

1ST CONSTITUTION BANCORP

Form 10-K

April 15, 2008

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file Number: 000-32891

1ST CONSTITUTION BANCORP  
(Exact Name of Registrant as Specified in Its Charter)

New Jersey  
(State or Other Jurisdiction of  
Incorporation or Organization)

22-3665653  
IRS Employer Identification Number)

2650 Route 130, P.O. Box 634, Cranbury, NJ 08512  
(Address of Principal Executive Offices, including Zip  
Code)

(609) 655-4500  
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Common Stock, No Par Value

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Stock Purchase Rights Relating to Common Stock, No Par Value  
(Title of Class)

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 15(d) of the Act. Yes ☐ No ☒

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

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

---

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

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant’s common stock held by non-affiliates of the registrant, computed by reference to the price at which the common stock was last sold, or the average bid and asked price of such common stock, as of the last business day of the registrant’s most recently completed second quarter, is \$57,045,025.

As of March 25, 2008, 3,992,715 shares of the registrant’s common stock were outstanding.

Portions of the registrant’s definitive Proxy Statement for its 2008 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.

---

## FORM 10-K

## TABLE OF CONTENTS

EXPLANATORY NOTE	ii
PART I	
Item 1.	Business 1
Item 1A.	Risk Factors 10
Item 1B.	Unresolved Staff Comments 13
Item 2.	Properties 13
Item 3.	Legal Proceedings 14
Item 4.	Submission of Matters to a Vote of Security Holders 14
PART II	
Item 5.	Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities 14
Item 6.	Selected Financial Data 15
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operation 15
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk 63
Item 8.	Financial Statements and Supplementary Data 63
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure 63
Item 9A.	Controls and Procedures 64
Item 9B.	Other Information 66
PART III	
Item 10.	Directors, Executive Officers and Corporate Governance 66
Item 11.	Executive Compensation 66
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters 66
Item 13.	Certain Relationships and Related Transactions, and Director Independence 67
Item 14.	Principal Accounting Fees and Services 67
PART IV	
Item 15.	Exhibits and Financial Statement Schedules 68
SIGNATURES	72

ANNUAL REPORT ON FORM 10-K  
For the fiscal year ended December 31, 2007  
EXPLANATORY NOTE

In this Form 10-K, we are restating our consolidated balance sheet as of December 31, 2006, and the related consolidated statement of operations, shareholders' equity and cash flows for the year ended December 31, 2006, including the applicable notes. We have also included in this report restated unaudited consolidated financial information for each of the first three quarters of 2007 and the four quarters of 2006.

We do not plan to file an amendment to our Annual Report on Form 10-K for the year ended December 31, 2006. Nor do we plan to file amendments to our Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, June 30, and September 30, 2007 and 2006, respectively. Thus, you should not rely on any of the previously filed annual or quarterly reports relating to the foregoing periods. They are superseded by this report.

For more detailed information about the restatement, please see Note 2, "Restatement of Consolidated Financial Statements For the Year Ended and As At December 31, 2006" and Note 24, "Unaudited Quarterly Financial Statements and Restatement of Interim Financial Statements" in the accompanying consolidated financial statements and "Restatement of Previously Issued Financial Results" in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of this Annual Report on Form 10-K.

In addition, management has determined that we had material weaknesses in our internal control over financial reporting relating to quantifying and reporting current tax liabilities and deferred tax assets, failure to document and properly evaluate certain non-interest operating expenses and failure to accurately estimate accruals related to the Company's Supplemental Executive Retirement Plan. As described in more detail in Item 9A of this Annual Report, we have identified the causes of these material weaknesses and are implementing measures designed to remedy them.

## Forward-Looking Statements

This Annual Report on Form 10-K contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 relating to, without limitation, our future economic performance, plans and objectives for future operations, and projections of revenues and other financial items that are based on our beliefs, as well as assumptions made by and information currently available to us. The words “may,” “will,” “anticipate,” “should,” “would,” “believe,” “contemplate,” “could,” “project,” “predict,” “expect,” “estimate,” “continue,” and “intend,” as well as other similar expressions of the future, are intended to identify forward-looking statements.

These forward-looking statements generally relate to our plans, objectives and expectations for future events and include statements about our expectations, beliefs, plans, objectives, intentions, assumptions and other statements that are not historical facts. These statements are based upon our opinions and estimates as of the date they are made. Although we believe that the expectations reflected in these forward-looking statements are reasonable, such forward-looking statements are subject to known and unknown risks and uncertainties that may be beyond our control, which could cause actual results, performance and achievements to differ materially from results, performance and achievements projected, expected, expressed or implied by the forward-looking statements.

Examples of events that could cause actual results to differ materially from historical results or those anticipated, expressed or implied include, without limitation, changes in the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in accounting, tax or regulatory practices and requirements; changes in deposit flows, loan demand or real estate values; legislation or regulatory changes; changes in loan delinquency rates or in our levels of non-performing assets; and changes in the economic climate in the market areas in which we operate; and the economic impact of any future terrorist threats and attacks, acts of war or threats thereof and the response of the United States to any such threats and attacks. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on profitability.

Additional information concerning the factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Item 1. “Business”, Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, and elsewhere in this Annual Report on Form 10-K and in our other filings with the Securities and Exchange Commission (the “SEC”). We undertake no obligation to publicly revise any forward-looking statements or cautionary factors, except as required by law.

## PART I

### Item 1. Business.

#### 1st Constitution Bancorp

1st Constitution Bancorp (the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of 1st Constitution Bank (the “Bank”) and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. The Bank is a wholly-owned subsidiary of the Company. Other than its investment in the Bank, the Company currently conducts no other significant business activities.

The main office of the Company and the Bank is located at 2650 Route 130 North, Cranbury, New Jersey 08512, and the telephone number is (609) 655-4500.

1st Constitution Bank

The Bank, a commercial bank formed under the laws of the State of New Jersey, engages in the business of commercial and retail banking. As a community bank, the Bank offers a wide range of services (including demand, savings and time deposits and commercial and consumer/installment loans) to individuals, small businesses and not-for-profit organizations principally in Middlesex, Mercer and Somerset Counties, New Jersey. The Bank conducts its operations through its main office located in Cranbury, New Jersey, and operates ten additional branch offices in downtown Cranbury, Hamilton Square, Hightstown, Jamesburg, Montgomery, Perth Amboy, Plainsboro, West Windsor, Fort Lee and Princeton, New Jersey. The Bank's deposits are insured up to applicable legal limits by the Federal Deposit Insurance Corporation ("FDIC").

Management efforts focus on positioning the Bank to meet the financial needs of the communities in Middlesex, Mercer and Somerset Counties and the Fort Lee area of Bergen County and to provide financial services to individuals, families, institutions and small businesses. To achieve this goal, the Bank is focusing its efforts on:

- personal service;
- expansion of its branch network;
- innovative product offerings; and
- technological advances and e-commerce.

#### Personal Service

The Bank provides a wide range of commercial and consumer banking services to individuals, families, institutions and small businesses in central New Jersey and the Fort Lee area of Bergen County. The Bank's focus is to understand the needs of the community and the customers and tailor products, services and advice to meet those needs. The Bank seeks to provide a high level of personalized banking services, emphasizing quick and flexible responses to customer demands.

#### Expansion of Branch Banking

The Bank continually evaluates opportunities for branch bank expansion, either mini branches or full service banks, to continue to grow and meet the needs of the community. During the first quarter of 2007, the Bank completed its acquisition of the Hightstown, New Jersey branch of another financial institution. During the third quarter of 2006, the Bank relocated its Plainsboro branch office from 10 Schalks Crossing Road to 11 Schalks Crossing Road and opened a new branch office at 180 Main Street, Fort Lee, Bergen County, New Jersey.

#### Innovative Product Offerings

In the fourth quarter of 2006, the Bank launched its new EZ Deposit service. This new product allows customers of the Bank to scan checks, using a scanning device furnished by the Bank, at the customer's place of business and transmit them directly to the Bank for deposit into the customer's account. The Check 21 Act allows for the creation of Image Replacement Documents ("IRD") that are the legal equivalent of the original check. Therefore, the check images captured at customer locations are sent electronically to the Bank and customers can reduce the number of trips to the Bank, as deposits are made directly from their place of business to the Bank. The service also has a later deposit time cutoff than branch locations and this allows customers to process deposits and have them posted the same day rather than the following business day.

