for Fair Value Measurement		
	Total	**Level 1**	**Level 2**	**Level 3**
December 31, 2012				
Assets:				
Investment securities available for sale:				
U.S. Treasury obligations	**$ 10,011**	**$ 10,011**	**$ —**	**$ —**
U.S. Government agencies	**4,949**	**—**	**4,949**	**—**
U.S. Government agency mortgage-backed securities	**354,978**	**—**	**354,978**	**—**
Other mortgage-backed securities	**286**	**—**	**286**	**—**
State and municipal obligations	**40,170**	**—**	**40,170**	**—**
Trust preferred securities	**5,882**	**—**	**—**	**5,882**
Corporate bonds	**25,442**	**—**	**25,442**	**—**
Other securities	**1,464**	**1,464**	**—**	**—**
Residential loans held-for-sale	**99,013**	**—**	**99,013**	**—**
Interest rate lock commitments on residential mortgages	**847**	**—**	**—**	**847**
Interest rate swaps	**40,594**	**—**	**40,594**	**—**
Interest rate floor	**275**	**—**	**275**	**—**
Liabilities:				
Fair value interest rate swaps	**3,503**	**—**	**3,503**	**—**
Interest rate swaps	**40,646**	**—**	**40,646**	**—**
Interest rate floor	**275**	**—**	**275**	**—**
December 31, 2011				
Assets:				
Investment securities available for sale:				
U.S. Treasury obligations	**$ 12,079**	**$ 12,079**	**$ —**	**$ —**
U.S. Government agencies	**—**	**—**	**—**	**—**
U.S. Government agency mortgage-backed securities	**428,904**	**—**	**428,904**	**—**
Other mortgage-backed securities	**296**	**—**	**296**	**—**
State and municipal obligations	**48,785**	**—**	**48,785**	**—**
Trust preferred securities	**4,908**	**—**	**—**	**4,908**
Corporate bonds	**19,408**	**—**	**19,408**	**—**
Other	**1,165**	**665**	**500**	**—**
Interest rate swaps	**50,355**	**—**	**50,355**	**—**
Interest rate floor	**360**	**—**	**360**	**—**
Liabilities:				
Fair value interest rate swaps	**4,489**	**—**	**4,489**	**—**
Interest rate swaps	**50,462**	**—**	**50,462**	**—**
Interest rate floor	**360**	**—**	**360**	**—**

Level 1 Valuation Techniques and Inputs

U.S. Treasury securities. The Company reports U.S. Treasury securities at fair value utilizing Level 1 inputs. These securities are priced using observable quotations for the indicated security.

Other securities. The other securities category is comprised of money market mutual funds. Given the short maturity structure and the expectation that the investment can be redeemed at par value, the fair value of these investments is assumed to be the book value.

Level 2 Valuation Techniques and Inputs

The majority of the Company's investment securities are reported at fair value utilizing Level 2 inputs. Prices of these securities are obtained through independent, third-party pricing services. Prices obtained through these sources include market derived quotations and matrix pricing and may include both observable and unobservable inputs. Fair market values take into consideration data such as dealer quotes, new issue pricing, trade prices for similar issues, prepayment estimates, cash flows, market credit spreads and other factors. The Company reviews the output from the third-party providers for reasonableness by the pricing consistency among securities with similar characteristics, where available, and comparing values with other pricing sources available to the Company.

In general, the Level 2 valuation process uses the following significant inputs in determining the fair value of the Company's different classes of investments:

U.S. Government agency securities. These securities are evaluated based on either a nominal spread basis for non-callable securities or on an option adjusted spread ("OAS") basis for callable securities. The nominal spread and OAS levels are derived from observations of identical or comparable securities actively trading in the markets.

U.S. Government agency mortgage-backed securities. The Company's agency mortgage-backed securities generally include fixed-rate agency mortgage-backed pools and adjustable-rate agency mortgage-backed pools.

Fixed-rate agency mortgage-backed pools are evaluated based on spreads to actively traded To-Be-Announced ("TBA") and seasoned securities, the pricing of which is provided by inter-dealer brokers, broker dealers and other contributing firms active in trading the security class. Further delineation is made by weighted average coupon ("WAC") and weighted average maturity ("WAM") with spreads on individual securities relative to actively traded securities as determined and quality controlled using OAS valuations.

Adjustable-rate agency mortgage-backed pools are evaluated on a bond equivalent effective margin ("BEEM") basis obtained from broker dealers and other contributing firms active in the market. BEEM levels are established for key sectors using characteristics such as month-to-roll, index, periodic and life caps and index margins and convertibility. Individual securities are then evaluated based on how their characteristics map to the sectors established.

Agency collateralized mortgage obligations ("CMOs") are evaluated based on nominal spread and OAS values of securities with comparable tranche type, average life, average life variance and prepayment characteristics of the underlying collateral.

Other mortgage-backed securities. The Company's other mortgage-backed securities consist of whole loan, non-agency CMOs. These securities are evaluated based on generic tranche and generic prepayment speed estimates of various types of collateral from contributing firms and broker/dealers in the whole loan CMO market.

State and municipal obligations. These securities are evaluated using information on identical or similar securities provided by market makers, broker/dealers and buy-side firms, new issue sales and bid-wanted lists. The individual securities are then priced based on mapping the characteristics of the security such as obligation type (general obligation, revenue, etc.), maturity, state discount and premiums, call features, taxability and other considerations.

Corporate bonds. The fair value measurements for corporate bonds consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit quality information and the bond's terms and conditions, among other things. If relevant and observable prices are available, those valuations would be classified as Level 2. If prices are not available, other valuation techniques would be used and the item would be classified as Level 3.

