SB ONE BANCORP
Form 10-K
March 18, 2019

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission File Number 0-29030

SB ONE BANCORP
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| New Jersey | 22-3475473 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

100 Enterprise Drive, Suite 700
Rockaway, New Jersey 07866
(Address of principal executive offices) (Zip Code)
(844) 256-7328
(Registrant's telephone number, including area code)
Securities Registered Pursuant to Section 12(b) of the Act:

| Title of each class | Name of exchange on which registered |
|---|---|
| Common Stock, no par value | The NASDAQ Stock Market LLC |

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

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of the 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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| | | | | |
|---|---|---|---|---|
| Large accelerated filer | Accelerated filer x | Non-accelerated filer (Do not check if a smaller reporting company) | Smaller reporting company x | Emerging growth company |

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

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

Based upon the closing price of $29.70 on June 30, 2018, the aggregate market value of the voting and non-voting common equity held by non-affiliates was $235,509,506. The number of shares of the registrant's common stock, no par value, outstanding as of March 7, 2019 was 9,501,741.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2019 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended December 31, 2018.

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FORWARD-LOOKING STATEMENTS

We may, from time to time, make written or oral "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission (the "SEC"), our reports to stockholders and in other communications by us. This Annual Report on Form 10-K contains "forward-looking statements," which may be identified by the use of such words as "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential." Examples of forward-looking statements include, bu not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to:

- changes to interest rates, the ability to control costs and expenses;
- our ability to integrate new technology into our operations;
- general economic conditions;
- the success of our efforts to diversify our revenue base by developing additional sources of non-interest income while continuing to manage our existing fee based business;
- the impact on us of the changing statutory and regulatory requirements; and
- the risks inherent in commencing operations in new markets.

Any or all of our forward-looking statements in this Annual Report on Form 10-K, and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statements can be guaranteed. We disclaim any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements, or to reflect the occurrence of anticipated or unanticipated events.

Unless the context indicates otherwise, all references in this Annual Report on Form 10-K to "SB One Bancorp," "we," "us," "our" and "the Company" refer to SB One Bancorp and its subsidiaries. References to the "Bank" are to SB One Bank, our wholly owned bank subsidiary.

PART I

ITEM 1. BUSINESS

General

SB One Bancorp is a bank holding company under the Bank Holding Company Act of 1956, as amended (the "BHC Act") and was incorporated under the laws of the State of New Jersey under the name Sussex Bancorp in January 1996. On May 3, 2018, we changed our name to SB One Bancorp. The Company is the parent company of SB One Bank, formerly known as Sussex Bank (the "Bank"). The only significant asset of SB One Bancorp is its investment in the Bank. At December 31, 2018, the Company had consolidated total assets of $1.8 billion, gross loans of $1.5 billion, deposits of $1.4 billion and stockholders' equity of $185.4 million.

The Bank is a commercial bank formed under the laws of the State of New Jersey in 1975 and is regulated by the New Jersey Department of Banking and Insurance (the "Department") and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank's wholly owned subsidiaries are SCB Investment Company, Inc., SCBNY Company, Inc., ClassicLake Enterprises, LLC, PPD Holding Company, LLC, Community Investing Company, Inc., GFR Maywood LLC, 490 Boulevard Realty Corp., and SB One Insurance Agency, Inc. ("SB One Insurance"). SCB Investment Company, Inc., Community Investing Company, Inc. and SCBNY Company, Inc. hold portions of the Bank's investment portfolio. ClassicLake Enterprises, LLC, PPD Holding Company, LLC, hold certain foreclosed properties. SB One Insurance provides insurance agency services mostly through the sale of property and casualty insurance policies.

The corporate office of the Company is located at 100 Enterprise Drive, Suite 700, Rockaway, New Jersey, 07866, and the telephone number is (844) 256-7328.

Community Bank of Bergen County, NJ Acquisition

On January 4, 2018, the Company completed the previously announced acquisition of Community Bank of Bergen County, NJ ("Community"). In connection with the acquisition, Community merged with and into SB One Bank, with SB One Bank continuing as the surviving entity. In connection with the acquisition, the Company also acquired certain subsidiaries of Community.

Enterprise Bank, NJ Acquisition

On December 21, 2018, the Company completed the previously announced acquisition of Enterprise, NJ ("Enterprise"). In connection with the acquisition, Enterprise merged with and into SB One Bank, with SB One Bank continuing as the surviving entity. In connection with the acquisition, the Company also acquired certain subsidiaries of Enterprise.

Our Business

Our primary business is ownership and supervision of the Bank. Through the Bank, we conduct a traditional commercial banking business, and offer services including personal and business checking accounts and time deposits, money market accounts and savings accounts. We structure our specific services and charges in a manner designed to attract the business of the small and medium sized business and professional community as well as that of individuals residing, working and shopping in the northern New Jersey and New York markets. We engage in a wide range of lending activities and offer commercial, consumer, mortgage, home equity and personal loans.

Through the Bank's subsidiary, SB One Insurance, we operate a full service general insurance agency, offering both commercial and personal lines of insurance.

We have two business segments, banking and financial services and insurance services. For financial data on the segments see Note 3 of our consolidated financial statements located elsewhere in this report.

Market Area

Our service area primarily consists of Sussex, Morris, Bergen, Essex, Middlesex, and Union Counties in New Jersey and Queens County, New York; however, we make loans throughout New Jersey and the New York metropolitan markets. We operate from our corporate office in Rockaway, New Jersey, and, as of December 31, 2018, our eighteen branch offices located in Andover, Augusta, Bloomfield, Edison, Fair Lawn, Franklin, Hackettstown, Kenilworth, Maywood, Montague, Newark, Newton, Oradell, Rochelle Park, Sparta, Vernon, and Wantage, New Jersey, and in Astoria, New York, our regional office and corporate center in Rochelle Park, New Jersey and Wantage, New Jersey and our insurance agency offices in Augusta and Oradell, New Jersey. Our market area is among the most affluent in the nation. Following the completion of the acquisition of Community on January 4, 2018, the Bank has an additional three branches located in Bergen County. Following the completion of the acquisition of Enterprise on December 21, 2018, the Bank has one branch located in Union County, one branch located in Middlesex County and two branches located in Essex County. On December 21, 2018, we announced the closing of our Andover, New Jersey branch location effective March 29, 2019.

Competition

We operate in a highly competitive environment competing for deposits and loans with commercial banks, thrifts and other financial institutions, many of which have greater financial resources than us. Many large financial institutions in New York City and other parts of New Jersey compete for the business of customers located in our service area. Many of these institutions have significantly higher lending limits than us and provide services to their customers which we do not offer.

Management believes we are able to compete on a substantially equal basis with our competitors because we provide responsive personalized services through management's knowledge and awareness of our service area, customers and business.

Personnel

At December 31, 2018, we employed 216 full-time employees and 21 part-time employees. None of these employees are covered by a collective bargaining agreement and we believe that our employee relations are good.

Supervision and Regulation

The Company, the Bank and certain of its non-banking subsidiaries are subject to extensive regulation under federal and state laws. The regulatory framework applicable to bank holding companies and their subsidiary banks is intended to protect depositors, federal deposit insurance fund (the "DIF") of the FDIC, and the U.S. banking system as a whole. This system is not designed to protect investors in bank holding companies such as the Company.

Set forth below is a summary of the significant laws and regulations applicable to the Company and its subsidiaries. The summary that follows is qualified in its entirety by reference to the full text of the statutes, regulations, and policies that are described. Statutes, regulations and policies are subject to ongoing review by Congress, state legislatures and federal and state regulatory agencies. A change in any statute, regulation or policy applicable to the Company and its subsidiaries may have a material effect on the Company's operations and financial performance. Financial reform legislation and regulations, including the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), may have adverse implications on the financial industry, the competitive environment and our ability to conduct business. As a result, we may incur additional expenses to comply with applicable laws and regulations, which may increase our costs of operations and adversely impact our earnings.

Overview

The Company is a separate and distinct legal entity from the Bank. As a registered bank holding company, the Company is regulated under the BHC Act, and is subject to inspection, examination and supervision by the FRB. The Company is also subject to the jurisdiction of the U.S. Securities and Exchange Commission ("SEC") and the regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. The Company's common stock is listed on the NASDAQ under the trading symbol, "SBBX," and the Company is subject to the NASDAQ rules for listed companies.

The Bank is organized as a state-chartered commercial bank pursuant to the banking laws and regulations of the Department. The Bank is subject to the supervision of, and to regular examination by, the Department as its primary chartering authority, as well as by the FDIC as its primary federal regulator and deposit insurer. Financial products and services offered by the Company and the Bank are subject to federal consumer protection laws and regulations promulgated by the Consumer Financial Protection Bureau ("CFPB"). The Company, the Bank and certain of its nonbank subsidiaries must also comply with state consumer protection laws which are enforced by state attorneys general. The Bank`s deposits are insured by the FDIC up to the applicable deposit insurance limits in accordance with FDIC laws and regulations. The non-bank subsidiaries of the Company and the Bank are subject to federal and state laws and regulations, including regulations of the FRB, the FDIC and the Department, respectively. Insurance agencies are licensed by the State of New Jersey and are regulated by the Department under state law.

The Dodd-Frank Act significantly changed the U.S. financial regulatory landscape. Several provisions of the Dodd-Frank Act are subject to further rulemaking, guidance and interpretation by the federal banking agencies. As a result, management cannot predict the ultimate impact of the Dodd-Frank Act or the extent to which it could affect operations of the Company and the Bank.

Federal Bank Holding Company Regulation

The Company is a bank holding company under the BHC Act. The BHC Act generally limits the business of the Company to banking, managing or controlling banks, and other activities that the FRB has determined to be so closely related to banking "as to be a proper incident thereto." The Company is required to file periodic reports with the FRB and other information regarding its business operations and those of its subsidiaries.