By the end of 2007, there were 51 EZ Deposit customers using the service and a number of customers requesting the service in 2008. Management believes that there is great customer acceptance of this service and that the demand for this service will be strong in 2008.

#### Technological Advances and e-Commerce

The Bank recognizes that customers want to receive service via their most convenient delivery channel, be it the traditional branch office, by telephone, ATM, or the internet. For this reason, the Bank continues to enhance its e-commerce capabilities. At [www.1stconstitution.com](http://www.1stconstitution.com), customers have easy access to online banking, including account access, and to the Bank's bill payment system. Consumers can apply online for loans and interact with senior



management through the e-mail system. Business customers have access to cash management information and transaction capability through the Bank's online Business Express product offering. This overall expansion in electronic banking offers the Bank's customers another means to access the Bank's services easily and at their own convenience.

## Competition

The Bank experiences substantial competition in attracting and retaining deposits and in making loans. In attracting deposits and borrowers, the Bank competes with commercial banks, savings banks, and savings and loan associations, as well as regional and national insurance companies and non-bank financial institutions, regulated small loan companies and local credit unions, regional and national issuers of money market funds and corporate and government borrowers. Within the direct market area of the Bank, there are a significant number of offices of competing financial institutions. In New Jersey generally, and in the Bank's local market specifically, large commercial banks, as well as savings banks and savings and loan associations, including Provident Savings Bank and Hudson City Savings Bank, hold a dominant market share and there has been significant merger activity in the last few years, creating even larger competitors.

Locally, the Bank's most direct competitors include Bank of America, PNC Bank, Wachovia Bank, and Sovereign Bank. The Bank is at a competitive disadvantage compared with these larger national and regional commercial and savings banks. By virtue of their larger capital, asset size or reserves, many of such institutions have substantially greater lending limits (ceilings on the amount of credit a bank may provide to a single customer that are linked to the institution's capital) and other resources than the Bank. Many such institutions are empowered to offer a wider range of services, including trust services, than the Bank and, in some cases, have lower funding costs (the price a bank must pay for deposits and other borrowed monies used to make loans to customers) than the Bank. In addition to having established deposit bases and loan portfolios, these institutions, particularly large national and regional commercial and savings banks, have the financial ability to finance extensive advertising campaigns and to allocate considerable resources to locations and products perceived as profitable.

In addition, non-bank financial institutions offer services that compete for deposits with the Bank. For example, brokerage firms and insurance companies offer such instruments as short-term money market funds, corporate and government securities funds, mutual funds and annuities. It is expected that competition in these areas will continue to increase. Some of these competitors are not subject to the same degree of regulation and supervision as the Company and the Bank and therefore may be able to offer customers more attractive products than the Bank.

However, management of the Bank believes that loans to small and mid-sized businesses and professionals, which represent the main commercial loan business of the Bank, are not always of primary importance to the larger banking institutions. The Bank competes for this segment of the market by providing responsive personalized services, local decision-making, and knowledge of its customers and their businesses.

## Lending Activities

The Bank's lending activities include both commercial and consumer loans. Loan originations are derived from a number of sources including real estate broker referrals, mortgage loan companies, direct solicitation by the Bank's loan officers, existing depositors and borrowers, builders, attorneys, walk-in customers and, in some instances, other lenders. The Bank has established disciplined and systematic procedures for approving and monitoring loans that vary depending on the size and nature of the loan.

## Commercial Lending

The Bank offers a variety of commercial loan services including term loans, lines of credit, and loans secured by equipment and receivables. A broad range of short-to-medium term commercial loans, both secured and unsecured, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition and development of real estate and improvements), and the purchase of equipment and machinery. The Bank also makes construction loans to real estate developers for the acquisition, development and

construction of residential subdivisions.

Commercial loans are granted based on the borrower's ability to generate cash flow to support its debt obligations and other cash related expenses. A borrower's ability to repay commercial loans is substantially dependent on the success of the business itself and on the quality of its management. As a general practice, the Bank takes as collateral a security interest in any available real estate, equipment, inventory, receivables or other personal property of its borrowers, although occasionally the Bank makes commercial loans on an unsecured basis. Generally, the Bank requires personal guaranties of its commercial loans to offset the risks associated with such loans.

## Residential Consumer Lending

A portion of the Bank's lending activities consists of the origination of fixed and adjustable rate residential first mortgage loans secured by owner-occupied property located in the Bank's primary market areas. Home mortgage lending is unique in that a broad geographic territory may be serviced by originators working from strategically placed offices either within the Bank's traditional banking facilities or from affordable storefront locations in commercial buildings. The Bank also offers construction loans, second mortgage home improvement loans and home equity lines of credit.

The Bank finances the construction of individual, owner-occupied houses on the basis of written underwriting and construction loan management guidelines. First mortgage construction loans are made to contractors secured by real estate that is both a pre-sold and a "speculation" basis. Such loans are also made to qualified individual borrowers and are generally supported by a take-out commitment from a permanent lender. The Bank makes residential construction loans to individuals who intend to erect owner occupied housing on a purchased parcel of real estate. The construction phase of these loans has certain risks, including the viability of the contractor, the contractor's ability to complete the project and changes in interest rates.

In most cases, the Bank will sell its mortgage loans with terms of 15 years or more in the secondary market. The sale to the secondary market allows the Bank to hedge against the interest rate risks related to such lending operations. This brokerage arrangement allows the Bank to accommodate its clients' demands while eliminating the interest rate risk for the 15- to 30- year period generally associated with such loans.

The Bank in most cases requires borrowers to obtain and maintain title, fire, and extended casualty insurance, and, where required by applicable regulations, flood insurance. The Bank maintains its own errors and omissions insurance policy to protect against loss in the event of failure of a mortgagor to pay premiums on fire and other hazard insurance policies. Mortgage loans originated by the Bank customarily include a "due on sale" clause, which gives the Bank the right to declare a loan immediately due and payable in certain circumstances, including, without limitation, upon the sale or other disposition by the borrower of the real property subject to a mortgage. In general, the Bank enforces due on sale clauses. Borrowers are typically permitted to refinance or repay loans at their option without penalty.

## Non-Residential Consumer Lending

Non-residential consumer loans made by the Bank include loans for automobiles, recreation vehicles, and boats, as well as personal loans (secured and unsecured) and deposit account secured loans. The Bank also conducts various indirect lending activities through established retail companies in its market areas. Non-residential consumer loans are attractive to the Bank because they typically have a shorter term and carry higher interest rates than are charged on other types of loans. Non-residential consumer loans, however, do pose additional risk of collectibility when compared to traditional types of loans, such as residential mortgage loans granted by commercial banks.

Consumer loans are granted based on employment and financial information solicited from prospective borrowers as well as credit records collected from various reporting agencies. Stability of the borrower, willingness to pay and credit history are the primary factors to be considered. The availability of collateral is also a factor considered in making such a loan. The Bank seeks collateral that can be assigned and has good marketability with a clearly adequate margin of value. The geographic area of the borrower is another consideration, with preference given to borrowers in the Bank's primary market areas.

## Supervision and Regulation

Banking is a complex, highly regulated industry. The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of monetary policy. In furtherance of those goals, Congress has created several largely autonomous regulatory agencies and enacted a myriad of legislation that governs banks, bank holding companies and the banking industry. This regulatory framework is intended primarily for the protection of depositors and not for the protection of the Company's shareholders. Descriptions of, and references to, the statutes and regulations below are brief summaries thereof, and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

## State and Federal Regulations

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the “BHCA”). As a bank holding company, the Company is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the BHCA. The Federal Reserve Board may also make examinations of the Company and its subsidiaries. The Company is subject to capital standards similar to, but separate from, those applicable to the Bank.

Under the BHCA, bank holding companies that are not financial holding companies generally may not acquire the ownership or control of more than 5% of the voting shares, or substantially all the assets, of any company, including a bank or another bank holding company, without the Federal Reserve Board’s prior approval. The Company has not applied to become a financial holding company but did obtain such approval to acquire the shares of the Bank. A bank holding company that does not qualify as a financial holding company is generally limited in the types of activities in which it may engage to those that the Federal Reserve Board had recognized as permissible for bank holding companies prior to the date of enactment of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999. For example, a holding company and its banking subsidiary are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or lease or sale of any property or the furnishing of services. At present, the Company does not engage in any significant activity other than owning the Bank.