Residential mortgage loans held-for-sale. Effective July 1, 2012, the Company's residential mortgage loans held-for-sale were recorded at fair value utilizing Level 2 measurements. This fair value measurement is determined based upon third party quotes obtained on similar loans. The Company adopted the fair value option on these loans as it believes the fair value measurement of such loans reduces certain timing differences in the Company's financial statements and better aligns with the management of the portfolio from a business perspective. The fair value option allows the Company to record the mortgage loans held-for-sale portfolio at fair market value as opposed to the lower of cost or market. The adoption of this accounting election resulted in an increase of $2.1 million in gain on sale of loans in the consolidated statements of operations for the year ended December 31, 2012. The Company economically hedges its residential loans held for sale portfolio with forward sale agreements which are reported at fair value. A lower of cost or market accounting treatment would not allow the Company to record the excess of the fair market value over book value but would require the Company to record the corresponding reduction in value on the hedges. Both the loans and related hedges are carried at fair value which reduces earnings volatility as the amounts more closely offset, particularly in environments when interest rates are declining. For loans held-for-sale for which the fair value option has been elected, the aggregate fair value exceeded the aggregate principal balance by $2.1 million as of December 31, 2012. There were no residential mortgage loans held-for-sale that were nonaccrual or 90 or more days past due as of December 31, 2012 or December 31, 2011. Interest income on these loans is recognized in interest and fees on loans in the consolidated statements of operations.

Interest rate swaps. The Company's interest rate swaps, including fair value interest rate swaps and small exposures in interest rate caps and floors, are reported at fair value utilizing models provided by an independent third-party and observable market data. When entering into an interest rate swap agreement, the Company is exposed to fair value changes due to interest rate movements, and also the potential nonperformance of its contract counterparty. Interest rate swaps are evaluated based on a zero coupon LIBOR curve created from readily observable data on LIBOR, interest rate futures and the interest rate swap markets. The zero coupon curve is used to discount the projected cash flows on each individual interest rate swap. In addition, the Company has developed a methodology to value the nonperformance risk based on internal credit risk metrics and the unique characteristics of derivative instruments, which include notional exposure rather than principal at risk and interest payment netting. The results of this methodology are used to adjust the base fair value of the instrument for the potential counterparty credit risk. Interest rate caps and floors are evaluated using industry standard options pricing models and observed market data on LIBOR and Eurodollar option and cap/floor volatilities.

Level 3 Valuation Techniques and Inputs

Trust preferred securities. The trust preferred securities are evaluated based on whether the security is an obligation of a single issuer or part of a securitization pool. For single issuer obligations, the Company uses present value cash flow models which incorporate the contractual cash flow for each issue adjusted as necessary for any potential changes in amount or timing of cash flows. The cash flow model of a pooled issue incorporates anticipated loss rates and severities of the underlying collateral as well as credit support provided within the securitization. At least quarterly, the Company's Treasury personnel review the modeling assumptions and the discount and forward rates. Changes in these assumptions could potentially have a significant impact on the fair value of the trust preferred securities. The cash flow model for the pooled issue owned by the Company at December 31, 2012 assumes no recovery on defaulted collateral, no recovery on securities in deferral and an additional 3.6% future default rate assumption on the remaining performing collateral every three years with no recovery rate.

For trust preferred securities, projected cash flows are discounted at a rate based on a trading group of similar securities quoted on the New York Stock Exchange ("NYSE") or over-the-counter markets which is reviewed for market data points such as credit rating, maturity, price and liquidity. The Company indexes the market securities to a comparable maturity interest rate swap to determine the market spread, which is then used as the discount rate in the cash flow models. As of the reporting date, those market spreads were 6.0% for the pooled security and 10.0% for the single issuer that is currently deferring interest payments. An increase or decrease of 3% in the discount rate on the pooled issue would result in a decrease of $1.3 million or an increase of $2.2 million in the security fair value, respectively. An increase or decrease of 3% in the discount rate on the single issuer would result in a decrease of $407 thousand or an increase of $649 thousand in the security fair value, respectively.

Interest rate lock commitments on residential mortgages. The determination of the fair value of interest rate lock commitments is based on agreed upon pricing with the respective investor on each loan and includes a pull through percentage. The pull through percentage represents an estimate of loans in the pipeline to be delivered to an investor versus the total loans committed for delivery. Significant changes in this input could result in a significantly higher or lower fair value measurement. As the pull through percentage is a significant unobservable input, this is deemed a Level 3 valuation input. The pull through percentage, which is based upon historical experience, was 70% as of December 31, 2012. An increase or decrease of 20% in the pull through assumption would result in a positive or negative change of $236 thousand in the fair value of interest rate lock commitments. The fair value of interest rate lock commitments was $847 thousand at December 31, 2012.

The following provides details of the Level 3 fair value measurement activity for the years ended December 31, 2012 and 2011:

FAIR VALUE MEASUREMENTS USING SIGNIFICANT UNOBSERVABLE INPUTS – LEVEL 3
TRUST PREFERRED SECURITIES

For the Years Ended December 31,	2012	2011
Balance, beginning of year	**$4,908**	$5,642
Total gains (losses), realized/unrealized:		
Included in earnings (1)	**—**	(250)
Included in accumulated other comprehensive income (loss)	**974**	(484)
Purchases	**—**	—
Maturities	**—**	—
Prepayments	**—**	—
Calls	**—**	—
Transfers into Level 3	**—**	—
Balance, end of year	**$5,882**	$4,908

(1) Amount included in net impairment losses on available for sale securities of the consolidated statements of operations.