The BHC Act requires, among other things, prior FRB approval where a bank holding company proposes to (i) acquire all or substantially all of the assets of any other bank, (ii) acquire direct or indirect ownership or control of more than 5% of any class of voting stock of any bank or its parent company (unless it owns a majority of such bank's voting shares) or (iii) merge or consolidate with any other bank holding company. The FRB will not approve any acquisition, merger, or consolidation that would have a substantially anti-competitive effect, unless the anti-competitive impact of the proposed transaction is clearly outweighed by a greater public interest in meeting the convenience and needs of the community to be served. When reviewing acquisitions or mergers, the FRB also considers, among other factors: (i) capital adequacy; (ii) the financial and managerial resources and future prospects of the companies and the banks concerned; (iii) the convenience and needs of the community to be served; (iv) banks' record under the Community Reinvestment Act ("CRA"); and (v) the effectiveness of the companies and the banks in combating money laundering.

The BHC Act also generally prohibits a bank holding company, with certain limited exceptions, from (i) acquiring or retaining direct or indirect ownership or control of more than 5% of the outstanding voting stock of any company which is not a bank or bank holding company; or (ii) engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or performing services for its subsidiaries, unless such non banking business is determined by the FRB to be so closely related to banking or managing or controlling banks "as to be properly incident thereto". In making such determinations, the FRB is required to weigh the expected benefits to the public, such as, greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as, undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

Bank holding companies whose subsidiary banks meet certain capital, management and standards under the CRA, that elect to become "financial holding companies," are permitted to engage in a substantially broader range of non-banking financial activities than is otherwise permissible for bank holding companies under the BHC Act. These activities include, among others, certain insurance, securities and merchant banking activities. As our business is currently limited to activities permissible for a bank holding company, we have not elected to become a financial holding company.

Mergers and Acquisitions

The BHC Act, the Bank Merger Act, and other federal and state statures regulate the direct and indirect acquisition of depository institutions. The BHC Act requires the prior FRB approval for a bank holding company to acquire, directly or indirectly, 5% or more of any class of voting securities of commercial bank or its parent holding company and for a company, other than a bank holding company, to acquire 25% or more of any class of voting securities of a bank or bank holding company. Under the Change in Bank Control Act, any person, including a company, may not acquire, directly or indirectly, control of a bank without providing 60 days` prior notice and receiving a non-objection from the appropriate federal banking agency.

Under the Bank Merger Act, the prior approval of the appropriate federal banking agency is required for insured depository institutions to merge or enter into purchase and assumption transactions. In reviewing applications seeking approval of merger and purchase and assumption transactions, the federal banking agencies will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined banking organization, the applicant`s performance record under the CRA, and the effectiveness of the subject organizations in combating money laundering activities. For further information relating to the CRA, see "Community Reinvestment Act of 1977" below.

Source of Strength Doctrine

FRB policy requires that bank holding companies act as a source of financial and managerial strength to their subsidiary banks. Section 616 of the Dodd-Frank Act codifies the requirement that bank holding companies serve as a source of financial strength to their subsidiary depository institutions.  As a result, the Company is expected to commit resources to support the Bank, including at times when the Company may not be in a financial position to provide such resources.  Any capital loan by the Company to the Bank is subordinate in right of payment to deposits and to certain other indebtedness of the Bank.  The U.S. Bankruptcy Code provides that, in the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Volcker Rule

Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, restricts the ability of banking entities, such as the Company, from: (i) engaging in "proprietary trading" and (ii) investing in or sponsoring certain types of funds ("Covered Funds"), subject to certain limited exceptions. The implementing regulation defines a Covered Fund to include certain investments such as collateralized loan obligation ("CLO") and collateralized debt obligation securities. The regulation also provides, among other exemptions, an exemption for CLOs meeting certain requirements.  The Company is fully compliant with the Volcker Rule.  Given the Company's size and the scope of its activities, the Company's implementation of the Volcker Rule had no significant effect on its financial statements.

Dividend Rights

The principal source of the Company's liquidity is dividends from the Bank.  As a New Jersey-chartered bank, the Bank may declare and pay dividends only if, after payment of the dividend, the capital stock of the Bank will be unimpaired and either the Bank will have a surplus of not less than 50% of its capital stock or the payment of the dividend will not reduce the Bank's surplus.

The Company`s ability to pay dividends is subject to the regulatory authority of the FRB. The supervisory concern of the FRB focuses on a bank holding company`s capital position, its ability to meet its financial obligations as they come due, and its capacity to act as a source of financial strength to its insured depository institution subsidiaries. In addition, FRB policy discourages the payment of dividends by a bank holding company that is not supported by current operating earnings.

Capital Adequacy and Prompt Corrective Action

In July 2013, the FRB, the Office of the Comptroller of the Currency (the "OCC") and the FDIC approved final rules (the "Capital Rules") that established a new comprehensive capital framework for U.S. banking organizations. The Capital Rules generally implement the Basel Committee on Banking Supervision's (the "Basel Committee") December 2010 final capital framework referred to as "Basel III" for strengthening international capital standards. In addition, the Capital Rules implement certain provisions of the Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal banking agencies' rules.

The Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries. The risk-based capital guidelines are designed to make regulatory capital requirements sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposures and to minimize disincentives for holding liquid, low-risk assets. The Capital Rules apply on a consolidated basis to bank holding companies with consolidated assets of $1 billion or more, and to certain bank holding companies with less than $1 billion in assets if they are engaged in substantial non-banking activity or meet certain other criteria.  Under FRB reporting requirements, a bank holding company that reaches $1 billion or more in total consolidated assets as of June 30 of the preceding year must begin reporting its consolidated capital beginning in March of the following year.   The threshold for capital consolidation was raised from $500 million to $1 billion effective May 15, 2015. The Company will begin reporting its consolidated capital on March, 31, 2019, as it reached $1 billion in total consolidated assets as of June 30, 2018.

The Capital Rules: (i) require a capital measure called "Common Equity Tier 1" ("CET1") and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. The Capital Rules revised the definitions and the components of regulatory capital and impacted the calculation of the numerator in banking institutions' regulatory capital ratios. The Capital Rules became effective for the Bank on January 1, 2015, subject to phase-in periods for certain components and other provisions. Under the Capital Rules, for most banking organizations, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock and the most common forms of Tier 2 capital are subordinated notes and a portion of the allocation for loan losses, in each case, subject to the Capital Rules' specific requirements.

Pursuant to the Capital Rules, the minimum capital ratios are as follows:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (CET1 plus Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (the “leverage ratio”).

The Capital Rules also requires a “capital conservation buffer,” composed entirely of CET1, in addition to these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity and other capital instrument repurchases and compensation based on the amount of the shortfall. When fully phased-in on January 1, 2019, the capital standards applicable to the Bank will include an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios inclusive of the capital conservation buffer of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) Total capital to risk-weighted assets of at least 10.5%.

The Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1. The deduction and adjustments will be incrementally phased in between January 1, 2015 and January 1, 2019.

In addition, under the prior general risk-based capital rules, the effects of accumulated other comprehensive income or loss (“AOCI”) items included in shareholders’ equity (for example, marks-to-market of securities held in the available-for-sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios. Pursuant to the Capital Rules, the effects of certain AOCI items are not excluded; however, banking organizations not using the advanced approaches, including the Bank were permitted to make a one-time permanent election to continue to exclude these items in January 2015. The Bank elected to make the one-time permanent election to exclude certain AOCI items for regulatory capital ratios. The Capital Rules also preclude certain hybrid securities, such as trust preferred securities issued after May 19, 2010, from inclusion in bank holding companies’ Tier 1 capital.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and increases by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

The Capital Rules prescribe a standardized approach for risk weightings, generally ranging from 0% for U.S. governmental and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset classes.

Pursuant to Section 38 of the Federal Deposit Insurance Act (the "FDIA"), federal banking agencies are required to take "prompt corrective action" should a depository institution fail to meet certain capital adequacy standards. For purposes of prompt corrective action, to be: (i) well-capitalized, a bank must have a total risk based capital ratio of at least 10%, a Tier 1 risk based capital ratio of at least 8%, a CET1 risk based capital ratio of at least 6.5%, and a Tier 1 leverage ratio of at least 5%; (ii) adequately capitalized, a bank must have a total risk based capital ratio of at least 4.5%, and a Tier 1 leverage ratio of at least 4%; (iii) undercapitalized, a bank would have a total risk based capital ratio of less than 8%, a Tier 1 risk based capital ratio of less than 6%, a CET1 risk based capital ratio of less than 4.5%, and a Tier 1 leverage ratio of less than 4%; (iv) significantly undercapitalized, a bank would have a total risk based capital ratio of less than 6%, a Tier 1 risk based capital ratio of less than 4%, a CET1 risk based capital ratio of less than 3%, and a Tier 1 leverage ratio of less than 3%; and (v) critically undercapitalized, a bank would have a ratio of tangible equity to total assets that is less than or equal to 2%.

Bank holding companies and insured banks also may be subject to potential enforcement actions of varying levels of severity by the federal banking agencies for unsafe or unsound practices in conducting their business, or for violation of any law, rule, regulation, condition imposed in writing by the agency or term of a written agreement with the agency. In more serious cases, enforcement actions may include the issuance of directives to increase capital; the issuance of formal and informal agreements;

the imposition of civil monetary penalties; the issuance of a cease and desist order that can be judicially enforced; the issuance of removal and prohibition orders against officers, directors, and other institution-affiliated parties; the termination of the bank's deposit insurance; the appointment of a conservator or receiver for the bank; and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

Management believes that the Bank is in compliance, and will remain in compliance, with the targeted capital ratios as such capital requirements are phased in.

Depositor Preference

The FDIA provides that, in the event of the “liquidation or other resolution” of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution

Federal Deposit Insurance

The Bank`s deposit accounts are fully insured by the DIF of the FDIC up to the deposit insurance limits of $250,000 per depositor, per insured institution, in accordance with applicable laws and regulations.