In addition to federal bank holding company regulation, the Company is registered as a bank holding company with the New Jersey Department of Banking and Insurance (the “Department”). The Company is required to file with the Department copies of the reports it files with the federal banking and securities regulators.

## Capital Adequacy

The Company is required to comply with minimum capital adequacy standards established by the Federal Reserve Board. There are two basic measures of capital adequacy for bank holding companies and the depository institutions that they own: a risk based measure and a leverage measure. All applicable capital standards must be satisfied for a bank holding company to be considered in compliance.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) required each federal banking agency to revise its risk-based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of non-traditional activities. In addition, pursuant to FDICIA, each federal banking agency has promulgated regulations, specifying the levels at which a bank would be considered “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” or “critically undercapitalized,” and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution.

The regulations implementing these provisions of FDICIA provide that a bank will be classified as “well capitalized” if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) has a Tier 1 leverage ratio of at least 5.0 percent, and (iv) meets certain other requirements. A bank will be classified as “adequately capitalized” if it (i) has a total risk-based capital ratio of at least 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 4.0 percent, (iii) has a Tier 1 leverage ratio of (a) at least 4.0 percent, or (b) at least 3.0 percent if the institution was rated 1 in its most recent examination and is not experiencing or anticipating significant growth, and (iv) does not meet the definition of “well capitalized.” A bank will be classified as “undercapitalized” if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, or (iii) has a Tier 1 leverage ratio of (a) less than 4.0 percent, or (b) less than 3.0 percent if the institution was rated 1 in its most recent examination and is not experiencing or anticipating significant growth. A bank will be classified as “significantly undercapitalized” if it (i) has a total risk-based capital ratio of less than 6.0

percent, (ii) has a Tier 1 risk-based capital ratio of less than 3.0 percent, or (iii) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as “critically undercapitalized” if it has a tangible equity to total assets ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination.

As of December 31, 2007, the Bank’s capital ratios exceed the requirements to be considered a well capitalized institution under these regulations.

The risk-based capital guidelines for bank holding companies such as the Company currently require a minimum ratio of total capital to risk-weighted assets (including off-balance sheet activities, such as standby letters of credit) of 8%. At least half of the total capital is required to be Tier 1 capital, consisting principally of common shareholders' equity, non-cumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interest in the equity accounts of consolidated subsidiaries, less goodwill. The remainder of the total capital (Tier 2 capital) may consist of a limited amount of subordinated debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, perpetual preferred stock and a limited amount of the general loan loss allowance. At December 31, 2007, the Company maintained a Tier 1 capital ratio of 15.59% and total qualifying capital ratio of 17.76%.

In addition to the risk-based capital guidelines, the federal banking regulators established minimum leverage ratio (Tier 1 capital to total assets) guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a leverage ratio of at least 1% to 2% above the 3% stated minimum. The Company's leverage ratio at December 31, 2007 was 12.67%.

On April 10, 2002, 1st Constitution Capital Trust I ("Trust I"), a statutory business trust and a wholly owned subsidiary of the Company, issued \$5.0 million of variable rate trust preferred securities (the "Trust Preferred Securities") in a pooled institutional placement transaction maturing April 22, 2032. Trust I utilized the \$5.0 million proceeds along with \$155,000 invested in Trust I by the Company to purchase \$5,155,000 of floating rate subordinated debentures issued by the Company and due to mature on April 22, 2032 (the "Subordinated Debentures"). The Subordinated Debentures constituted the sole assets of Trust I, had terms that mirrored the Trust Preferred Securities and were redeemable in whole or part prior to maturity after April 22, 2007. Trust I was obligated to distribute all proceeds of a redemption of these Subordinated Debentures, whether voluntary or upon maturity, to holders of the Trust Preferred Securities. The Company's obligation with respect to the Trust Preferred Securities and the Subordinated Debentures, when taken together, provided a full and unconditional guarantee on a subordinated basis by the Company of the obligations of Trust I to pay amounts when due on the Trust Preferred Securities. On February 23, 2007, the Company notified Wilmington Trust Company, as Indenture Trustee, of the Company's intention to redeem the Subordinated Debentures on April 22, 2007, and the Company redeemed the Subordinated Debentures on that date, as discussed below.

On May 30, 2006, 1st Constitution Bancorp established 1st Constitution Capital Trust II, a Delaware business trust subsidiary ("Trust II"), for the sole purpose of issuing \$18 million of trust preferred securities (the "Capital Securities"). The Capital Securities were issued in connection with a pooled offering involving approximately 50 other financial institution holding companies. All of the Capital Securities were sold to a single pooling vehicle. The proceeds from the sale of the Capital Securities were loaned to the Company under 30-year floating rate junior subordinated debentures issued to Trust II by the Company. The debentures are the only asset of Trust II. Interest payments on the debentures flow through Trust II to the pooling vehicle. Payments of distributions by Trust II to the pooling vehicle are guaranteed by the Company.

Effective April 22, 2007, the Company redeemed all of the Subordinated Debentures. The redemption price was 100% of the aggregate \$5,155,000 principal amount of the Subordinated Debentures, plus approximately \$236,882 of accrued interest thereon through the redemption date. As a result of the redemption of the Subordinated Debentures, a like amount of capital securities issued by Trust I was redeemed under the same terms and conditions. This redemption does not impact the Capital Securities issued by Trust II on May 30, 2006.

#### Restrictions on Dividends



The primary source of cash to pay dividends, if any, to the Company's shareholders and to meet the Company's obligations is dividends paid to the Company by the Bank. Dividend payments by the Bank to the Company are subject to the New Jersey Banking Act of 1948 (the "Banking Act") and the Federal Deposit Insurance Act (the "FDIA"). Under the Banking Act and the FDIA, the Bank may not pay any dividends if after paying the dividend, it would be undercapitalized under applicable capital requirements. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the immediately preceding year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividend that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiary. A bank holding company may not pay dividends when it is insolvent.

The Company has never paid a cash dividend and the Company's Board of Directors has no plans to pay a cash dividend in the foreseeable future. The Bank paid a stock dividend every year from 1993 to 1999, when it was acquired by the Company. The Company has paid a stock dividend every year since its formation in 1999. From 1999 through 2006, the Company paid a 5% stock dividend each year. On December 21, 2006, the Company declared a 6% stock dividend, which was paid on January 31, 2007 to shareholders of record as of the close of business on January 23, 2007. On December 20, 2007, the Company declared another 6% stock dividend, which was paid on February 6, 2008 to shareholders of record as of the close of business on January 23, 2008. The Company also declared a two-for-one stock split on January 20, 2005, which was paid on February 28, 2005 to shareholders of record on February 10, 2005. All share and per share data has been retroactively adjusted for stock dividends.

#### Priority on Liquidation

The Company is a legal entity separate and distinct from the Bank. The rights of the Company as the sole shareholder of the Bank, and therefore the rights of the Company's creditors and shareholders, to participate in the distributions and earnings of the Bank when the Bank is not in bankruptcy, are subject to various state and federal law restrictions as discussed above under the heading "Restrictions of Dividends." In the event of a liquidation or other resolution of an insured depository institution such as the Bank, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of an obligation of the institution to its shareholders (the Company) or any shareholder or creditor of the Company. The claims on the Bank by creditors include obligations in respect of federal funds purchased and certain other borrowings, as well as deposit liabilities.

#### Financial Institution Legislation

The Gramm-Leach-Bliley Financial Modernization Act of 1999 (the "Modernization Act") became effective in early 2000. The Modernization Act:

- allows bank holding companies meeting management, capital and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than is permissible for a bank holding company, including insurance underwriting and making merchant banking investments in commercial and financial companies; if a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals;
- allows banks to establish subsidiaries to engage in certain activities which a financial holding company could engage in, if the bank meets certain management, capital and Community Reinvestment Act standards;
- allows insurers and other financial services companies to acquire banks and removes various restrictions that currently apply to bank holding company ownership of securities firms and mutual fund advisory companies; and establishes the overall regulatory structure applicable to financial holding companies that also engage in insurance and securities operations.