FAIR VALUE MEASUREMENTS USING SIGNIFICANT UNOBSERVABLE INPUTS – LEVEL 3
INTEREST RATE LOCK COMMITMENTS ON RESIDENTIAL MORTGAGES

For the Years Ended December 31,	2012	2011
Balance, beginning of year	**$—**	**$—**
Total gains (losses), realized/unrealized:		
Included in other income	**847**	**—**
Included in accumulated other comprehensive income (loss)	**—**	**—**
Transfers into Level 3	**—**	**—**
Balance, end of year	**$847**	**—**

Certain assets are measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The Company measures commercial real estate loans, impaired loans, SBA servicing assets, restricted equity investments and loans or bank properties transferred into other real estate owned at fair value on a non-recurring basis. At December 31, 2012 and 2011, these assets were valued in accordance with GAAP and the following table summarizes these assets requiring fair value disclosure under the provisions of FASB ASC 820.

SUMMARY OF NON-RECURRING FAIR VALUE MEASUREMENTS

	Total	Category Used for Fair Value Measurement			Total (Losses) Gains Or Changes in Net Assets
		Level 1	Level 2	Level 3	
December 31, 2012					
Assets:					
Impaired loans	**$75,550**	**$ —**	**$ —**	**$75,550**	**$ (33,105)**
Commercial real estate loans held-for-sale	**21,922**	**—**	**21,922**	**—**	**(5,890)**
Real estate owned	**1,881**	**—**	**—**	**1,881**	**(1,322)**
SBA servicing asset	**389**	**—**	**—**	**389**	**(95)**
December 31, 2011					
Assets:					
Impaired loans	$82,031	$ —	$ —	$82,031	$ (90,390)
Real estate owned	2,272	—	—	2,272	(666)

Under FASB ASC 310, collateral dependent impaired loans are based on the fair value of the underlying collateral which is based on appraisals. It is the policy of the Company to obtain a current appraisal or evaluation when a loan has been identified as non-performing. The type of appraisal obtained will be commensurate with the size and complexity of the loan. The resulting value will be adjusted for the potential cost of liquidation. New appraisals are obtained on an annual basis, at a minimum, until the loan is repaid in full, liquidated or returns to performing status.

While the loan policy dictates that a loan be assigned to the special assets department when it is downgraded to classified, there is a need for loan officers to consistently and accurately determine collateral values when a loan is initially designated as criticized or classified. The most effective means of determining the fair value of real estate collateral at a point in time is by obtaining a current appraisal or evaluation of the property. In anticipation of the receipt of a current appraisal or evaluation, the Company has provided for an alternative and interim means of determining the fair value of the real estate collateral.

The most recent appraised or reported value of the collateral securing a loan, net of a discount, is the Company's basis for determining fair value. The discount is based on the age of the existing appraisal or evaluation and on the nature of the property. Values developed from the discounting of real estate and equipment collateral will be subject to a further 10% discount for the cost of liquidation based on the net value of the collateral.

The following steps are taken to determine the fair value of commercial real estate securing a loan that will be potentially subject to impairment:

Loan Category Used for Impairment Review	Method of Determining the Value
Loans less than $1 million	Evaluation or restricted use appraisal
Loans $1 million or greater	
Existing appraisal 18 months or less	Restricted use appraisal
Existing appraisal greater than 18 months	Summary form appraisal
Commercial loans secured primarily by residential real estate	
Loans less than $1 million	Automated valuation model
Loans $1 million or greater	Summary form appraisal
Non-commercial loans secured primarily by residential real estate	
Loans less than $250,000	Automated valuation model or Summary form appraisal
Loans $250,000 or greater	Summary form appraisal

An evaluation report, as defined by the OCC, is a written report prepared by an appraiser that describes the real estate collateral, its condition, current and projected uses and sources of information used in the analysis, and provides an estimate of value in situations when an appraisal is not required.

A restricted use appraisal report is defined as a written report prepared under the Uniform Standards of Professional Appraisal Practice ("USPAP"). A restricted use appraisal is for the Company's use only and contains a brief statement of information significant to the solution of the appraisal problem. This report can be used for ongoing collateral monitoring.

A summary form appraisal report is defined as a written report prepared under the USPAP which contains a detailed summary of all information significant to the solution of the appraisal problem. This report is more detailed than a restricted use report and provides sufficient information to enable the user to understand the rationale for the opinions and conclusions in the report.

An automated valuation model is an internal computer program that estimates a property's market value based on market, economic, and demographic factors.

On a quarterly basis, or more frequently as necessary, the Company will review the circumstances of each collateral dependent loan and real estate owned property. A collateral dependent loan is defined as one that relies solely on the operation or the sale of the collateral for repayment. Adjustments to any specific reserve relating to a collateral shortfall, as compared to the outstanding loan balance, will be made if justified by appraisals, market conditions or current events concerning the credit.

All appraisals received which are utilized to determine valuations for criticized and classified loans or properties placed in real estate owned are provided under an "as is value". Partially charged off loans are measured for impairment upon receipt of an updated appraisal based on the relationship between the remaining balance of the charged down loan and the discounted appraised value. Such loans will remain on non-accrual status unless performance by the borrower warrants a return to accrual status. Recognition of non-accrual status occurs at the time a loan can no longer support principal and interest payments in accordance with the original terms and conditions of the loan documents.
When impairment is determined, a specific reserve reflecting any calculated shortfall between the

value of the collateral and the outstanding balance of the loan is recorded. Subsequent adjustments, prior to receipt of a new appraisal, to any specific reserve relating will be made if justified by market conditions or current events concerning the credit. If an internal discount-based evaluation is being used, the discount percentage may be adjusted to reflect market changes, changes to the collateral value of similar credits or circumstances of the individual credit itself. The amount of charge off is determined by calculating the difference between the current loan balance and the current collateral valuation, plus estimated cost to liquidate.