The FDIC uses a risk-based assessment system that imposes insurance premiums based upon a risk matrix that accounts for a bank's capital level and supervisory rating (“CAMELS rating”). The risk matrix uses different risk categories distinguished by capital levels and supervisory ratings. The base for deposit insurance assessments is consolidated average assets less average tangible equity. Assessment rates are calculated using formulas that take into account the risk of the institution being assessed. In addition to deposit insurance assessments, the FDIA provides for additional assessments to be imposed on insured depository institutions to pay for the cost of Financing Corporation (“FICO”) funding. The FICO is a mixed-ownership government corporation established by the Competitive Equality Banking Act of 1987, whose sole purpose was to function as a financing vehicle for the now defunct Federal Savings & Loan Insurance Corporation. The FICO assessments are adjusted quarterly to reflect changes in the assessment base of the DIF and do not vary depending upon a depository institution’s capitalization or supervisory evaluation.

Under the FDIA, the FDIC may terminate deposit insurance upon a finding that an insured depository institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The Company’s management is not aware of any practice, condition or violation that might lead to the termination of deposit insurance.

Reserve Requirements

FRB regulations require insured depository institutions to maintain non-interest earning reserves against their transaction accounts (primary interest-bearing and regular checking accounts). The Bank’s required reserves can be in the form of vault cash. If vault cash does not fully satisfy the required reserves, in the form of a balance maintained with the Federal Reserve Bank of New York. In 2018 FRB regulations required that reserves be maintained against aggregate transaction accounts, except for transaction accounts which are exempt up to $16.0 million. Transaction accounts greater than $16.0 million up to and including $122.3 million have a reserve requirement of 3%. A 10% reserve ratio will be assessed on transaction accounts in excess of $122.3 million. The FRB makes annual adjustments to the tiered reserves. The Bank was in compliance with these reserve requirements.

Transactions with Affiliates and Insiders

Under federal law, transactions between insured depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act ("FRA") and its implementing Regulation W. In a bank holding company context, at a minimum, the parent holding company of a bank, and any companies which are controlled by such parent holding company, are affiliates of the bank. Generally, sections 23A and 23B of the FRA are intended to protect insured depository institutions from losses arising from transactions with non-insured affiliates by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and requiring that such transactions be on terms consistent with safe and sound banking practices.

Further, Section 22(h) of the FRA and its implementing Regulation O restricts loans to directors, executive officers, and principal stockholders ("insiders"). Under Section 22(h), loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the institution's total capital and surplus. Loans to insiders above specified amounts must receive the prior approval of the board of directors. Further, under Section 22(h) of the FRA, loans to directors, executive officers and principal stockholders must be made on terms substantially the same as offered in comparable transactions to other persons, except that such insiders may receive preferential loans made under a benefit or compensation program that is widely available to the bank's employees and does not give preference to the insider over the employees. Section 22(g) of the FRA places additional limitations on loans to executive officers.

Anti-Money-Laundering

The Bank Secrecy Act ("BSA"), as amended by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act"), imposes obligations on U.S. financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. The USA PATRIOT Act requires all financial institutions, including the Company and the Bank, to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. The USA PATRIOT Act also encourages information-sharing among financial institutions, regulators, and law enforcement authorities by providing an exemption from the privacy provisions of the GLB Act for financial institutions that comply with this provision. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank, or the BHC Act, which applies to the Company. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences. As of December 31, 2018, the Company and the Bank believe that they are in compliance with the BSA and the USA PATRIOT Act, and implementing regulations thereof.

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, they contain one or more of the following elements: i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Consumer Protection and CFPB Supervision

The Dodd-Frank Act centralized responsibility for federal consumer financial protection in the CFPB, which is an independent agency charged with responsibility for implementing, enforcing, and examining compliance with federal consumer financial protection laws and regulations. The Company and the Bank are subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy. Among others, these laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, various state law counterparts, and the Consumer Financial Protection Act of 2010, which is part of the Dodd-Frank Act and established the CFPB. The Dodd-Frank Act does not prevent states from adopting stricter consumer protection standards. State regulation of financial products and potential enforcement actions could also adversely affect the Company`s business, financial condition or operations.

Community Reinvestment Act of 1977

The Bank has a responsibility under the CRA to help meet the credit needs of its communities, including low- and moderate-income neighborhoods.  The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community consistent with the CRA.  Regulators periodically assess the Bank’s record of compliance with the CRA.  In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit discrimination in lending practices on the basis of characteristics specified in those statutes. The Bank's failure to comply with the CRA could, at a minimum, result in regulatory restrictions on its activities and the activities of the Company. The Bank`s failure to comply with the Equal Credit Opportunity Act of the Fair Housing Act could result in enforcement actions. The Bank received a "Satisfactory" CRA rating in its most recent examination.

Financial Privacy and Data Security

The Company is subject to federal laws, including the Gramm-Leach-Bliley Act (the "GLBA"), and certain state laws containing consumer privacy protection provisions. These provisions limit the ability of banks and other financial institutions to disclose non-public information about consumers to affiliated and non-affiliated third parties and limit the reuse of certain consumer information received from non-affiliated institutions. These provision require notice of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to affiliates or non-affiliated third parties by means of "opt out" or "opt in" authorizations.

The GLBA requires that financial institutions implement comprehensive written information security programs that include administrative, technical, and physical safeguards to protect consumer information. Further, pursuant to interpretive guidance issued under the GLBA and certain state laws, financial institutions are required to notify customers of security breaches that result in unauthorized access to their nonpublic personal information.

The federal banking agencies, including the FRB, through the Federal Financial Institutions Examination Council ("FFIEC") have adopted guidelines to encourage financial institutions to address cybersecurity risks and identify, assess, and mitigate these risks, both internally and at critical third party services providers. FFIEC has provided a Cybersecurity Assessment Toll for institutions to identity and address cybersecurity risks in their systems.

The Fair Credit Reporting Act ("FCRA"), as amended by the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"), Red Flags Rule requires financial institutions with covered accounts (e.g., consumer bank accounts and loans) to develop, implement, and administer an identity theft prevention program. This program must include reasonable policies and procedures to detect suspicious patterns or practices that indicate the possibility of identity theft, such as inconsistencies in personal information or changes in account activity.

Employee Compensation

The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called "golden parachute" payments in connection with approvals of mergers and acquisitions.

The Dodd-Frank Act also requires the federal banking agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities with at least $1 billion in total consolidated assets that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits that could lead to material financial loss to the entity. The federal banking agencies and the SEC most recently proposed such regulations in 2016, but the regulations have not yet been finalized. If the regulations are adopted in the form initially proposed, they will restrict the manner in which executive compensation is structured.

Future Legislative Initiatives

From time to time, federal and state legislatures may introduce legislation that will impact the financial services industry. In addition, the federal banking agencies may introduce regulatory initiatives that are likely to impact the financial services industry. However, it is not clear whether such changes will be enacted or, if enacted, what effect such changes would have on the Company. New legislative and regulatory initiatives are introduced by Congress, state legislatures, and financial regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and/or depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities, or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it or any implementing regulations would have on the financial condition or results of operations of the Company. A change in statutes, regulations, or regulatory policies applicable to the Company or any of its subsidiaries could have a material effect on the business of the Company.

Available Information

We file annual reports, quarterly reports, proxy statements and other documents with the SEC under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The public can obtain any documents that we file with the SEC at www.sec.gov.

We maintain a website at www.sbone.bank. Through a link to our Investor Relations section of our website, we make available, free of charge, copies of each of our filings with the SEC, including our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K, and, if applicable, any amendments to those reports filed or furnished pursuant to the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

ITEM 1A. RISK FACTORS

If the bank regulators impose limitations on our commercial real estate lending activities, our earnings could be adversely affected.

In 2006, the FDIC, the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System (collectively, the “Agencies”) issued joint guidance entitled “Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices” (the “CRE Guidance”). Although the CRE Guidance did not establish specific lending limits, it provides that a bank’s commercial real estate lending exposure may receive increased supervisory scrutiny where total non-owner occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate and construction and land loans, represent 300% or more of an institution’s total risk-based capital and the outstanding balance of the commercial real estate loan portfolio has increased by 50% or more during the preceding 36 months. Our level of non-owner occupied commercial real estate equaled 398% of Bank total risk-based capital at December 31, 2018.

In December 2015, the Agencies released a new statement on prudent risk management for commercial real estate lending (the “2015 Statement”). In the 2015 Statement, the Agencies express concerns about easing commercial real estate underwriting standards, direct financial institutions to maintain underwriting discipline and exercise risk management practices to identify, measure and monitor lending risks, and indicate that the Agencies will continue “to pay special attention” to commercial real estate lending activities and concentrations going forward. If the FDIC, the Bank's primary federal regulator were to impose restrictions on the amount of commercial real estate loans we can hold in our portfolio, or require higher capital ratios as a result of the level of commercial real estate loans we hold, our earnings would be adversely affected.

Our allowance for loan losses may not be adequate to cover actual losses.

Like all financial institutions, we maintain an allowance for loan losses to provide for loan defaults and nonperformance. Our allowance for loan losses may not be adequate to cover actual losses, and future provisions for loan losses could materially and adversely affect the results of our operations. In addition to periodic reviews by an independent loan review function, risks within the loan portfolio are analyzed on a continuous basis by management and by the Board of Directors. A risk system, consisting of multiple-grading categories, is utilized as an analytical tool to assess risk and the appropriate level of loss reserves. Along with the risk system, management further evaluates risk characteristics of the loan portfolio under current economic conditions and considers such factors as the financial condition of the borrowers, past and expected loan loss experience and other factors management feels deserve recognition in establishing an adequate reserve. This risk assessment process is performed at least quarterly and any necessary adjustments are realized in the periods in which they become known. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond our control, and these losses may exceed current estimates.  State and federal regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses and have in the past required an increase in our allowance for loan losses.  Although we believe that our allowance for loan losses is adequate to cover probable and reasonably estimated losses, we cannot assure you that we will not further increase the allowance for loan losses or that our regulators will not require us to increase this allowance.  Either of these occurrences could adversely affect our earnings.