The Modernization Act modified other financial laws, including laws related to financial privacy and community reinvestment.

The Modernization Act also amends the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

Additional proposals to change the laws and regulations governing the banking and financial services industry are frequently introduced in Congress, in the state legislatures and before the various bank regulatory agencies. The likelihood and timing of any such changes and the impact such changes might have on the Company cannot be determined at this time.

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”), which became law on July 30, 2002, added new legal requirements affecting corporate governance, accounting and corporate reporting for companies with publicly traded securities.

The Sarbanes-Oxley Act provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O);
  - independence requirements for audit committee members;
- disclosure of whether at least one member of the audit committee is a “financial expert” (as such term is defined by the SEC) and if not, why not;
  - independence requirements for outside auditors;
- a prohibition by a company’s registered public accounting firm from performing statutorily mandated audit services for the company if the company’s chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date;
- certification of financial statements and annual and quarterly reports by the principal executive officer and the principal financial officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement due to corporate misconduct;
  - disclosure of off-balance sheet transactions;
- two-business day filing requirements for insiders filing Forms 4;
- disclosure of a code of ethics for financial officers and filing a Form 8-K for a change or waiver of such code;
  - “real time” filing of periodic reports;
- posting of certain SEC filings and other information on the company website;
- the reporting of securities violations “up the ladder” by both in-house and outside attorneys;
  - restrictions on the use of non-GAAP financial measures;
  - the formation of a public accounting oversight board; and
- various increased criminal penalties for violations of securities laws.

Additionally, Section 404 of the Sarbanes-Oxley Act requires that a public company subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), include in its annual report (i) a management’s report on internal control over financial reporting assessing the company’s internal controls, and (ii) an

auditor's attestation report, completed by the registered public accounting firm that prepares or issues an accountant's report which is included in the company's annual report, attesting to the effectiveness of management's internal control assessment. Because we are neither a "large accelerated filer" nor an "accelerated filer", under current rules we are not required to provide management's report on internal control over financial reporting until we file our annual report for 2007, and compliance with the auditor's attestation report requirement is not required until we file our annual report for 2008.

Each of the national stock exchanges, including the Nasdaq Global Market where the Company's common stock is listed, have implemented new corporate governance rules, including rules strengthening director independence requirements for boards, and the adoption of charters for the nominating, corporate governance, and audit committees. The rule changes are intended to, among other things, make the board of directors independent of management and allow shareholders to more easily and efficiently monitor the performance of companies and directors. These increased burdens have increased the Company's legal and accounting fees and the amount of time that the Board of Directors and management must devote to corporate governance issues.

Effective August 29, 2002, as directed by Section 302(a) of Sarbanes-Oxley, the Company's principal executive officer and principal financial officer are each required to certify that the Company's Quarterly and Annual Reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls; they have made certain disclosures to the Company's auditors and the audit committee of the Board of Directors about the Company's internal controls; and they have included information in the Company's Quarterly and Annual Reports about their evaluation and whether there have been significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation.

As part of the USA Patriot Act, signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "Act"). The Act authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the Act expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

The Department of Treasury has issued regulations implementing the due diligence requirements. These regulations require minimum standards to verify customer identity and maintain accurate records, encourages cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibits the anonymous use of "concentration accounts," and requires all covered financial institutions to have in place an anti-money laundering compliance program.

The Bank, a New Jersey-chartered commercial bank, is subject to supervision and examination by the New Jersey Department of Banking and Insurance. The Bank is also subject to regulation by the FDIC, which is its principal federal bank regulator.

The Bank must comply with various requirements and restrictions under federal and state law, including the maintenance of reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that may be charged thereon, limitations on the types of investments that may be made and the services that may be offered, and restrictions on dividends as described in the preceding section. Consumer laws and regulations also affect the operations of the Bank. In addition to the impact of regulation, commercial banks are affected significantly by the actions of the Federal Reserve Board which influence the money supply and credit availability in the national economy.



### Community Reinvestment Act

Under the Community Reinvestment Act (“CRA”), as implemented by FDIC regulations, a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. 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 CRA. CRA requires the FDIC to assess an institution’s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by the applicable institution. The CRA requires public disclosure of an institution’s CRA rating and requires that the FDIC provide a written evaluation of an institution’s CRA performance utilizing a four-tiered descriptive rating system. An institution’s CRA rating is considered in determining whether to grant charters, branches and other deposit facilities, relocations, mergers, consolidations and acquisitions. Performance less than satisfactory may be the basis for denying an application. At its last CRA examination, the Bank was rated “satisfactory” under CRA.

### FIRREA

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”), a depository institution insured by the FDIC can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. These provisions have commonly been referred to as FIRREA’s “cross guarantee” provisions. Further, under FIRREA, the failure to meet capital guidelines could subject a bank to a variety of enforcement remedies available to federal regulatory authorities.

FIRREA also imposes certain independent appraisal requirements upon a bank’s real estate lending activities and further imposes certain loan-to-value restrictions on a bank’s real estate lending activities. The bank regulators have promulgated regulations in these areas.

### Insurance of Deposits

The Bank’s deposits are insured up to a maximum of \$100,000 per depositor under the Deposit Insurance Fund. The FDICIA is applicable to depository institutions and deposit insurance. The FDICIA requires the FDIC to establish a risk-based assessment system for all insured depository institutions. Under this legislation, the FDIC is required to establish an insurance premium assessment system based upon: (i) the probability that the insurance fund will incur a loss with respect to the institution, (ii) the likely amount of the loss, and (iii) the revenue needs of the insurance fund. In compliance with this mandate, the FDIC has developed a matrix that sets the assessment premium for a particular institution in accordance with its capital level and overall rating by the primary regulator. Under the matrix as currently in effect, the assessment rate ranges from 0 to 27 basis points of assessed deposits. The Bank is also subject to a quarterly FICO assessment.

### Employees

The Company has two paid employees. Banking operations are conducted by the Bank, and as of December 31, 2007, the Bank had 100 full-time employees and 12 part-time employees. Neither the Bank’s nor the Company’s employees are represented by any collective bargaining group. The Bank and the Company each considers its relations with such employees to be good.

### Item 1A. Risk Factors.



The common stock of the Company is speculative in nature and involves a significant degree of risk. The risk factors below are not listed in order of importance.

The Company faces significant competition.

The Company faces significant competition from many other banks, savings institutions and other financial institutions which have branch offices or otherwise operate in the Company's market area. Non-bank financial institutions, such as securities brokerage firms, insurance companies and money market funds, engage in activities which compete directly with traditional bank business, which has also led to greater competition. Many of these competitors have substantially greater financial resources than the Company, including larger capital bases that allow them to attract customers seeking larger loans than the Company is able to accommodate and the ability to aggressively advertise their products. There can be no assurance that the Company and the Bank will be able to successfully compete with these entities in the future. See "BUSINESS -- Competition."

The Company's business is affected by economic conditions and related uncertainties.

Commercial banking is affected, directly and indirectly, by local, domestic, and international economic and political conditions, and by government monetary and fiscal policies. Conditions such as inflation, recession, unemployment, volatile interest rates, tight money supply, scarce natural resources, real estate values, international conflicts and other factors beyond the control of the Company may adversely affect the potential profitability of the Company. A downtrend in several areas, such as real estate, construction and consumer spending, could have a material adverse impact on the Company's ability to maintain or increase profitability.

The Company is subject to interest rate risk.

The Company's earnings are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

The Company is subject to risks associated with speculative construction lending.

The risks associated with speculative construction lending include the borrower's inability to complete the construction process on time and within budget, the sale of the project within projected absorption periods, the economic risks associated with real estate collateral, and the potential of a rising interest rate environment. Such loans may include financing the development and/or construction of residential subdivisions. This activity may involve financing land purchase, infrastructure development (i.e. roads, utilities, etc.), as well as construction of residences or multi-family dwellings for subsequent sale by developer/builder. Because the sale of developed properties is integral to the success of developer business, loan repayment may be especially subject to the volatility of real estate market values. Management has established underwriting and monitoring criteria to minimize the inherent risks of speculative commercial real estate construction lending. Further, management concentrates lending efforts with developers demonstrating successful performance on marketable projects within the Bank's lending areas.