Impaired loan fair value measurements are based upon unobservable inputs, and therefore, are categorized as a Level 3 measurement. Specific reserves were calculated for impaired loans with an aggregate carrying amount of $5.8 million and $24.1 million at December 31, 2012 and 2011, respectively. The collateral underlying these loans had a fair value of $4.8 million and $18.7 million, including a specific reserve in the allowance for loan losses of $1.0 million and $5.4 million at December 31, 2012 and 2011, respectively. There were charge-offs of $2.0 million and $20.6 million during the years ended December 31, 2012 and 2011, respectively. No specific reserve was calculated for impaired loans with an aggregate carrying amount of $70.8 million and $63.3 million at December 31, 2012 and 2011, respectively, as the underlying collateral was not below the carrying amount; however, these loans did include charge-offs of $30.1 million and $64.4 million during the years ended December 31, 2012 and 2011, respectively.

Once a loan is determined to be uncollectible, the underlying collateral is repossessed and reclassified as real estate owned. The balance of other real estate owned also includes bank properties transferred from operations. These assets are carried at lower of cost or fair value of the collateral, less cost to sell. In some cases, adjustments are made to the appraised values for various factors including age of the appraisal, age of comparable properties included in the appraisal, and known changes in the market and the collateral. During the year ended December 31, 2012, the Company recorded a decrease in fair value of $733 thousand on six bank properties, $439 thousand on six commercial properties, and $149 thousand on four residential properties. During the year ended December 31, 2011, the Company recorded a decrease in fair value of $406 thousand on five bank properties and $260 thousand on two commercial properties. The adjustments to the bank, commercial, and residential properties were based upon unobservable inputs, and therefore categorized as Level 3 measurements. Total real estate owned measured at fair value at December 31, 2012 and 2011 was $1.9 million and $2.3 million, respectively.

From time to time, the Company may identify commercial loans which it intends to sell to a third-party. The Company signed a definitive agreement on January 17, 2013 to sell $45.8 million of loans, having a book balance of $35.1 million, to a third-party investor for gross proceeds of $21.9 million. As the formal approval to sell these loans occurred during 2012, the related loans were transferred to held-for-sale as of December 31, 2012 at lower of cost or estimated fair value. The estimated fair value was determined based upon the agreed upon sales price with the third-party purchaser, which is considered a Level 2 input and resulted in a net loss of $5.9 million upon transfer to loans held-for-sale.

The SBA servicing assets are reviewed for impairment in accordance with FASB ASC 860, *Transfers and Servicing* . Because loans are sold individually and not pooled, the Company does not stratify groups of loans based on risk characteristics for purposes of measuring impairment. The Company measures the SBA servicing assets by estimating the present value of expected future cash flows for each servicing asset, based on their unique characteristics and market-based prepayment assumptions. This is a Level 3 input. A valuation allowance is recorded for the amount by which the carrying amount of the servicing asset exceeds the calculated fair value. The Company had a valuation allowance of $118 thousand and $23 thousand on its SBA servicing assets at December 31, 2012 and 2011, respectively.

In accordance with ASC 825-10-50-10, *Fair Value of Financial Instruments*, the Company is required to disclose the fair value of its financial instruments. The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a distressed sale. Fair value is best determined using observable market prices; however, for many of the Company’s financial instruments, no quoted market prices are readily available. In instances where quoted market prices are not readily available, fair value is determined using cash flow models or other techniques appropriate for the particular instrument. These techniques involve some degree of judgment and, as a result, are not necessarily indicative of the amounts the Company would realize in a current market exchange. Utilizing different assumptions or estimation techniques may have a material effect on the estimated fair value.

CARRYING AMOUNTS AND ESTIMATED FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

December 31,	2012		2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Cash and due from banks	**$ 77,564**	**$ 77,564**	$ 68,773	$ 68,773
Interest-earning bank balances	**92,052**	**92,052**	51,049	51,049
Investment securities available for sale	**443,182**	**443,182**	515,545	515,545
Investment securities held to maturity	**912**	**960**	1,344	1,413
Loans receivable, net	**2,203,307**	**2,055,025**	2,215,785	2,031,013
Loans held-for-sale	**123,005**	**123,005**	23,192	23,287
Hedged commercial loans (1)	**26,980**	**30,477**	33,670	38,148
Restricted equity investments	**17,886**	**17,886**	15,826	15,826
Interest rate lock commitments on residential mortgages	**847**	**847**	—	—
Interest rate swaps	**40,594**	**40,594**	50,355	50,355
Interest rate floor	**275**	**275**	360	360
Liabilities:				
Demand deposits	**1,751,183**	**1,729,671**	1,772,386	1,797,554
Savings deposits	**264,155**	**262,636**	262,044	264,469
Time deposits	**697,886**	**695,093**	633,547	638,036
Securities sold under agreements to repurchase – customers	**1,968**	**1,968**	5,668	5,668
Advances from FHLBNY	**61,415**	**62,784**	2,733	3,017
Securities sold under agreements to repurchase – FHLBNY	**—**	**—**	15,000	15,382

Junior subordinated debentures	**92,786**	**57,072**	92,786	46,973
Fair value interest rate swaps	**3,503**	**3,503**	4,489	4,489
Interest rate swaps	**40,646**	**40,646**	50,462	50,462
Interest rate floor	**275**	**275**	360	360

(1) Includes positive market value adjustment of $3.5 million and $4.5 million at December 31, 2012 and December 31, 2011, respectively, which is equal to the change in value of related interest rate swaps designated as fair value hedges of these hedged loans in accordance with FASB ASC 815.