If our non-performing assets increase, our earnings will be negatively impacted.

At December 31, 2018, our non-performing assets (“NPAs”) (which consist of non-accrual loans, loans 90 days or more delinquent, performing troubled debt restructurings and foreclosed real estate assets) totaled $25.8 million, which was an increase of $16.5 million or 179.2% from December 31, 2017.  However, we can give no assurance that our NPAs will decrease and we may experience further increases in NPAs in the future. Our NPAs adversely affect our net income in various ways. We do not record interest income on non-accrual loans or real estate owned. We must reserve for estimated credit losses, which are established through a current period charge to the provision for loan losses, and from time to time, if appropriate, we must write down the value of properties in the other real estate owned portfolio to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs, including taxes, insurance and maintenance related to our other real estate owned. Further, the resolution of NPAs requires the active involvement of management, potentially distracting them from the overall supervision of our operations and other income-producing activities.

Our earnings may not grow if we are unable to successfully attract core deposits and lending opportunities and exploit opportunities to generate fee-based income.

We have experienced growth, and our future business strategy is to continue to expand. Historically, the growth of our loans and deposits has been the principal factor in our increase in net-interest income. In the event that we are unable to execute our business strategy of continued growth in loans and deposits, our earnings could be adversely impacted. Our ability to continue to grow depends, in part, upon our ability to expand our market share, to successfully attract core deposits and identify loan and investment opportunities, as well as opportunities to generate fee-based income. Our ability to manage growth successfully will also depend on whether we can continue to efficiently fund asset growth and maintain asset quality and cost controls, as well as on factors beyond our control, such as economic conditions and interest-rate trends.

We do not have any control over the commissions our insurance business expects to earn on the sale of insurance products, which are based on premiums and commission rates set by insurers and the conditions prevalent in the insurance market.

The revenues of our fee-based insurance business are derived primarily from commissions from the sale of insurance policies, which commissions are generally calculated as a percentage of the policy premium. Commission rates and premiums can change based on the prevailing economic and competitive factors that affect insurance underwriters. In addition, the insurance industry has been characterized by periods of intense price competition due to excessive underwriting capacity and periods of favorable premium levels due to shortages of capacity. We cannot predict the timing or extent of future changes in commission rates or premiums or the effect any of these changes will have on the operations of our insurance business.

Changes in interest rates could adversely affect our results of operations and financial condition.

Our profitability, like that of most financial institutions, depends substantially on our net interest income, which is the difference between the interest income earned on our interest-earning assets and the interest expense paid on our interest-bearing liabilities. Increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans. In addition, as market interest rates rise, we will have competitive pressures to increase the rates we pay on deposits, which will result in a decrease of our net interest income.

We also are subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities as borrowers refinance to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities.

We may experience impairments of goodwill or other intangible assets in the future.

As of December 31, 2018, our consolidated balance sheet included goodwill of $27.3 million and other intangible assets of $2.1 million. Our business acquisitions typically result in goodwill and other intangible assets, which affect the amount of future period amortization expense and possible impairment expense. We make estimates and assumptions in valuing such intangible assets that affect our consolidated financial statements. In accordance with GAAP, our goodwill and indefinite-lived intangible assets are not amortized, but are tested for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that an asset might be impaired. Impairment testing incorporates the current market price of our common stock, the estimated fair value of our assets and liabilities, and certain information of similar companies. Impairment testing may be based on valuation models that estimate fair value. In preparing the valuation models, we consider a number of factors, including operating results, business plans, economic conditions, future cash flows, and transactions and market data. There are inherent uncertainties related to these factors and our judgment in applying them to the impairment analyses. It is possible that future impairment testing could result in a decline in fair value of our goodwill or other intangible assets, which may be less than the carrying value, and, as a result may adversely affect our financial condition. If we determine that impairment exists at a given point in time, our earnings and the book value of goodwill or other related intangible asset will be reduced by the amount of the impairment. If we record an impairment loss related to our goodwill or other intangible assets, it could have a material adverse effect on our business, financial condition, results of operations, cash flows and the trading price of our securities. Notwithstanding the foregoing, the results of impairment testing on our goodwill or other intangible assets have no impact on our tangible book value or regulatory capital levels.

We operate in a highly-regulated environment and are subject to extensive government supervision and regulation that affects our operations and may adversely impact our business.

We are subject to extensive federal and state supervision and regulation that govern nearly all aspects of our operations and can have a material impact on our business. Financial regulatory authorities have significant discretion regarding the supervision, regulation and enforcement of banking laws and regulations.

Banking and insurance laws, regulations and policies are subject to amendment by Congress, the State of New Jersey and federal and state financial regulatory agencies. Changes to statutes, regulations or policies, including changes in the administrative interpretation of regulations or policies, could materially impact our business. These changes could impose additional costs on us and limit the types of financial products and services that we may offer our customers. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose significant compliance costs. Failure to comply with any laws, regulations or policies could result in sanctions by financial regulatory agencies, including civil money penalties, private lawsuits or reputational damage, any of which could adversely affect our business or results of operations. While we have policies and procedures designed to prevent such violations, there can be no assurance that violations will not occur. See “Supervision and Regulation” in ITEM 1. Business.

Since the 2008 global financial crisis, financial institutions have been subject to increased scrutiny from Congress, state legislatures and federal and state financial regulatory agencies. The Dodd-Frank Act, among other laws and regulations, has increased our costs of doing business and resulted in decreased revenues and net income. Several mandates of the Dodd-Frank Act are still subject to further rulemaking and could have adverse implications on the financial industry, the competitive environment and our ability to conduct business. We cannot provide assurance that future changes in laws, regulations and policies will not adversely affect our business.

State and federal financial regulatory agencies periodically conduct examinations of our business, including for compliance with laws and regulations, and our failure to comply with any supervisory actions to which we are or become subject as a result of such examinations may adversely affect our business.

Federal and state financial regulatory agencies periodically conduct examinations of our business, including our compliance with laws and regulations. If, as a result of an examination, an agency were to determine that the financial, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of any of our operations had become unsatisfactory, or violates any law or regulation, federal financial agencies may take several different remedial or enforcement actions it deems appropriate to correct any deficiency. Such actions include the power to enjoin “unsafe or unsound” practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in the bank’s capital, to restrict the bank’s growth, to assess civil monetary penalties against the bank’s officers or directors, to remove officers and directors and, if the FDIC concludes that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance. The Department, as the supervisory and regulatory authority for state-chartered banks, has similar enforcement powers with respect to our banking business and insurance agency. The CFPB has the authority to take enforcement actions, including cease-and-desist orders or civil monetary penalties against us if it finds that we offer consumer financial products and services in violation of federal consumer financial protection laws.

If we were unable to comply with future regulatory directives, or if we were unable to comply with the terms of any future supervisory requirements to which we may become subject, then we could become subject to a variety of supervisory actions and orders, including cease and desist orders, prompt corrective actions, MOUs, and/or other regulatory enforcement actions. If our financial regulators were to take such supervisory actions, then we could, among other things, become subject to greater restrictions on our ability to develop any new business, as well as restrictions on our existing business, and we could be required to raise additional capital, dispose of certain assets and liabilities within a prescribed period of time, or both. Failure to implement remedial measures as required by financial regulatory agencies could result in additional orders or penalties from federal and state regulators, which could result in one or more of the remedial actions described above. The terms of any supervisory action and associated consequences with any failure to comply with any supervisory action could have a material negative effect on our business, operating flexibility and overall financial condition.

There is a risk that we may not be repaid in a timely manner, or at all, for loans we make.

The risk of non-payment (or deferred or delayed payment) of loans is inherent in commercial banking. Such non-payment, or delayed or deferred payment of loans to us, if they occur, may have a material adverse effect on our earnings and overall financial condition. Additionally, in compliance with applicable banking laws and regulations, we maintain an allowance for loan losses created through charges against earnings. As of December 31, 2018, our allowance for loan losses was $8.8 million. Our marketing focus on small to medium-size businesses may result in the assumption by us of certain lending risks that are different from or greater than those which would apply to loans made to larger companies. We seek to minimize our credit risk exposure through credit controls, which include evaluation of potential borrowers' available collateral, liquidity and cash flow. However, there can be no assurance that such procedures will actually reduce loan losses.

Replacement of the LIBOR benchmark interest rate could adversely affect our business, financial condition, and results of operations.

In 2017, the United Kingdom's Financial Conduct Authority ("FCA"), which regulates the London Interbank Offered Rate ("LIBOR"), announced that the FCA intends to stop persuading or compelling banks to submit the rates required to calculate LIBOR after 2021. This announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, at this time, it is not possible to predict whether and to what extent banks will continue to provide submissions for the calculation of LIBOR. Similarly, it is not possible to predict whether LIBOR will continue to be viewed as an acceptable market benchmark, what rate or rates may become accepted alternatives to LIBOR or what the effect of any such changes in views or alternatives may be on the markets for LIBOR-indexed financial instruments.

We have a significant number of loans, derivative contracts, borrowings and other financial instruments with attributes that are either directly or indirectly dependent on LIBOR. The transition from LIBOR, or any changes or reforms to the determination or supervision of LIBOR, could have an adverse impact on the market for or value of any LIBOR-linked securities, loans, and other financial obligations or extensions of credit held by or due to us, could create considerable costs and additional risk and could have an adverse impact on or overall financial condition or results of operations. Since proposed alternative rates are calculated differently, payments under contracts referencing new rates will differ from those referencing LIBOR. The transition will change our market risk profiles, requiring changes to risk and pricing models, valuation tools, product design and hedging strategies. Furthermore, failure to adequately manage this transition process with our customers could adversely impact our reputation. Although we are currently unable to assess what the ultimate impact of the transition from LIBOR will be, failure to adequately manage the transition could have a material adverse effect on our business, financial condition and results of operations.