Federal and state government regulation impact the Company's operations.

The operations of the Company and the Bank are heavily regulated and will be affected by present and future legislation and by the policies established from time to time by various federal and state regulatory authorities. In particular, the monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future. Among the instruments of monetary policy used

by the Federal Reserve Board to implement its objectives is changes in the discount rate charged on bank borrowings. It is not possible to predict what changes, if any, will be made to the monetary policies of the Federal Reserve Board or to existing federal and state legislation or the effect that such changes may have on the future business and earnings prospects of the Company.

The Company and the Bank are subject to examination, supervision and comprehensive regulation by various federal and state agencies. Compliance with the rules and regulations of these agencies may be costly and may limit growth and restrict certain activities, including payment of dividends, investments, loans and interest rate charges, interest rates paid on deposits, and locations of offices. The Bank is also subject to capitalization guidelines set forth in federal legislation. See “BUSINESS -- Supervision and Regulation.”

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the impact of these changes on our business and profitability. Because government regulation greatly effects the business and financial results of all commercial banks and bank holding companies, the cost of compliance could adversely affect the Company’s ability to operate profitably.

If economic conditions deteriorate, particularly in the Bank’s market area, our results of operations and financial condition could be adversely affected as borrowers’ ability to repay loans declines and the value of the collateral securing our loans decreases.

Our financial results may be adversely affected by changes in prevailing economic conditions, particularly in the Bank’s market area, including decreases in real estate values, changes in interest rates which may cause a decrease in interest rate spreads, adverse employment conditions, the monetary and fiscal policies of the federal government and other significant external events.

Decreases in local real estate values would adversely affect the value of property used as collateral for our loans. Adverse changes in the economy also may have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease.

We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loss and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance. Material additions to our allowance would materially decrease our net income.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities might have a material adverse effect on our financial condition and results of operations.

We have significant investments in mortgage-backed securities and securities of this kind may be subject to deterioration in value in certain market conditions.

The Company owned as of December 31, 2007 \$80,876,181 in collateralized mortgages and mortgage-backed securities. Several financial institutions have reported significant write-downs of the value of mortgage related securities. Certain of these types of securities may also not be marketable except at significant discounts. While management of the Company is as of the date of this report unaware of any material exposures in its portfolio of these securities, market conditions could further deteriorate and result in the recognition of losses in the value of these securities.

We had a material weakness in our internal control over financial reporting as of December 31, 2007, and we cannot assure that we have developed an effective remediation plan.

We have identified deficiencies in our internal control over financial reporting and have developed a plan to remediate such deficiencies. We cannot assure you that such plan will adequately address these deficiencies or that we have discovered all of the deficiencies that may exist in our internal control over financial reporting.

## Item 1B. Unresolved Staff Comments

Not applicable.

## Item 2. Properties.

The following table provides certain information with respect to our eleven banking offices as of December 31, 2007:

Location	Leased or Owned	Original Year Leased or Acquired	Year of Lease Expiration
Main Office 2650 Route 130 Cranbury, New Jersey	Leased	1989	2010
Village Office 74 North Main Street Cranbury, New Jersey	Owned	2005	
Montgomery Office 947 State Road Princeton, New Jersey	Leased	1995	2010
Plainsboro Office Plainsboro Village Center 11 Shalks Crossing Road Plainsboro, New Jersey	Leased	1998	2021
Hamilton Office 3659 Nottingham Way Hamilton, New Jersey	Leased	1999	2014
Princeton Office The Windrows at Princeton Forrestal 200 Windrow Drive Princeton, New Jersey	Leased	2001	2011
Perth Amboy Office 145 Fayette Street Perth Amboy, New Jersey	Leased	2003	2015
Jamesburg Office 1 Harrison Street Jamesburg, New Jersey	Owned	2002	
West Windsor Office 44 Washington Road Princeton Jct, New Jersey	Leased	2004	2019

Fort Lee Office 180 Main Street Fort Lee, New Jersey	Leased	2006	2014
--	--------	------	------

Hightstown Office 140 Mercer Street Hightstown, New Jersey	Leased	2007	2009
--	--------	------	------

Management believes the foregoing facilities are suitable for the Company's and the Bank's present and projected operations.

## Item 3. Legal Proceedings.

The Company may, in the ordinary course of business, become a party to litigation involving collection matters, contract claims and other legal proceedings relating to the conduct of its business. The Company may also have various commitments and contingent liabilities which are not reflected in the accompanying consolidated statement of condition. Management is not aware of any present legal proceedings or contingent liabilities and commitments that would have a material impact on the Company's financial position or results of operations.

## Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of the Company's shareholders during the fourth quarter of the fiscal year ended December 31, 2007.

## PART II

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

The common stock of the Company trades on the Nasdaq Global Market under the trading symbol "FCCY". The following are the high and low sales prices per share for 2007 and 2006, as reported on the Nasdaq Global Market.

	2007			2006		
		High	Low		High	Low
First Quarter	\$	18.25	\$ 16.06 (1)	\$	18.64	\$ 15.26 (1)
Second Quarter	\$	17.59	\$ 15.92 (1)	\$	17.58	\$ 15.55 (1)
Third Quarter	\$	16.76	\$ 13.73 (1)	\$	16.91	\$ 15.30 (1)
Fourth Quarter	\$	15.64	\$ 13.25 (1)	\$	17.77	\$ 15.58 (1)

(1) Prices have been retroactively adjusted for the 6% stock dividend declared December 20, 2007 and paid February 6, 2008 to shareholders of record on January 23, 2008.

As of March 25, 2008, there were approximately 331 record holders of the Company's common stock.

The Company paid a 6% stock dividend on February 6, 2008 and January 31, 2007 and a 5% dividend on January 31, 2006. The Company has never paid a cash dividend and there are no plans to pay a cash dividend at this time. All per share data has been retroactively adjusted for stock dividends. The Company will retain its earnings in order to provide capital for growth of the Bank.



## Issuer Purchases of Equity Securities

In 2005, the Board of Directors authorized a stock repurchase program under which the Company may repurchase in open market or privately negotiated transactions up to 5% of its common shares outstanding at that date. The Company undertook this repurchase program in order to increase shareholder value. The following table provides common stock repurchases made by or on behalf of the Company during the three months ended December 31, 2007.

## Issuer Purchases of Equity Securities (1)

Period		Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet be Purchased Under the Plan or Program
Beginning	Ending				
October 1, 2007	October 31, 2007	-	-	-	161,430
November 1, 2007	November 30, 2007	400	\$ 15.70	400	161,030
December 1, 2007	December 31, 2007	-	-	-	161,030
Total		400	\$ 15.70	400	161,030

(1) The Company's common stock repurchase program covers a maximum of 185,787 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on July 21, 2005, as adjusted for the 6% stock dividend declared December 21, 2006 and paid January 31, 2007 and the 6% stock dividend declared December 20, 2007 and paid February 6, 2008.

## Item 6. Selected Financial Data.

Not required.

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

This discussion should be read in conjunction with the consolidated financial statements, notes and tables included elsewhere in this report. Throughout the following sections, the "Company" refers to 1st Constitution Bancorp and its wholly owned subsidiaries, 1st Constitution Bank, 1st Constitution Capital Trust I, and 1st Constitution Capital Trust II, the "Bank" refers to 1st Constitution Bank, and the "Trusts" refers to 1st Constitution Capital Trust I and 1st Constitution Capital Trust II, collectively. The purpose of this discussion and analysis is to assist in the understanding and evaluation of the Company's financial condition, changes in financial condition and results of operations.

## Restatement of Previously Issued Financial Results

The Company is restating its consolidated balance sheet as of December 31, 2006, and the related consolidated statement of operations, shareholders' equity and cash flows for the year ended December 31, 2006, including the applicable notes, as well as its unaudited consolidated financial information for each of the first three quarters of 2007 and the four quarters of 2006. For more information about the restatement, please see the Explanatory Note to this

report and Note 2, “Restatement of Consolidated Financial Statements For the Year Ended and As At December 31, 2006” and Note 24, “Unaudited Quarterly Financial Statements and Restatement of Interim Financial Statements” in the accompanying consolidated financial statements.