Cash and cash equivalents. For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value. This is a Level 1 fair value input.

Investment securities. For investment securities, fair values are based on a combination of quoted prices for identical assets in active markets, quoted prices for similar assets in markets that are either actively or not actively traded and pricing models, discounted cash flow methodologies, or similar techniques that may contain unobservable inputs that are supported by little or no market activity and require significant judgment. The fair value of held-to-maturity securities is measured utilizing Level 2 inputs.

Loans receivable. The fair value of loans receivable is estimated using a discounted cash flow analysis. Projected future cash flows are calculated using loan characteristics, and assumptions of voluntary and involuntary prepayment speeds. For performing loans Level 2 inputs are utilized as the cash flow analysis is performed using available data on the performance of similar loans. Projected cash flows are prepared using discount rates believed to represent current market rates. For non-performing loans, the cash flow assumptions are considered Level 3 inputs as market data is not readily available.

Loans held-for-sale. Loans held-for-sale includes residential mortgage loans that are originated with the intent to sell. At December 31, 2012, these loans were recorded at fair value as the Company elected the fair value option under FASB 825, effective July 1, 2012. At December 31, 2011, loans held-for-sale were recorded at the lower of amortized cost or fair value. The fair value of loans held-for-sale is valued using the quoted market price of such loans, which is a Level 2 input. At December 31, 2012, loans held-for-sale also included $21.9 million of commercial real estate loans recorded at lower of cost or estimated fair value for which the fair value was determined based upon the agreed upon sales price with the third-party purchaser.

Hedged commercial loans. The hedged commercial loans are one component of a declared hedging relationship as defined under FASB ASC 815. The Interest Rate Swap component of the declared hedging relationship is carried at their fair value and the carrying value of the commercial loans includes a similar change in fair values. The fair value of these loans is measured utilizing Level 2 inputs.

Restricted equity securities. Ownership in equity securities of FRB, FHLBNY, and Atlantic Central Bankers Bank is restricted and there is no established market for their resale. The carrying amount is a reasonable estimate of fair value. As these securities are readily marketable, the fair value is based on Level 2 inputs.

Interest rate lock commitments on residential mortgages. The fair value of interest rate lock commitments is estimated using pricing from existing purchase commitments on each loan in the pipeline. This value is adjusted for a pull through estimate which is determined based on historical experience with loan deliveries from the residential mortgage pipeline. As this estimate is unobservable and can result in significant fluctuation in the fair value determination, this is considered a Level 3 input under the fair value hierarchy.

Interest rate swaps/floors and fair value interest rate swaps. The Company's derivative financial instruments are not exchange-traded and therefore are valued utilizing models with the primary input being readily observable market parameters, specifically the LIBOR swap curve. In addition, the Company incorporates a qualitative fair value adjustment related to credit quality variations between counterparties as required by FASB ASC 820. This is a Level 2 input.

Demand deposits, savings deposits and time deposits. The fair value of demand deposits and savings deposits is determined by projecting future cash flows using an estimated economic life based on account characteristics, a Level 2 input. The resulting cash flow is discounted using rates available on alternative funding sources. The fair value of time deposits is estimated using the rate and maturity characteristics of the deposits to estimate their cash flow. This cash flow is discounted at rates for similar term wholesale funding.

Securities sold under agreements to repurchase - customer. The fair value is estimated to be the amount payable at the reporting date. This is considered a Level 2 input.

Securities sold under agreements to repurchase – FHLBNY and FHLBNY advances. The fair value is estimated through Level 2 inputs by determining the cost or benefit for early termination of the individual borrowing.

Junior subordinated debentures. The fair value was estimated by discounting approximate cash flows of the borrowings by yields estimating the fair value of similar issues. The valuation model considers current market spreads known and anticipated credit losses of the underlying collateral, term and reinvestment period and market transactions of similar issues, if available. This is a Level 3 input under the fair value hierarchy.

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2012 and 2011. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these consolidated financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amount presented herein.

25. RELATED PARTY TRANSCATIONS

Certain officers, directors and their associates (related parties) have loans and conduct other transactions with the Company. Such transactions are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for other non-related party transactions. Related party activity for the years ended December 31, 2012 and 2011 is summarized as follows:

SUMMARY OF LOANS TO RELATED PARTIES

At or for the Years Ended December 31,	2012	2011
Balance, beginning of year	**$57,753**	$ **68,259**
Additions	**5,947**	**5,980**
Repayments	**(5,879)**	**(16,486)**
Balance, end of year	**$57,821**	$ **57,753**

Interest income earned on related party loans was $2.0 million and $1.7 million for the years ended December 31, 2012 and 2011, respectively.

Certain office space of the Company is leased from companies affiliated with the Chairman of the Company's Board of Directors under separate agreements with the Company. Terms of these three agreements at December 31, 2012 are as follows:

SUMMARY OF LEASES WITH AFFILIATES TO THE CHAIRMAN OF THE BOARD OF DIRECTORS

December 31, 2012	Annual Rental Payment	Renewal Option Remaining	Annual Rental Increases
Expiration date:			
October 2027	$1,136	2 five-year terms	CPI
August 2025 (1)	506	4 five-year terms	Fixed
June 2029 (2)	269	4 five-year terms	CPI

(1) This lease is recorded as a $4.7 million obligation under capital lease at December 31, 2012.
(2) This lease is recorded as a $2.9 million obligation under capital lease at December 31, 2012.