We are in competition with many other financial service providers, including larger commercial banks which have greater resources than us.

The banking industry within our trade area is highly competitive. Our principal market area is also served by branch offices of large commercial banks and thrift institutions. In addition, the Gramm-Leach-Bliley Financial Modernization Act of 1999 permits other financial entities, such as insurance companies and securities firms, to acquire or form financial institutions, thereby further increasing competition. A number of our competitors have substantially greater resources than we do to expend upon advertising and marketing, and their substantially greater capitalization enables them to make much larger loans. Our success depends upon our ability to serve small business clients in a more responsive manner than the large and mid-size financial institutions against whom we compete in our principal market area. In addition to competition from larger institutions, we also face competition for individuals and small businesses from recently formed banks seeking to compete as "home town" institutions. Most of these new institutions have focused their marketing efforts on the smaller end of the small business market we serve.

We depend on our executive officers and key personnel to continue the implementation of our long-term business strategy and could be harmed by the loss of their services.

We believe that our continued growth and future success will depend in large part upon the skills of our management team. The competition for qualified personnel in the financial services industry is intense, and the loss of our key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect our business. We cannot assure you that we will be able to retain our existing key personnel or attract additional qualified personnel. We have employment agreements and/or change in control agreements with our Chief Executive Officer, Chief Financial Officer, Chief Banking Officer, Chief Operating Officer, Senior Executive Vice President of Regional Banking, Market Executive and Chief Executive Officer of SB One Insurance, and the loss of the services of one or more of our executive officers and key personnel could impair our ability to continue to develop our business strategy.

Changes in local economic conditions could adversely affect our loan portfolio.

Our success depends to a great extent upon the general economic conditions of the local markets that we serve. Unlike larger banks that are more geographically diversified, we provide banking and financial services primarily to customers in the New Jersey and New York markets in which we have branches, so any decline in the economy of this specific region could have an adverse impact on us.

The ability of our borrowers to repay their loans, our financial results, the credit quality of our existing loan portfolio, and the ability to generate new loans with acceptable yield and credit characteristics may be adversely affected by changes in prevailing economic conditions, including declines in real estate values, changes in interest rates, adverse employment conditions and the monetary and fiscal policies of the federal government. We cannot assure you that negative trends or developments would not have a significant adverse effect on us.

We cannot predict how changes in technology will impact our business.

The financial services market, including banking services, is increasingly affected by advances in technology, including developments in telecommunications, data processing, automation, internet-based banking, telephone banking, and debit cards and so-called “smart cards.”

Our ability to compete successfully in the future will depend on whether we can anticipate and respond to technological changes. To develop these and other new technologies, we will likely have to make additional capital investments. Although we continually invest in new technology, we cannot assure you that we will have sufficient resources or access to the necessary proprietary technology to remain competitive in the future.

The risks presented by acquisitions could adversely affect our financial condition and results of operations.

From time to time we may pursue growth through strategic acquisitions of assets or companies. Acquisitions are subject to many risks, including potential loss of significant customers or key personnel of the acquired business as a result of the change in ownership, difficulty integrating the operations of the acquired business or achieving targeted efficiencies, the incurrence of substantial costs and expenses related to the acquisition effort, and diversion of management's attention from other aspects of our business operations. For example, we may face integration challenges as we continue to fully integrate the operations of Community and Enterprise, both of which were acquired in 2018.

Acquisitions may also cause us to incur debt or result in dilutive issuances of our equity securities. Our acquisitions may cause large one-time expenses or create goodwill or other intangible assets that could result in significant impairment charges in the future. We also make various estimates and assumptions in order to determine purchase price allocation and estimate the fair value of assets acquired and liabilities assumed. If our estimates or assumptions used to value these assets and liabilities vary from actual or future projected results, we may be exposed to losses, including impairment losses, which could be material.

We do not provide any assurance that we will be able to successfully integrate the operations of any acquired businesses into our operations or achieve the expected benefits of any acquisitions. The failure to successfully integrate newly acquired businesses or achieve the expected benefits of strategic acquisitions in the future could have an adverse effect on our financial condition, results of operations or cash flows. We may not complete a potential acquisition for a variety of reasons, but we may nonetheless incur material costs in the preliminary stages of evaluating and pursuing such an acquisition that we cannot recover.

We face cybersecurity risks and risks associated with security breaches which have the potential to disrupt our operations, cause material harm to our financial condition, result in misappropriation of assets, compromise confidential information and/or damage our business relationships and can provide no assurance that the steps we and our service providers take in response to these risks will be effective.

We face cybersecurity risks and risks associated with security breaches or disruptions such as those through cyber-attacks or cyber intrusions over the Internet, malware, computer viruses, attachments to emails, social engineering and phishing schemes or persons inside our organization. The risk of a security breach or disruption, particularly through cyber-attacks or cyber intrusions, including by computer hackers, nation-state affiliated actors, and cyber terrorists, has generally increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased. These incidents may result in disruption of our operations, material harm to our financial condition, cash flows and the market price of our common stock, misappropriation of assets, compromise or corruption of confidential information collected in the course of conducting our business, liability for stolen information or assets, increased cybersecurity protection and insurance costs, regulatory enforcement, litigation and damage to our stakeholder relationships. These risks require continuous and likely increasing attention and other resources from us to, among other actions, identify and quantify these risks, upgrade and expand our technologies, systems and processed to adequately address them and provide periodic training for our employees to assist them in detecting phishing, malware and other schemes. Such attention diverts time and other resources from other activities and there is no assurance that our efforts will be effective.

In the normal course of business, we collect and retain certain personal information provided by our customers, employees and vendors. We also rely extensively on computer systems to process transactions and manage our business. We can provide no assurance that the data security measures designed to protect confidential information on our systems established by us will be able to prevent unauthorized access to this personal information. There can be no assurance that our efforts to maintain the security and integrity of the information we and our service providers collect and our and their computer systems will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well protected information, networks, systems and facilities remain potentially vulnerable because the techniques used in such attempted security breaches evolve and generally are not recognized until launched against a target, and in some cases are designed not be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques to implement adequate security barriers or other preventative measures, and thus it is impossible for us to entirely mitigate this risk.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We conduct our business through our corporate office in Rockaway, New Jersey, our regional office and corporate center in Wantage, New Jersey, our insurance agency offices in Augusta, New Jersey, and our eighteen branch offices. The following table sets forth certain information regarding our properties as of December 31, 2018. We believe that our existing facilities are sufficient for our current needs. All properties are adequately covered by insurance.

| LOCATION | YEAR OPENED | LEASED OR OWNED |
|---|---|---|
| 28-21 Astoria Blvd<br>Astoria, New York | 2015 | Leased |
| 324 Broad Street<br>Bloomfield, NJ | 2018 | Leased |
| 3900 Park Ave, Suite 108<br>Edison, NJ | 2018 | Leased |
| 12-79 River Road<br>Fair Lawn, NJ | 2018 | Owned |
| 490 Kenilworth Blvd<br>Kenilworth, NJ | 2018 | Leased |
| 125 W Pleasant Ave<br>Maywood, NJ | 2018 | Owned |
| 188-190 Wilson Ave<br>Newark, NJ | 2018 | Leased |
| 210 Rochelle Ave<br>Rochelle Park, NJ | 2018 | Owned |
| 18 Railroad Ave<br>Rochelle Park, NJ | 2018 | Owned |
| 399 Route 23<br>Franklin, New Jersey | 1976 | Owned |
| 7 Church Street<br>Vernon, New Jersey | 1980 | Owned |
| 266 Clove Road<br>Montague, New Jersey | 1982 | Leased |
| 96 Route 206<br>Augusta, New Jersey | 1983 | Leased |
| 378 Route 23<br>Wantage, New Jersey | 2007 | Owned |

| | | |
|---|---|---|
| 455 Route 23<br>Wantage, New Jersey | 1992 | Owned (1) |
| 15 Boulder Hills Blvd.<br>Wantage, New Jersey | 2014 | Leased |
| 15 Trinity Street<br>Newton, New Jersey | 1991 | Owned |
| 165 Route 206<br>Andover, New Jersey | 1992 | Owned |
| 100 Route 206 | | |

| | | |
|---|---|---|
| Augusta, New Jersey | 2000 | Owned |
| 33 Main Street<br>Sparta, New Jersey | 2001 | Owned |
| 100 Enterprise Drive, Suite 700<br>Rockaway, New Jersey | 2014 | Leased |
| 430 Schooley's Mtn. Road<br>Hackettstown, New Jersey | 2014 | Leased |
| 296 Kinderkamack Road<br>Oradell, New Jersey | 2016 | Leased |

(1). We own the building housing our former Wantage branch. The land on which the building is located is leased pursuant to a ground lease which runs until December 31, 2020, and contains the sole option of the bank to extend the lease for an additional 25 year term.

ITEM 3. LEGAL PROCEEDINGS

We are periodically involved in various legal proceedings as a normal incident to our business. In the opinion of management no material loss is expected from any such pending lawsuit.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

## ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

### Market Information

Our common stock trades on the NASDAQ Global Market, under the symbol “SBBX.” As of December 31, 2018, we had approximately 637 holders of record.

### Dividend Policy

The payment of dividends depends upon our debt and equity structure, earnings, financial condition, need for capital in connection with possible future acquisitions and other factors, including economic conditions, regulatory restrictions and tax considerations. We cannot guarantee the payment of dividends.

The only funds available for the payment of dividends on our capital stock will be cash and cash equivalents held by us, dividends paid to us by the Bank, and borrowings. The Bank is prohibited from paying cash dividends to us to the extent that any such payment would reduce the Bank’s capital below required capital levels. See “Bank Holding Company Regulation – Capital Adequacy Guidelines for Bank Holding Companies” and “Bank Regulation” for a discussion of these restrictions. For additional information see Note 20 in our consolidated financial statements contained elsewhere in this report.