The following discussion and analysis of the Company’s financial condition and results of operations incorporate the restated amounts.

## Critical Accounting Policies and Estimates

“Management’s Discussion and Analysis of Financial Condition and Results of Operation” is based upon the Company’s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Company’s Consolidated Financial Statements for the year ended December 31, 2007 contains a summary of the Company’s significant accounting policies. Management believes the Company’s policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical policy and its application is periodically reviewed with the Audit Committee and the Board of Directors. The provision for loan losses is based upon management’s evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectibility may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available to it, the level of the allowance for loan losses remains an estimate which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Company’s loans are secured by real estate in the State of New Jersey. Accordingly, the collectibility of a substantial portion of the carrying value of the Company’s loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or the Central New Jersey area experience an adverse economic shock. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Company’s control.

## Results of Operations

The Company reported net income for the 12 months ended December 31, 2007 of \$5,442,782, an increase of 15.2% from the \$4,724,962 reported for the 12 months ended December 31, 2006. Diluted net income per share was \$1.35 for the year ended December 31, 2007 compared to \$1.18 reported for the year ended December 31, 2006. Basic net income per share for the year ended December 31, 2007 was \$1.37 as compared to the \$1.21 reported for the year ended December 31, 2006. All share information has been restated for the effect of a 6% stock dividend declared on December 20, 2007 and paid on February 6, 2008 to shareholders of record on January 23, 2008.

Key performance ratios remained strong for the 2007 fiscal year as compared to the prior year. Return on average assets (“ROA”) and return on average equity (“ROE”) were 1.29% and 14.32%, respectively, for the year ended December 31, 2007, compared to 1.24% and 14.73%, respectively, for the year ended December 31, 2006.

The Company’s earnings for the 2007 fiscal year reflect continuing momentum across a broad range of product and service offerings. Increased lending activity, coupled with increases in deposits through branch network expansion and secondary market loan sales volume, as well as a reduction in the provision for loan losses in 2007 versus 2006, fueled both the record earnings and balance sheet growth.

Management believes that the Company has positioned itself for continued success with the combination of a strong capital base, a commitment to provide exceptional customer service, and a commitment to maintain the technology necessary to provide its customers with easy access to the financial products and services offered by the Bank.

## Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 87.4% of the Company's net revenues for the year ended December 31, 2007. Net interest income also depends upon the relative amount of interest earning assets, interest-bearing liabilities, and the interest rate earned or paid on them.

The following tables set forth the Company's consolidated average balances of assets and liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the years ended December 31, 2007 and 2006. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

#### Average Balance Sheets with Resultant Interest and Rates

(yields on a tax-equivalent basis)

	2007			2006		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets:</b>						
<b>Federal Funds Sold/Short-Term</b>						
Investments	\$ 1,653,896	\$ 101,171	6.12%	\$ 1,457,568	\$ 85,012	5.14%
<b>Investment Securities:</b>						
Collateralized Mortgage Obligations / Mortgage Backed Securities	80,876,181	4,278,288	5.29%	70,048,748	3,448,780	4.92%
Obligations of States and Political Subdivisions (4)	22,968,401	1,296,032	5.64%	16,198,497	895,172	5.53%
<b>Total</b>	<b>103,844,582</b>	<b>5,574,320</b>	<b>5.37%</b>	<b>86,247,245</b>	<b>4,343,952</b>	<b>5.04%</b>
<b>Loan Portfolio:</b>						
Construction	129,285,776	11,486,944	8.88%	125,022,769	11,129,600	8.90%
Residential Real Estate	8,878,427	657,928	7.41%	8,072,109	517,146	6.41%
Commercial and Commercial Real Estate	117,463,693	9,140,142	7.78%	99,521,245	7,706,864	7.74%
Installment	1,542,082	129,483	8.40%	2,013,438	167,126	8.30%
All Other Loans	35,201,373	3,698,990	10.51%	37,111,086	3,645,808	9.82%
<b>Total (1)</b>	<b>292,371,351</b>	<b>25,113,487</b>	<b>8.59%</b>	<b>271,740,647</b>	<b>23,166,544</b>	<b>8.53%</b>
<b>Total Interest-Earning Assets</b>	<b>397,869,829</b>	<b>30,788,978</b>	<b>7.74%</b>	<b>359,445,460</b>	<b>27,595,508</b>	<b>7.68%</b>
Allowance for Loan Losses	(3,270,810)			(2,662,370)		
Cash and Due From Banks	10,254,911			9,391,415		
Other Assets	17,648,099			15,422,593		
<b>Total Assets</b>	<b>\$ 422,502,029</b>			<b>\$ 381,597,098</b>		
<b>Liabilities and Shareholders' Equity:</b>						
<b>Interest-Bearing Liabilities:</b>						
Money Market and NOW Accounts	\$ 83,597,940	\$ 1,737,487	2.08%	\$ 87,135,125	\$ 1,455,755	1.67%
Savings Accounts	64,408,442	2,017,580	3.13%	44,867,384	939,324	2.09%
Certificates of Deposit	67,236,813	3,170,322	4.72%	58,183,657	2,907,883	5.00%
Certificates of Deposit of \$100,000 and Over	54,252,087	2,711,467	5.00%	43,870,647	1,385,119	3.16%
Other Borrowed Funds	29,580,685	1,514,907	5.12%	32,539,699	1,687,749	5.19%

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Trust Preferred Securities	19,534,247	1,438,876	7.37%	14,863,014	1,141,667	7.68%	5,000,000
Total Interest-Bearing Liabilities	318,610,214	12,590,639	3.95%	281,459,526	9,517,497	3.38%	257,959,029
Net Interest Spread (2)			3.79%			4.30%	
Non-interest Bearing							
Demand Deposits	60,892,433			63,040,519			57,792,900
Other Liabilities	4,989,809			5,013,813			3,447,500
Total Liabilities	384,492,456			349,513,858			319,199,500
Shareholders' Equity	38,009,573			32,083,240			27,650,400
Total Liabilities and Shareholders' Equity	\$ 422,502,029			\$ 381,597,098			\$ 346,850,000
Net Interest Margin (3)		\$ 18,198,339	4.57%		\$ 18,078,011	5.03%	

(1) Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include nonaccrual loans with no related interest income.

(2) The interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.

(3) The net interest margin is equal to net interest income divided by average interest earning assets.

(4) Tax equivalent basis.

Changes in net interest income and margin result from the interaction between the volume and composition of interest earning assets, interest bearing liabilities, related yields, and associated funding costs. The Rate/Volume Table demonstrates the impact on net interest income of changes in the volume of interest earning assets and interest bearing liabilities and changes in interest rates earned and paid.

The Company's net interest income increased on a tax equivalent basis by \$120,328, or 0.7%, to \$18,198,339 for the year ended December 31, 2007, from the \$18,078,011 reported for the year ended December 31, 2006. As indicated in the Rate/Volume Table, the principal factor contributing to the 2007 increase in net interest income was an increase in the interest income of \$1,596,826, resulting from increased balances in the loan portfolio components. This was partially offset by an increase in interest expense resulting from increases in the rates paid on deposit components.

The Company's net interest income on a tax-equivalent basis increased by \$2,460,897, or 15.8%, to \$18,078,011 for the year ended December 31, 2006, from the \$15,617,114 reported for the year ended December 31, 2005. As indicated in the Rate/Volume Table, the principal factor contributing to the 2006 increase in net interest income was an increase in the interest income of \$3,368,409, resulting from increased balances in the loan portfolio components. This was partially offset by an increase in interest expense resulting from increases in the rates paid on deposit components.