Certain office space of the Company is leased from companies affiliated with certain Directors under separate agreements with the Company. Terms of these two agreements at December 31, 2012 are as follows:

SUMMARY OF LEASES WITH AFFILIATES TO THE DIRECTORS

December 31, 2012	Annual Rental Payment	Renewal Option Remaining	Annual Rental Increases
Expiration date:			
January 2017	$ 167	1 five-year terms	Fixed
January 2027	174	4 five-year terms	Fixed

The Company believes that each of the related party transactions described above were on terms as fair to the Company as could have been obtained from unaffiliated third parties.

26. CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

The condensed financial statements of Sun Bancorp, Inc. are as follows:

CONDENSED STATEMENTS OF FINANCIAL CONDITION

December 31,	2012	2011
Assets:		
Cash and due from banks	**$ 17,962**	$ 47,614
Investments in subsidiaries:		
Bank subsidiaries	**334,584**	352,333
Non-bank subsidiaries	**2,786**	2,786
Accrued interest receivable and other assets	**2,040**	1,302
Total assets	**$357,372**	$404,035
Liabilities and Shareholders' Equity:		
Liabilities		
Junior subordinated debentures	**$ 92,786**	$ 92,786
Other liabilities	**1,991**	2,166
Total liabilities	**94,777**	94,952
Shareholders' equity	**262,595**	309,083
Total liabilities and shareholders' equity	**$357,372**	$404,035

CONDENSED STATEMENTS OF OPERATIONS

Years Ended December 31,	2012	2011	2010
Interest expense	**$ (2,594)**	$ **(2,997)**	$ (4,117)
Management fee	**3,438**	**5,172**	6,936
Other expenses	**(3,791)**	**(5,054)**	(6,734)
Loss before equity in undistributed loss of subsidiaries and income tax benefit	**(2,947)**	**(2,879)**	(3,915)
Equity in undistributed loss of subsidiaries	**(48,560)**	**(65,614)**	(182,850)
Income tax benefit	**1,016**	**988**	1,347
Net loss available to common shareholders	**$(50,491)**	$**(67,505)**	$(185,418)

CONDENSED STATEMENTS OF CASH FLOWS

Years Ended December 31,	2012	2011	2010
Operating activities:			
Net loss	**$(50,491)**	$ (67,505)	$(185,418)
Adjustments to reconcile net (loss) income to net cash used in operating activities:			
Undistributed loss of subsidiaries	**48,561**	65,614	182,849
Stock-based compensation	**(75)**	110	2,612
Change in assets and liabilities which provided (used) cash:			
Accrued interest receivable and other assets	**(1,024)**	498	(61)
Accounts payable and other liabilities	**(235)**	291	555
Net cash (used in) provided by operating activities	**(3,264)**	(992)	537
Investing activities:			
Payments for investments in and advances to subsidiaries	**(28,000)**	(64,000)	(103,173)
Net cash used in investing activities	**(28,000)**	(64,000)	(103,173)
Financing activities:			
Proceeds from issuance of preferred stock and warrant	**—**	—	88,009
Redemption of preferred stock	**—**	—	(88,009)
Preferred stock issuance costs	**—**	—	(7,495)
Proceeds from issuance of common stock	**1,612**	100,077	106,839
Net cash provided by financing activities	**1,612**	100,077	99,344
Net (decrease) increase in cash	**(29,652)**	35,085	(3,292)
Cash, beginning of year	**47,614**	12,529	15,821
Cash, end of year	**$ 17,962**	$ 47,614	$ 12,529

* * * * * *

SUMMARIZED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table presents summarized quarterly data for 2012 and 2011 (amounts are in thousands, except per share amounts).

QUARTERLY DATA

Three Months Ended	December 31,	September 30,	June 30,	March 31,
2012				
Interest income	**$ 28,155**	**$ 28,469**	**$29,402**	**$ 29,407**
Interest expense	**4,174**	**4,135**	**4,519**	**4,757**
Net interest income	**23,981**	**24,334**	**24,883**	**24,650**
Provision for loan losses	**24,154**	**1,868**	**510**	**30,683**
Non-interest income	**6,816**	**9,588**	**7,527**	**5,519**
Non-interest expense	**31,597**	**30,860**	**30,587**	**27,564**
(Loss) income before income taxes	**(24,954)**	**1,194**	**1,313**	**(28,078)**
Income tax expense (benefit)	**—**	**(34)**	**—**	**—**
Net (loss) income available to common shareholders	**$ (24,954)**	**1,228**	**1,313**	**(28,078)**
Loss per common share – basic	**$ (0.29)**	**$ 0.01**	**$ 0.02**	**$ (0.33)**
Loss per common share—diluted	**$ (0.29)**	**$ 0.01**	**$ 0.02**	**$ (0.33)**
2011				
Interest income	$ 30,816	$ 31,510	$32,305	$ 32,049
Interest expense	5,087	5,329	5,813	6,923
Net interest income	25,729	26,181	26,492	25,126
Provision for loan losses	6,826	2,321	4,836	60,283
Non-interest income (loss)(1)	6,804	5,770	4,993	(4,099)
Non-interest expense	27,226	26,973	28,244	27,782
(Loss) income before income taxes	(1,519)	2,657	(1,595)	(67,038)
Income tax expense (benefit)	—	(23)	4	29
Net (loss) income available to common shareholders	$ (1,519)	2,680	(1,599)	(67,067)
Loss per common share – basic	$ (.02)	$ .03	$ (.02)	$ (1.25)
Loss per common share—diluted	$ (.02)	$ .03	$ (.02)	$ (1.25)

(1) During the fourth quarter of 2012, the $24.2 million of provision for loan losses recorded by the Company included $6.7 million relating to accelerated resolutions of three non-performing commercial real estate relationships, $5.9 million for the transfer of commercial real estate loans to held-for sale and $4.3 million for additional reserves required from the impact of Hurricane Sandy.