### Recent Sales of Unregistered Securities

There were no sales by us of unregistered securities during the year ended December 31, 2018.

### Purchases of Equity Securities by the Issuer and Affiliated Purchasers

There were no purchases made by or on behalf of us of our common stock during the fourth quarter of 2018.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data as of December 31 for each of the five years presented should be read in conjunction with our audited consolidated financial statements and the accompanying notes.

| (Dollars in thousands, except per share data)) | As of and for the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| SUMMARY OF INCOME: | | | | | |
| Interest income | $56,709 | $35,699 | $29,160 | $23,644 | $21,300 |
| Interest expense | 12,629 | 6,611 | 4,762 | 3,568 | 3,294 |
| Net interest income | 44,080 | 29,088 | 24,398 | 20,076 | 18,006 |
| Provision for loan losses | 1,437 | 1,586 | 1,291 | 636 | 1,537 |
| Net interest income after provision for loan losses | 42,643 | 27,502 | 23,107 | 19,440 | 16,469 |
| Other income | 10,749 | 8,285 | 7,829 | 6,453 | 5,961 |
| Other expenses | 40,410 | 25,617 | 22,585 | 20,553 | 18,829 |
| Income before income tax expense (benefit) | 12,982 | 10,170 | 8,351 | 5,340 | 3,601 |
| Income tax expense (benefit) | 3,059 | 4,479 | 2,828 | 1,640 | 1,001 |
| Net income | $9,923 | $5,691 | $5,523 | $3,700 | $2,600 |
| | | | | | |
| WEIGHTED AVERAGE NUMBER OF SHARES: (1) | | | | | |
| Basic | 7,874,676 | 5,359,430 | 4,619,124 | 4,559,316 | 4,541,305 |
| Diluted | 7,921,269 | 5,404,381 | 4,651,108 | 4,591,822 | 4,580,350 |
| | | | | | |
| PER SHARE DATA: | | | | | |
| Basic earnings per share | $1.26 | $1.06 | $1.20 | $0.81 | $0.57 |
| Diluted earnings per share | 1.25 | 1.05 | 1.19 | 0.81 | 0.57 |
| Cash dividends (2) | 0.29 | 0.22 | 0.16 | 0.16 | 0.09 |
| BALANCE SHEET: | | | | | |
| Loans, net | $1,466,000 | $813,365 | $688,561 | $537,833 | $466,332 |
| Total assets | 1,795,703 | 979,383 | 848,728 | 684,503 | 595,915 |
| Total deposits | 1,353,939 | 762,491 | 660,921 | 517,856 | 458,270 |
| Total stockholders’ equity | 185,444 | 94,193 | 60,072 | 53,941 | 51,229 |
| Average assets | 1,426,455 | 914,747 | 770,470 | 627,298 | 559,885 |
| Average stockholders’ equity | 149,895 | 79,329 | 57,518 | 52,715 | 49,494 |
| PERFORMANCE RATIOS: | | | | | |
| Return on average assets | 0.70 % | 0.62 % | 0.72 % | 0.59 % | 0.46 % |
| Return on average stockholders’ equity | 6.62 % | 7.17 % | 9.60 % | 7.02 % | 5.25 % |
| Average equity/average assets | 10.51 % | 8.67 % | 7.47 % | 8.40 % | 8.84 % |
| Net interest margin | 3.36 % | 3.39 % | 3.37 % | 3.45 % | 3.49 % |
| Efficiency ratio (3) | 73.70 % | 68.54 % | 70.08 % | 77.47 % | 78.56 % |
| Other income to net interest income plus other income | 19.60 % | 22.17 % | 24.29 % | 24.32 % | 24.87 % |
| Dividend payout ratio | 22.80 % | 20.95 % | 13.45 % | 19.75 % | 15.79 % |
| CAPITAL RATIOS: (4) | | | | | |
| Tier I capital to average assets | 12.06 % | 11.86 % | 10.41 % | 9.45 % | 10.19 % |
| Tier I capital to total risk-weighted assets | 12.34 % | 14.26 % | 12.87 % | 11.74 % | 12.79 % |
| Total capital to total risk-weighted assets | 12.94 % | 15.17 % | 13.86 % | 12.79 % | 14.02 % |
| Common equity Tier 1 capital to total risk-weighted assets | 12.34 % | 14.26 % | 12.87 % | 11.74 % | N/A |
| ASSET QUALITY RATIOS: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Non-accrual loans to total loans | 1.40 % | 0.73 % | 0.84 % | 0.98 % | 1.26 % |
| Non-performing assets to total assets (5) | 1.43 % | 0.94 % | 1.10 % | 1.49 % | 2.02 % |
| Net loan charge-offs to average total loans | — % | 0.13 % | 0.03 % | 0.14 % | 0.33 % |
| Allowance for loan losses to total loans at period end | 0.60 % | 0.89 % | 0.96 % | 1.03 % | 1.20 % |
| Allowance for loan losses to non-performing loans (6) | 40.61 % | 105.51 % | 95.93 % | 81.43 % | 74.23 % |

(1) The weighted average number of shares outstanding was computed based on the average number of shares outstanding during each period as adjusted for subsequent stock dividends.

(2) Cash dividends per common share are based on the actual number of common shares outstanding on the dates of record as adjusted for subsequent stock dividends, if any.

(3) Efficiency ratio is total other expenses divided by net interest income and total other income.

(4) Bank capital ratios.

(5) NPAs include non-accrual loans, loans past due 90 days and still accruing, troubled debt restructured loans still accruing and foreclosed real estate.

(6) Non-performing loans include non-accrual loans, loans past due 90 days and still accruing and troubled debt restructured loans still accruing.

## ITEM 7 MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

We are a bank holding company of a community bank primarily operating in northern New Jersey and New York that provides diversified financial services to both consumer and business customers. Our primary source of revenues, approximately 80%, is derived from net interest income which represents the difference between the interest we earn on our assets, principally loans and investment securities, and interest we pay on our deposits and borrowings. Net interest income expressed as a percentage of average interest-earning assets is referred to as net interest margin. The net interest margin decreased by 3 basis points to 3.36% for year ended December 31, 2018 as compared to 3.39% for 2017.

For 2018, our net income increased to $9.9 million, or $1.25 per diluted share, or a 74.4% increase, as compared to net income of $5.7 million, or $1.05 per diluted share, for the same period last year. For 2018 our adjusted net income (a non-GAAP measurement) was $14.7 million, or $1.86 per diluted share. The increase in net income for the twelve months ended December 31, 2018 was largely due to increases in net interest income of $15.0 million and non-interest income of $2.5 million and a decrease in income tax expense of $1.4 million, which were partially offset by an increase in non-interest expenses of $14.8 million. The increase in non-interest expenses was largely due to a $5.9 million increase in salaries and employee benefits and merger-related expenses of $4.6 million. Excluding tax effected merger-related expenses and non-recurring expenses of $4.5 million and $271 thousand, respectively, net income increased $7.0 million, or 91.1%, to $14.7 million for the year ended December 31, 2018, as compared to the year ended December 31, 2017.

### Use of Non-GAAP Financial Measures

The following table contains certain financial information determined by methods other than in accordance with generally accepted accounting policies in the United States (GAAP). This non-GAAP disclosure has limitations as an analytical tool and should not be considered in isolation or as a substitute for analysis of the Company's results as reported under GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies. Our management uses these non-GAAP measures in its analysis of our performance because it believes these measures are material and will be used as a measure of our performance by investors.

SB ONE BANCORP
Non-GAAP Reporting
(Dollars In Thousands)

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Net income (GAAP) | $9,923 | $5,691 |
| Merger related expenses net of tax (1) | 4,521 | 1,024 |
| Non-recurring expenses inclusive of rebrand net of tax (3) | 271 | — |
| S-3 registration filing expenses net of tax (1) | — | 45 |
| Tax Cut and Jobs Act adjusted (2) | — | 942 |
| Net income, as adjusted | $14,715 | $7,699 |
| Average diluted shares outstanding (GAAP) | 7,921,269 | 5,404,381 |
| Diluted EPS, as adjusted (4) | $1.86 | $1.42 |
| Average Assets | 1,426,455 | 914,747 |
| Return on average assets, as adjusted (5) | 1.03 % | 0.84 % |

(1) Merger related expenses net of tax expenses $1.3 million YTD 2018 and $137 thousand YTD 2017; S-3 registration filing net of tax expenses of $30 thousand in 2017.
(2) Represents acceleration of $942 thousand of deferred tax assets into expense due to recent enactment of the Tax Cut and Jobs Act
(3) Non-recurring rebrand expenses net of tax expense of $105 thousand
(4) Diluted EPS, as adjusted is calculated using Net income, as adjusted divided by Average diluted shares outstanding (GAAP)
(5) Return on average assets, as adjusted is calculated by using Net income, as adjusted divided by YTD average assets

We augment our primary revenue source through non-interest income sources that include insurance commissions from our wholly owned subsidiary, SB One Insurance, service charges on deposits, bank-owned life insurance ("BOLI") income and commissions on mutual funds and annuities. In addition, we from time to time may recognize income on gains on sales of securities; however, we do not consider this a primary source of income.

Total loans receivable, net of unearned income, increased $654.1 million, or 79.7%, to $1.5 billion at December 31, 2018, from $820.7 million at year-end 2017. Our total deposits increased $591.4 million, or 77.8%, to $1.4 billion at December 31, 2018, from $762.5 million at December 31, 2017. The increase in deposits was primarily due to an increase in interest bearing deposits of $477.8 million, or 77.5%, at December 31, 2018, as compared to December 31, 2017. The growth in both loans and deposits was primarily the result of the mergers with Community and Enterprise augmented by organic growth.