Rate/Volume Table  (Tax-equivalent basis)	Amount of Increase (Decrease) Year Ended December 31, 2007 versus 2006 Due to Change in:			Year Ended December 31, 2006 versus 2005 Due to Change in:	
	Volume	Rate	Total	Volume	Rate
<b>Interest Income:</b>					
Loans:					
Construction	\$ 382,349	\$ (25,005)	\$ 357,344	\$ 2,516,095	\$ 1,602,930
Residential Real Estate	55,873	84,909	140,782	(67,564)	11,860
Commercial and Commercial Real Estate	1,393,469	39,808	1,433,278	427,419	447,940
Installment	(39,657)	2,013	(37,643)	(31,770)	(1,110)
All Other Loans	(195,209)	248,390	53,182	524,238	114,380
<b>Total Loans</b>	<b>1,596,826</b>	<b>350,117</b>	<b>1,946,943</b>	<b>3,368,409</b>	<b>2,176,000</b>
Investment Securities :					
Collat. Mortg. Obligations / Mortg. Backed Securities	551,519	277,989	829,508	(281,233)	712,120
States and political subdivisions	378,709	22,151	400,860	(155,035)	72,100
<b>Total Investment Securities</b>	<b>930,227</b>	<b>300,141</b>	<b>347,968</b>	<b>(436,268)</b>	<b>784,230</b>
Federal Funds Sold / Short-Term Investments	16	437	454	30,300	27,530
<b>Total Interest Income</b>	<b>2,527,069</b>	<b>650,695</b>	<b>2,295,364</b>	<b>2,962,440</b>	<b>2,987,770</b>
<b>Interest Expense :</b>					
Money Market and NOW Accounts	(67,296)	349,028	\$ 281,732	(168,651)	412,500
Savings Accounts	510,021	568,235	1,078,256	186,786	343,140
Certificates of Deposit	439,006	(176,567)	262,439	(1,340,184)	1,864,670
Certificates of Deposit of \$100,000 and Over	432,591	902,757	1,326,347	1,268,520	(192,560)
Other Borrowed Funds	(151,819)	(21,023)	(172,842)	61,146	263,090
Trust Preferred Securities	349,788	(66,929)	282,859	757,845	33,000
<b>Total Interest Expense</b>	<b>1,503,290</b>	<b>1,555,501</b>	<b>3,058,791</b>	<b>765,462</b>	<b>2,723,850</b>
<b>Net Interest Income</b>	<b>\$ 1,023,779</b>	<b>\$ (904,806)</b>	<b>120,328</b>	<b>\$ 2,196,979</b>	<b>\$ 263,910</b>

Average interest earning assets increased by \$38,424,369, or 10.7%, to \$397,869,829 for the year ended December 31, 2007 from \$359,445,460 for the year ended December 31, 2006, consisting primarily of increases for 2007 of \$20,630,704 in loans and \$17,597,337 in investment securities compared to 2006. Led by the construction loans component, the Bank's average total loan portfolio grew by 7.6% and loan yields averaged 8.59% for the year ended December 31, 2007, 6 basis points higher than for the year ended December 31, 2006. The Bank's average investment securities portfolio increased 20.4%, and the yield on that portfolio increased 33 basis points for the year ended December 31, 2007 compared to the year ended December 31, 2006. Overall, the yield on interest earning assets increased 5 basis points to 7.73% in the 2007 fiscal year from 7.68% in the 2006 fiscal year.

Average interest earning assets increased by \$32,441,976, or 9.9%, to \$359,445,460 for the year ended December 31, 2006 from \$327,003,484 for the year ended December 31, 2005, consisting primarily of an increase for 2006 of \$40,321,975 in loans partially offset by a decrease of \$8,486,826 in investment securities compared to 2005. Led by the construction loans component, the Bank's average total loan portfolio grew by 17.4%, and loan yields averaged 8.53% for the year ended December 31 2006, 92 basis points higher than for the year ended December 31, 2005. This increase was primarily the result of 2006 loan growth at floating yields amid the increasing interest rate environment that continued during the first half of the year. The Bank's average investment securities portfolio decreased 9.0%, and the yield on that portfolio increased 82 basis points, for the year ended December 31, 2006 compared to the year ended December 31, 2005. Net premium amortization for the year ended December 31, 2006 was \$41,405 compared to \$139,507 for the year ended December 31, 2005. Overall, the yield on interest earning assets increased 106 basis points to 7.68% in the 2006 fiscal year from 6.62% in the 2005 fiscal year.



Interest expense increased by \$3,073,142, or 32.3%, to \$12,590,639 for the year ended December 31, 2007, from \$9,517,497 for the year ended December 31, 2006. This increase in interest expense is principally attributable to higher levels of interest-bearing liabilities priced at a higher market interest rate level. Savings accounts increased on average by \$19,541,058 in 2007, or 43.6%, as compared to 2006, contributing to the funding of loans and investments portfolio growth. The cost on these deposits increased 104 basis points in 2007 from 2006. Average interest bearing liabilities rose 13.2% in 2007 from 2006. The cost of total interest-bearing liabilities increased 57 basis points to 3.95% in 2007 from 3.38% in 2006.

Interest expense increased by \$3,489,318, or 57.9%, to \$9,517,497 for the year ended December 31, 2006, from \$6,028,179 for the year ended December 31, 2005. This increase in interest expense is principally attributable to higher levels of interest-bearing liabilities priced at a higher market interest rate level. Savings accounts increased on average by \$11,195,700 in 2006, or 33.2%, as compared to 2005, contributing to the funding of loan portfolio growth. The cost on these deposits increased 87 basis points in 2006 from 2005. Average interest bearing liabilities rose 9.1% in 2006 from 2005. The cost of total interest-bearing liabilities increased 104 basis points to 3.38% in 2006 from 2.34% in 2005.

Average non-interest bearing demand deposits decreased by \$2,148,086, or 3.4%, to \$60,892,433 for the year ended December 31, 2007 from \$63,040,519 for the year ended December 31, 2006.

#### Non-Interest Income

Non-interest income decreased by \$13,119, or 0.5%, to \$2,558,329 for the year ended December 31, 2007 from \$2,571,448 for the year ended December 31, 2006.

Service charges on deposit accounts represent a significant source of non-interest income. Service charge revenues remained level at \$673,826 for the year ended December 31, 2007 compared to \$668,071 for the year ended December 31, 2006. This component of non-interest income represented 26.3% and 25.8% of the total non-interest income for the years ended December 31, 2007 and 2006, respectively.

Gains on sales of loans held for sale decreased by \$311,727, or 29.1%, to \$761,004 for the year ended December 31, 2007, from \$1,072,731 for the year ended December 31, 2006. The rising interest rate environment that existed throughout 2006 and continued into the first nine months of 2007 has impacted the volume of sales transactions in the SBA loan secondary market and the resultant gains from these sales transactions.

Non-interest income also includes income from bank-owned life insurance ("BOLI") which amounted to \$265,601 for the year ended December 31, 2007 compared to \$330,915 for the year ended December 31, 2006. The Bank purchased \$6.0 million in tax-free BOLI assets in 2002 and \$2.0 million in 2005, which partially offset the cost of employee benefit plans and reduced the overall effective tax rate. The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit rentals, wire transfer service fees and Automated Teller Machine fees for non-customers. Deposit and service fee charges are reviewed and adjusted as needed from time to time by management to reflect current costs incurred by the Bank to offer the products or services and prices charged by competitor financial institutions amid the Bank's competitive market.

The Company recorded net losses on sales of securities available for sale of \$99,714 for the year ended December 31, 2006. The Company recorded no gains or losses on sales of securities available for sale of in 2007. These portfolio transactions in 2006 were primarily the result of modest portfolio restructurings. Their purpose was to improve the Company's longer-term interest rate risk position.



## Non-Interest Expenses

Non-interest expenses increased by \$86,421, or 0.7%, to \$12,101,268 for the year ended December 31, 2007, from \$12,014,847 for the year ended December 31, 2006. The largest increase in non-interest expenses for 2007 compared to 2006 was in salaries and employee benefits. To a lesser extent, occupancy expense also reflects an increase for the comparable periods. The following table presents the major components of non-interest expenses for the years 2007 and 2006.

Non-interest Expenses		2007	2006 (Restated)
Salaries and employee benefits	\$	7,196,552	\$ 6,741,050
Occupancy expense		1,658,820	1,448,227
Data processing services		829,037	733,954
Equipment expense		485,792	507,402
Marketing		106,862	258,012
Regulatory, professional and other fees		435,464	824,370
Office expense		572,293	470,211
All other expenses		816,448	1,031,621
Total	\$	12,101,268	\$ 12,014,847

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$455,502, or 6.8%, to \$7,196,552 for the year ended December 31, 2007 compared to \$6,741,050 for the year ended December 31, 2006. The 2007 increase was a result of an increase in staffing levels plus normal salary increases partially offset by a lower level of expenses incurred in connection with the Company's health insurance and other employee benefit plans. Salaries and employee benefits as a percentage of average assets were 1.70% for 2007 and 1.77% for 2006.