(2) During the first quarter 2011, the Company recognized negative fair value credit adjustments of $8.4 million and a pre-tax OTTI charge of $250 thousand on a single-issuer trust preferred security.

Basic and diluted loss per share are computed independently for each of the quarters presented. Consequently, the sum of the quarters may not equal the annual loss per share.

COMMON STOCK PRICE RANGE AND DIVIDENDS (UNAUDITED)

Shares of the Company’s common stock are quoted on the NASDAQ Global Select Market under the symbol “SNBC”. The following table sets forth the high and low sale prices (adjusted for stock dividends) for the common stock for the calendar quarters indicated, as published by the NASDAQ Stock Market.

COMMON STOCK PRICE RANGE

	High	Low
2012		
Fourth Quarter	**$3.55**	**$2.80**
Third Quarter	**$3.39**	**$2.56**
Second Quarter	**$3.62**	**$2.21**
First Quarter	**$3.69**	**$2.40**
2011		
Fourth Quarter	$3.17	$2.18
Third Quarter	$3.80	$2.33
Second Quarter	$3.96	$3.25
First Quarter	$4.95	$3.05

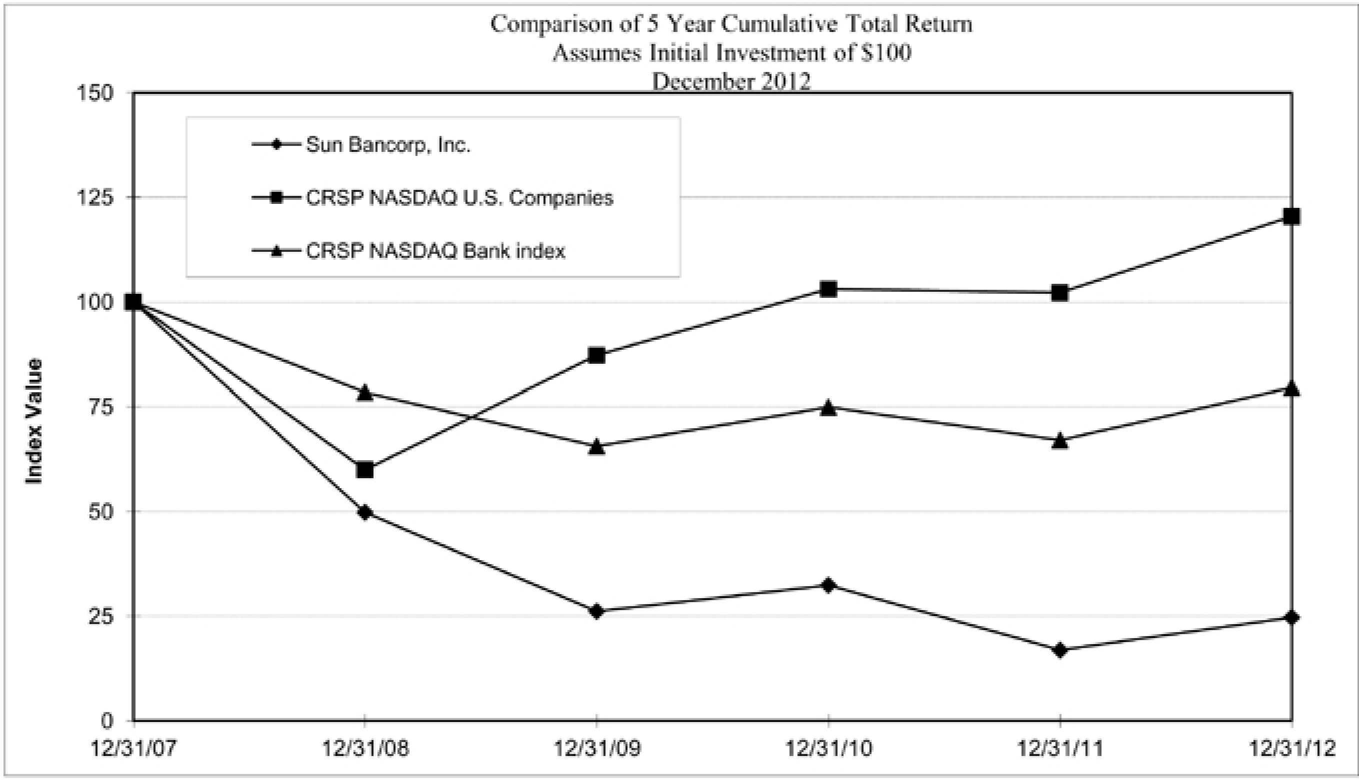
There were 926 holders of record of the Company's common stock as of March 8, 2013. This number does not reflect the number of persons or entities who held stock in nominee or "street" name through various brokerage firms. At March 8, 2013, there were 86,258,106 shares of the Company's common stock outstanding.

To date, the Company has not paid cash dividends on its common stock. Future declarations of dividends by the Board of Directors would depend upon a number of factors, including the Company's and the Bank's financial condition and results of operations, investment opportunities available to the Company or the Bank, approval of the OCC, capital requirements, regulatory limitations, tax considerations, the amount of net proceeds retained by the Company and general economic conditions. No assurances can be given that any dividends will be paid or, if payment is made, will continue to be paid.