At December 31, 2018, our total stockholders' equity was $185.4 million, an increase of $91.2 million when compared to December 31, 2017. The increase was largely due to the mergers with Community and Enterprise and the increase in net income for the year ended December 31, 2018. At December 31, 2018, the leverage, Tier I risk-based capital, total risk-based capital and common equity Tier I capital ratios for the Bank were 12.06%, 12.34%, 12.94% and 12.34%, respectively, all in excess of the ratios required to be deemed "well-capitalized."

Management Strategy

Our goal is to serve as a community-oriented financial institution serving northern New Jersey and the New York marketplace. While offering traditional community bank loan and deposit products and services, we obtain significant non-interest income through SB One Insurance's insurance brokerage operations. We report the operations of SB One Insurance as a separate segment from our commercial banking operations. See Note 3 to our consolidated financial statements contained elsewhere in this report for additional information regarding our two segments.

Critical Accounting Policies

Our accounting policies are fundamental to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations.  Our accounting policies are more fully described in Note 1 to our consolidated financial statements included elsewhere in this report.  The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the amounts reported in our consolidated financial statements and accompanying notes.  Since future events and their effect cannot be determined with absolute certainty, actual results may differ from those estimates.  Management makes adjustments to its assumptions and judgments when facts and circumstances dictate.  The amounts currently estimated by us are subject to change if different assumptions as to the outcome of future events are subsequently made.  We evaluate our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances.  Management believes the following critical accounting policies encompass the more significant judgments and estimates used in preparation of our consolidated financial statements.

Allowance for Loan Losses.  The allowance for loan losses reflects the amount deemed appropriate by management to provide for known and inherent losses in the existing loan portfolio.  Management's judgment is based on the evaluation of the past loss experience of individual loans, the assessment of current economic conditions, and other relevant factors.  Loan losses are charged directly against the allowance for loan losses and recoveries on previously charged-off loans are added to the allowance.  Management uses significant estimates to determine the allowance for loan losses.  Consideration is given to a variety of factors in establishing these estimates, including current economic conditions, diversification of the loan portfolio, delinquency statistics, borrowers' perceived financial and managerial strengths, the adequacy of underlying collateral, if collateral dependent, or present value of future cash flows, and other relevant factors.  Since the sufficiency of the allowance for loan losses is dependent to a great extent on conditions that may be beyond our control, it is possible that management's estimates of the allowance for loan losses and actual results could differ in the near term.  Although we believe that we use the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary if certain future events occur that cause actual results to differ from the assumptions used in making the evaluation.  For example, a downturn in the local economy could cause increases in non-performing loans.  Additionally, a decline in real estate values could cause some of our loans to become inadequately collateralized.  In either case, this may require us to increase our provisions for loan losses, which would negatively impact earnings.  Additionally, a large loss could deplete the allowance and require increased provisions to replenish the allowance, which would negatively impact earnings.  Finally, regulatory authorities, as an integral part of their examination, periodically review the allowance for loan losses.  They may require additions to the allowance for loan losses based upon their judgments about information available to them at the time of examination.  Future increases to our allowance for loan losses, whether due to unexpected changes in economic conditions or otherwise, could adversely affect our future results of operations.

Appraisal Policy.    We have a detailed policy covering the real estate appraisal process, including the selection of qualified appraisers, review of appraisal reports upon receipt, and complying with the federal regulatory standards that govern the minimum requirements for obtaining appraisals or evaluations to support the determination of the allowance for loan losses. Appraisals and evaluations are considered to be current when the valuation date is within 12 months of a new loan or 24 months of any renewal of an existing loan, provided that certain conditions are met.  The appraisal is not considered to be current if there has been a substantial change in value, demand, supply or competitive factors.

The following types of transactions require a real estate appraisal:

- Non-residential transactions when the transaction value exceeds $250,000.

- Loan transactions in which real estate is used as the primary security for the loan, regardless of the type of loan (commercial, installment or mortgage), including:

New loans, loan modifications, loan extensions and renewals, provided that certain conditions are met.

The purchase, sale, exchange or investment in real property or an interest in real property where the “transaction value” of the real property interest exceeds $250,000.

The long-term lease of real estate, which is the economic equivalent of a purchase or sale where the “transaction value” of the real property interest exceeds $250,000.

Purchase of a loan or pool of loans, or participation therein, or of an interest in real property, providing that any individual loan or property interest exceeds $250,000, and further provided that a satisfactory appraisal of the property relating to that loan or interest has not been made available to the Bank by another party to the transaction.

The need for real estate appraisals applies to initial loan underwriting and subsequently when the value of the real estate collateral might be materially affected by changing market conditions, changes in the occupancy of the property, changes in cash flow generated by the property, changes in the physical conditions of the property, or other factors. These factors include changes in the sales prices of comparable properties, absorption rates, capitalization rates, effective rental rates and current construction costs.

Real estate appraisals are not required for the following transactions:

- New loans, loan modifications, loan extensions and renewals with real property interest value of $250,000 or less.

- Purchase, sale, exchange, long-term lease or investment in real property where the "transaction value" of the real property interest does not exceed $250,000.

- Renewal or extension of an existing loan in excess of $250,000 provided that certain conditions are met.

- Purchase of a loan or pool of loans, or participation therein, or of an interest in real property where a satisfactory appraisal of the property relating to that loan or interest has been made available to the Bank by another federally insured depository institution that is subject to Title XI of Financial Institutions Reform Recovery and Enforcement Act of 1989.

While real estate appraisals are not required for transactions of $250,000 or less, we will consider obtaining an appraisal if the orderly liquidation of the collateral is the primary source of repayment. To the extent that an appraisal is not required for a real estate collateralized transaction, we will obtain for its credit files another acceptable form of valuation (i.e. equalized value with a reasonable market relevance or evaluation).

Additionally, real estate appraisals are not required on transactions over $250,000 when taking a lien on real property as collateral solely through an "abundance of caution," and where the terms of the transaction have not been made more favorable than would have been in the absence of the mortgage lien. In determining whether an appraisal can be waived due to this reason, approval must be obtained from our Chief Credit Officer.

Generally, we obtain updated appraisals for real estate loan renewals and modifications or certain classified loans depending on the age of the last appraisal, volatility of the local market, and other factors. In certain circumstances, if we can support an appraisal that is greater than one year old with an evaluation, utilizing current information, including, but not limited to, current comparable sales, independent appraisal, consultant data or tax assessment values, then we may continue to use the existing appraisal. For classified/criticized loans, when it is determined that a deficiency exists utilizing the above evaluation methods, a new appraisal will be ordered.

Foreclosed real estate is primarily comprised of property acquired through a foreclosure proceeding or acceptance of a deed-in-lieu of foreclosure. Foreclosed real estate is initially recorded at fair value, less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in expenses related to foreclosed real estate.

Derivatives. The Company utilizes derivative instruments in the form of interest rate swaps to hedge the variability in its cash flows due to interest rate risk. The variability in cash flows is managed as part of the Company's asset/liability management process. In accordance with accounting requirements, the Company formally designates all of its hedging relationships as cash flow hedges, intended to offset changes in the cash flows of certain financial instruments due to movement in interest rates, and documents the strategy for undertaking the hedge transactions and its method of assessing ongoing effectiveness.

All derivatives are recognized as either assets or liabilities in the Consolidated Financial Statements at their fair values.  Should the cash flow hedge become ineffective, the ineffective portion of changes in fair value (i.e. gain or loss) is reported in current period earnings.  The effective portion of the change in fair value is initially recorded as a component of other comprehensive income (loss) and subsequently reclassified into earnings when the hedged transaction affects earnings.

Derivative effectiveness and ineffectiveness will be assessed and measured at the date of designation (inception), each reporting date, and whenever a designated hedge period is terminated to ensure that ongoing high effectiveness is expected by regression analysis of the periodic change in fair value of the hedging instrument and the periodic change in fair value of the hypothetical derivative.

The Company's interest rate derivatives are comprised entirely of interest rate swaps hedging floating-rate and forecasted issuances of fixed-rate liabilities and accounted for as cash flow hedges. The carrying value of interest rate derivatives is included in the balance of other assets or other liabilities. Changes in fair value are offset against accumulated other comprehensive income, net of deferred income tax.

Income Taxes. Management considers accounting for income taxes as a critical accounting policy due to the subjective nature of certain estimates that are involved in the calculation and evaluation of the timing and recognition of resulting tax assets and liabilities. Management uses the asset liability method of accounting for income taxes in which deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. Deferred tax expense is the result of changes between deferred tax assets and liabilities. The principal types of differences between assets and liabilities for financial statement and tax return purposes are allowance for loan losses, deferred compensation, securities available for sale and interest rate swaps. Significant estimation is required to determine if a valuation allowance for deferred tax assets is required. A valuation allowance is established against deferred tax assets when, in the judgment of management, it is more likely than not that such deferred tax assets will not become available. Because the judgment about the level of future taxable income is dependent to a great extent on matters that may, at least in part, be beyond the Company's control, it is at least reasonably possible that management's judgment about the need for a valuation allowance for deferred taxes could change in the near term.

Goodwill. We have recorded goodwill of $27.3 million at December 31, 2018, primarily related to the acquisitions of Community and Enterprise of $22.3 million and $2.2 million, respectively. Our recorded goodwill total includes $2.8 million related to the acquisition of SB One Insurance in October of 2001. Our recorded goodwill total also includes $486 thousand related to the 2006 acquisition of $6.3 million in deposits in our Port Jervis branch. During the quarter ended March 31, 2016 we announced the closing of the Port Jervis branch and the deposits from that branch were transferred to our Montague, New Jersey branch. As of December 31, 2018 deposits originated in that branch were $7.6 million. FASB ASC 350, Intangibles-Goodwill and Others, requires that goodwill is not amortized to expense, but rather be tested for impairment at least annually. We periodically assess whether events or changes in circumstances indicate that the carrying amounts of goodwill require additional impairment testing. We perform our annual impairment test on the goodwill of SB One Insurance in the fourth quarter of each calendar year. If the fair value of the reporting unit exceeds the book value, no write-downs of goodwill are necessary. If the fair value is less than the book value, an additional test is necessary to assess the proper carrying value of goodwill. We determined that no impairment write-offs were necessary during 2018 and 2017.