The ability of the Bank to pay dividends to the Company is controlled by certain regulatory restrictions. Generally, dividends declared in a given year by a national bank are limited to its net profit, as defined by regulatory agencies, for that year, combined with its retained net income for the preceding two years, less any required transfer to surplus or to fund for the retirement of any preferred stock. In addition, a national bank may not pay any dividends in an amount greater than its undivided profits and a national bank may not declare any dividends if such declaration would leave the bank inadequately capitalized. Therefore, the ability of the Bank to declare dividends will depend on its future net income and capital requirements. Also, banking regulators have indicated that national banks should generally pay dividends only out of current operating earnings. Further, per the OCC Agreement, a dividend may only be declared if it is in accordance with the approved capital plan, the Bank remains in compliance with the capital plan following the payment of the dividend and the dividend is approved by the OCC. As a result of these restrictions, the amount available for payment of dividends to the Company by the Bank totaled $0 at December 31, 2012.

STOCK PERFORMANCE (UNAUDITED)

The following table provides a stock performance graph comparing cumulative total shareholders return on the Common Stock with (a) the cumulative total shareholder return on stocks of all U.S. companies that trade on the NASDAQ Stock Market and (b) the cumulative total shareholder return on stocks included in the NASDAQ Bank index, as prepared for the NASDAQ by the Center for Research in Security Prices ("CRSP") at the University of Chicago. All investment comparisons assume the investment of $100 at December 31, 2007. The cumulative returns for the NASDAQ Stock Market and the NASDAQ Bank index are computed assuming the reinvestment of dividends.



CUMULATIVE TOTAL RETURN

December 31,	2007	2008	2009	2010	2011	2012
CRSP NASDAQ U.S. Companies	$100.0	$60.0	$87.2	$103.1	$102.3	$120.4
CRSP NASDAQ Bank index	100.0	78.5	65.7	74.9	67.1	79.6
Sun Bancorp, Inc. (1)	100.0	49.8	26.2	32.4	16.9	24.7

(1) The cumulative return for Sun Bancorp, Inc. reflects a 5% stock dividend paid in May 2007, May 2008 and May 2009 and has been calculated based on the historical closing prices of $15.78, $7.49, $3.75, $4.64, $2.42 and $3.54 on December 31, 2007, 2008, 2009, 2010, 2011 and 2012, respectively.

There can be no assurance that the Company’s future stock performance will be the same or similar to the historical stock performance shown in the table. The Company neither makes nor endorses any predictions as to the stock performance.

ADDITIONAL INFORMATION

The Company’s Annual Report on Form 10-K (excluding exhibits) for the fiscal year ended December 31, 2012 is available without charge upon written request to Sun Bancorp, Inc. Shareholder Relations, 226 Landis Avenue, Vineland, NJ 08360.

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Section 3: EX-21 (EX-21)

Exhibit 21

Subsidiaries of the Company

Subsidiaries	Percentage Owned	Jurisdiction of Incorporation
Sun National Bank	100%	United States
Sun Capital Trust V	100%	Delaware
Sun Capital Trust VI	100%	Delaware
Sun Statutory Trust VII	100%	Connecticut
Sun Capital Trust VII	100%	Delaware
Sun Capital Trust VIII	100%	Delaware
Sun Financial Services, L.L.C. (1)	100%	New Jersey
2020 Properties, L.L.C. (1)	100%	New Jersey
4040 Properties, L.L.C. (1)	100%	New Jersey

(1) Wholly-owned subsidiary of Sun National Bank.
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Section 4: EX-23 (EX-23)

Exhibit 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-157131, 333-162143, 333-176529 and 333-176530 on Forms S-3 and Registration Statement Nos. 333-176754, 333-176755, 333-161288, 333-161289, 333-114436, 333-128793, 333-118812, 333-91184, 333-89839, and 333-32681 on Forms S-8 of our reports dated March 18, 2013, relating to the consolidated financial statements of Sun Bancorp, Inc. and subsidiaries which expresses an unqualified opinion and includes an explanatory paragraph relating to the change in presentation of comprehensive income due to the Company's adoption of Accounting Standards Update 2011-05 and the effectiveness of Sun Bancorp, Inc.'s internal control over financial reporting, appearing in the Annual Report on Form 10-K of Sun Bancorp, Inc. and subsidiaries for the year ended December 31, 2012.

/s/ Deloitte & Touche LLP

Philadelphia, PA
March 18, 2013
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Section 5: EX-31.A (EX-31.A)

Exhibit 31(a)

SECTION 302 CERTIFICATION

I, Thomas X. Geisel, certify that:

1. I have reviewed this Annual Report on Form 10-K for the year ended December 31, 2012 of Sun Bancorp, Inc (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 18, 2013	/s/ Thomas X. Geisel
	Thomas X. Geisel
	President and Chief Executive Officer

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Section 6: EX-31.B (EX-31.B)

Exhibit 31(b)

SECTION 302 CERTIFICATION

I, Thomas R. Brugger, certify that:

1. I have reviewed this Annual Report on Form 10-K for the year ended December 31, 2012 of Sun Bancorp, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: March 18, 2013

/s/ Thomas R. Brugger
Thomas R. Brugger
Executive Vice President and Chief Financial Officer

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Section 7: EX-32 (EX-32)

Exhibit 32

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K for the year ended December 31, 2012 (the “Report”) of Sun Bancorp, Inc. (the “Company”) as filed with the Securities and Exchange Commission on the date hereof, we, Thomas X. Geisel, President and Chief Executive Officer and Thomas R. Brugger, Executive Vice President and Chief Financial Officer, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 18, 2013

/s/ Thomas X. Geisel
Thomas X. Geisel
President and Chief Executive Officer
(Principal Executive Officer

/s/ Thomas R. Brugger
Thomas R. Brugger
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

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