Reporting unit valuation is inherently subjective, with a number of factors based on assumptions and management judgments. Among these are future growth rates, discount rates and earnings capitalization rates. Changes in assumptions and results due to economic conditions, industry factors and reporting unit performance could result in different assessments of the fair value and could result in impairment charges in the future.

Investment Securities Impairment Evaluation. The Company periodically evaluates the security portfolio to determine if a decline in the fair value of any security below its cost basis is other-than-temporary. The Company's evaluation of other-than-temporary impairment considers the duration and severity of the impairment, the company's intent and ability to hold the securities and our assessments of the reason for the decline in value and the likelihood of a near-term recovery. If a determination is made that a debt security is other-than-temporarily impaired, the Company will estimate the amount of the unrealized loss that is attributable to credit and all other non-credit related factors. The credit related component will be recognized as an other-than-temporary impairment charge in non-interest income. The non-credit related component will be recorded as an adjustment to AOCI, net of tax. For held to maturity securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security. No available for sale and held to maturity securities at December 31, 2018 or December 31, 2017 were deemed to be impaired.

Fair Value Measurements. We use fair value measurements to record fair value adjustments to certain assets to determine fair value disclosures. Investment, mortgage-backed securities available for sale, and interest rate swaps are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans, real estate owned and certain other assets. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets. FASB ASC Topic 820 "Fair Value Measurements and Disclosures" ("ASC Topic 820"), establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The three levels of the fair value hierarchy under ASC Topic 820 are as follows:

| | |
|---|---|
| Level 1: | Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. |
| Level 2: | Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability. Level 2 includes debt securities with quoted prices that are traded less frequently then exchange-traded instruments. Valuation techniques include matrix pricing which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. |
| Level 3: | Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity). |

Under ASC Topic 820, we base our fair values on 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. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in FASB ASC Topic 820. Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon our or other third-party's estimates, are often calculated based on the characteristics of the asset, the economic and competitive environment and other such factors. Management uses its best judgment in estimating the fair value of our financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts we could have realized in sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period end and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period-end. Additionally, changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future valuations.

COMPARISON OF FINANCIAL CONDITION AT YEAR-END DECEMBER 31, 2018 AND 2017

General. At December 31, 2018, we had total assets of $1.8 billion compared to total assets of $979.4 million at December 31, 2017, an increase of $816.3 million, or 83.4%. Gross loans increased $654.1 million, or 79.7%, to $1.5 billion at December 31, 2018, from $820.7 million at December 31, 2017. Total deposits increased 77.6% to $1.4 billion at December 31, 2018, from $762.5 million at December 31, 2017.

Cash and Cash Equivalents. Our cash and cash equivalents increased $15.0 million, or 129.1%, at December 31, 2018 to $26.7 million from $11.6 million at December 31, 2017.

Securities Portfolio.  Our securities portfolio is designed to provide interest income, including tax-exempt income, provide a source of liquidity, diversify the earning assets portfolio, allow for management of interest rate risk, and provide collateral for public fund deposits and borrowings.  Securities are classified as either, available for sale or held to maturity.  The portfolio is composed primarily of obligations of U.S. government agencies and government sponsored entities, including collateralized mortgage obligations issued by such agencies and entities, and tax-exempt municipal bonds.

We periodically conduct reviews to evaluate whether unrealized losses on our investment securities portfolio are deemed temporary or whether an other-than-temporary impairment has occurred.  Various inputs to economic models are used to determine if an unrealized loss is other-than-temporary.  All of our debt securities in an unrealized loss position have been evaluated as of December 31, 2018, and we do not consider any security to be other-than-temporarily impaired.  We evaluated the prospects of the issuers in relation to the severity and the duration of the unrealized losses.  Our securities in unrealized loss positions are mostly driven by wider credit spreads and changes in interest rates.  Based on that evaluation we do not intend to sell any security in an unrealized loss position, and it is more likely than not that we will not have to sell any of our securities before recovery of its cost basis.

Our available for sale securities are carried at fair value while securities held to maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts. Unrealized gains and losses on securities available for sale are excluded from results of operations, and are reported as a separate component of stockholders' equity net of taxes. Securities classified as available for sale include securities that may be sold in response to changes in interest rates, changes in prepayment risk, the need to increase regulatory capital or other similar requirements. Management determines the appropriate classification of securities at the time of purchase.

The following table shows the carrying value of our available for sale security portfolio as of December 31, 2018, 2017 and 2016.

| | December 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| U.S. government agencies | $24,794 | $18,861 | $13,087 |
| U.S. government sponsored agencies | 20,362 | 6,061 | — |
| State and political subdivisions | 60,362 | 41,234 | 40,688 |
| Mortgage-backed securities | | | |
| U.S. government-sponsored enterprises | 73,613 | 30,544 | 32,854 |
| Corporate debt | 3,008 | 2,030 | 1,982 |
| Total available for sale | $182,139 | $98,730 | $88,611 |

Our securities available for sale, increased by $83.4 million, or 84.5%, to $182.1 million at December 31, 2018 from $98.7 million at December 31, 2017. During 2018, we purchased $101.7 million in new securities, $82.7 million in securities were sold and $9.7 million in securities matured, were called or were repaid. At December 31, 2018, there was an unrealized loss of $1.6 million in securities available for sale as compared to an unrealized gain of $449 thousand at December 31, 2017. During 2018 there was a net realized gain of $36 thousand on the sale of available for sale securities as compared to a $9 thousand realized loss in 2017.

We had $4.1 million of our security portfolio classified as held to maturity at December 31, 2018, a decrease of $1.2 million from December 31, 2017. Held to maturity securities, carried at amortized cost, consist of the following at December 31, 2018, 2017 and 2016.

| (Dollars in thousands) | 2018 | 2017 | 2016 |
|---|---|---|---|
| State and political subdivisions | $4,078 | $5,304 | $11,618 |
| Total held to maturity securities | $4,078 | $5,304 | $11,618 |

The securities portfolio contained no high-risk securities or derivatives as of December 31, 2018.

The contractual maturity distribution and weighted average yield of our available for sale securities at December 31, 2018, are summarized in the following table. Securities available for sale are carried at amortized cost in the table for purposes of calculating the weighted average yield received on such securities. Weighted average yield is calculated by dividing income within each maturity range by the outstanding amount of the related investment and has not been tax-effected on the tax-exempt obligations.

| | Due under 1 Year | | Due 1-5 Years | | Due 5-10 Years | | Due over 10 Years | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| Available for sale: | | | | | | | | |
| U.S. Government agencies | $ — | —% | $— | — % | $11,395 | 2.90% | $13,766 | 2.92% |
| U.S. Government sponsored agencies | — | —% | — | — % | — | — % | 20,404 | 2.63% |
| State and political subdivisions | — | —% | — | — % | 3,802 | 3.043.08% | 56,655 | 2.87% |
| Mortgage-backed securities - | | | | | | | | |
| U.S. government-sponsored enterprises | — | —% | 7,500 | 2.40% | 17,264 | 2.80% | 49,906 | 3.06% |
| Corporate debt | — | —% | — | — % | 3,000 | 5.42% | — | — % |
| Total Available for Sale | $ — | —% | $7,500 | 2.40% | $35,461 | 3.08% | $140,731 | 2.91% |

The contractual maturity distribution and weighted average yield of our securities held to maturity, at cost, at December 31, 2018, are summarized in the following table. Weighted average yield is calculated by dividing income within each maturity range by the outstanding amount of the related investment and has not been tax-effected on the tax-exempt obligations.

| | Due under 1 Year | | Due 1-5 Years | | Due 5-10 Years | | Due over 10 Years | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| Held to maturity: | | | | | | | | |
| State and political subdivisions | $1,279 | 2.62% | $251 | 2.00% | $2,548 | 3.12% | $ — | —% |
| Total held to maturity | $1,279 | 2.62% | $251 | 2.00% | $2,548 | 3.12% | $ — | —% |

We held $11.8 million in Other Bank Stock, primarily Federal Home Loan Bank of New York (“FHLBNY”) stock at December 31, 2018 that we do not consider an investment security. Ownership of this restricted stock is required for membership in the FHLBNY.

Loans. The loan portfolio comprises the largest component of our earning assets. Total loans receivable, net of unearned income, at December 31, 2018, increased $654.1 million, or 79.7%, to $1.5 billion from $820.7 million at December 31, 2017. Loan growth for 2018 occurred primarily in commercial real estate loans (an increase of $327.0 million, or 59.3%) and residential real estate loans (an increase of $199.1 million, or 115.9%) which were driven largely by the mergers with Community and Enterprise. In 2018, at each acquisition date, the Company acquired $236.0 million in loans resulting from the merger with Community and $257.2 million in loans resulting from the merger with Enterprise.

The following table summarizes the composition of our loan portfolio by type as of December 31, 2014 through 2018:

| | December 31, | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Commercial and industrial | $81,709 | $54,759 | $40,280 | $20,023 | $20,549 |
| Construction | 142,321 | 42,484 | 25,360 | 13,348 | 12,379 |
| Commercial real estate | 878,449 | 551,445 | 479,227 | 382,262 | 326,370 |
| Residential real estate | 370,955 | 171,844 | 150,237 | 127,204 | 111,498 |
| Consumer and other loans | 2,393 | 1,130 | 1,038 | 1,253 | 1,665 |

| | | | | | |
|---|---|---|---|---|---|
| Total gross loans | $1,475,827 | $821,662 | $696,142 | $544,090 | $472,461 |

The increase in loans was largely driven by the mergers with Community and Enterprise. Organic loan growth of $161.0 million was primarily funded during 2018 by an increase in our deposits and borrowings.

The maturity ranges of the loan portfolio and the amounts of loans with predetermined interest rates and floating rates in each maturity range, as of December 31, 2018, are presented in the following table.