For the year ended December 31, 2007, occupancy expense increased by \$210,593, or 14.5%, to \$1,658,820 from \$1,448,227 for the year ended December 31, 2006. The February 27, 2007 acquisition of the Hightstown branch was primarily the cause for the current year increase in occupancy expense.

The occupancy expense component of total non-interest expense as a percentage of average assets was 0.39% for the year ended December 31, 2007 and 0.38% for the year ended December 31, 2006.

Data processing service expense increased by \$95,083, or 12.96%, to \$829,037 for the year ended December 31, 2007 compared to \$733,954 for the year ended December 31, 2006 as the Company incurred operating costs to bring the new branch location online during 2007 as well as upgrading existing systems throughout the year.

Marketing expense decreased by \$151,150, or 58.6%, to \$106,862 for the year ended December 31, 2007 compared to \$258,012 for the year ended December 31, 2006, as the Company ran fewer broadcast media promotions during 2007.

The Bank's ratio of non-interest expense to average assets has remained consistently favorable at 2.86% for the year ended December 31, 2007 compared to 3.15% for the year ended December 31, 2006.

An important industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income and other income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Bank's efficiency ratio for the year ended December 31, 2007 was 59.5% compared to 59.0% for the year ended December 31, 2006.

#### Financial Condition

On February 27, 2007, the Company, through the Bank, completed its acquisition of the Hightstown, New Jersey branch of another financial institution for a purchase price of \$747,330.

As a result of the acquisition, the Hightstown branch became a branch of the Bank. Included in the acquisition of the branch were deposit liabilities of \$19.5 million, mostly in certificates of deposit, cash of approximately \$18.8 million, net of assets acquired, cash on hand of approximately \$137,000, fixed and other assets of approximately \$91,000 and the assumption of the lease of the branch premises. The cash received in the transaction was utilized to repay short term borrowings used to purchase investment securities prior to, and in contemplation of, the completion of the acquisition.

In addition, the Bank recorded goodwill of \$445,653 and a deposit intangible asset of \$274,604.

### Cash and Cash Equivalents

At December 31, 2007, cash and cash equivalents totaled \$7,548,102 compared to \$10,361,812 at December 31, 2006. Cash and cash equivalents at December 31, 2007 consisted of cash and due from banks of \$7,517,158 and federal funds sold/short-term investments of \$30,944. The corresponding balances at December 31, 2006 were \$10,336,334 and \$25,478, respectively.

### Investment Securities

The Bank's investment securities portfolio amounted to \$98,704,483, or 23.0% of total assets at December 31, 2007, compared to \$89,675,804, or 22.8% of total assets at December 31, 2006. On an average balance basis, the investment securities portfolio represented 26.1% and 24.0% of average interest-earning assets for the years ended December 31, 2007 and 2006, respectively. The average yield earned on the portfolio was 5.37% for the year ended December 31, 2007, an increase of 33 basis points from 5.04% earned for the year ended December 31, 2006.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Securities available for sale consist primarily of U.S. Government and Federal agency securities as well as mortgage-backed securities. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create economically more attractive returns. At December 31, 2007, available-for-sale securities amounted to \$75,192,137, an increase of \$4,770,809 from December 31, 2006. The Company recorded net losses on sales of securities available for sale of \$99,714 for 2006.

Amortized cost, gross unrealized gains and losses, and the estimated fair value by security type are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2007				
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	\$ 29,561,717	\$ 317,245	\$ (421,604)	\$ 29,457,359
Mortgage backed securities	37,769,517	457,725	(57,365)	38,169,877
Obligations of State and Political subdivisions	3,446,517	14,778	(7,713)	3,453,582
FHLB stock and other securities	4,383,823	0	(272,504)	4,111,319
	\$ 75,161,574	\$ 789,748	\$ (759,185)	\$ 75,192,137
Held to maturity-				
Mortgage backed securities	\$ 4,502,574	\$ 2,132	\$ (121,197)	\$ 4,383,509
Obligations of State and Political subdivisions	18,013,721	142,232	(4,718)	18,151,235
Other Securities	996,051	-	(119,526)	876,525
	\$ 23,512,346	\$ 144,364	\$ (245,441)	\$ 23,411,269



2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	\$ 35,625,182	\$ 124,144	\$ (694,261)	\$ 35,055,065
Mortgage backed securities	28,305,557	113,353	(216,111)	28,202,799
Obligations of State and Political subdivisions	3,655,197	15,902	(31,749)	3,639,350
FHLB stock and other securities	3,554,759	304	(30,949)	3,524,115
	\$ 71,140,695	\$ 253,703	\$ (973,070)	\$ 70,421,328
Held to maturity-				
Mortgage backed securities	\$ 5,540,670	\$ 2,015	\$ (175,826)	\$ 5,366,859
Obligations of State and Political subdivisions	13,713,806	131,955	(47,941)	13,797,820
	\$ 19,254,476	\$ 133,970	\$ (223,767)	\$ 19,164,679
2005	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	\$ 34,032,814	\$ 7,198	\$ (977,560)	\$ 33,062,452
Mortgage backed securities	29,250,341	90,286	(302,193)	29,038,434
Obligations of State and Political subdivisions	3,855,987	1,333	(65,063)	3,792,257
FHLB stock and other securities	3,371,673	-	(28,158)	3,343,515
	\$ 70,510,815	\$ 98,817	\$ (1,372,974)	\$ 69,236,658
Held to maturity-				
Mortgage backed securities	\$ 5,807,730	\$ 7,233	\$ (206,275)	\$ 5,608,688
Obligations of State and Political subdivisions	15,950,640	108,525	(146,827)	15,912,338
	\$ 21,758,370	\$ 115,758	\$ (353,102)	\$ 21,521,026

Proceeds from maturities and prepayments of securities available for sale amounted to \$12,704,423 for the year ended December 31, 2007 and \$13,736,214 for the year ended December 31, 2006. At December 31, 2007, the portfolio had net unrealized gains of \$30,563, compared to net unrealized losses of \$719,367 at December 31, 2006. These unrealized losses are reflected net of tax in shareholders' equity as a component of other comprehensive income (loss).

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. The held-to-maturity portfolio consists primarily of obligations of states and political subdivisions. At December 31, 2007, securities held to maturity were \$23,512,346, an increase of \$4,257,870 from \$19,254,476 at December 31, 2006. The fair value of the held-to-maturity portfolio at December 31, 2007 was \$23,411,269, resulting in a net unrealized loss of \$101,077.

The amortized cost, estimated fair value and weighted average yield of investment securities at December 31, 2007, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Federal Home Loan Bank stock is included in "Held to maturity - Due in one year or less."



	Amortized Cost	Fair Value	Weighted Average Yield*
Available for sale-			
Due in one year or less	\$ 5,748,287	\$ 5,734,053	4.88%
Due after one year through five years	13,613,468	13,845,942	5.09%
Due after five years through ten years	10,654,348	10,736,895	5.12%
Due after ten years	45,145,471	44,875,247	5.39%
Total	\$ 75,161,574	\$ 75,192,137	5.25%
Held to maturity-			
Due in one year or less	\$ 7,519,727	\$ 7,521,621	4.49%
Due after one year through five years	1,904,665	1,917,828	5.56%
Due after five years through ten years	5,371,683	5,421,885	5.54%
Due after ten years	8,716,271	8,549,935	5.70%
Total	\$ 23,512,346	\$ 23,411,269	5.27%

\* computed on a tax equivalent basis.

## Loans

The loan portfolio, which represents the Bank's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Bank's primary lending focus continues to be construction loans (wholesale and retail), commercial loans, owner-occupied commercial mortgage loans and tenanted commercial real estate loans. Total loans averaged \$292,371,351 for the year ended December 31, 2007, an increase of \$20,630,704, or 7.6%, compared to an average of \$271,740,647 for the year ended December 31, 2006. Growth in the average loan portfolio balance was generated primarily by an increase of \$17,942,448, or 18.0%, in commercial and commercial real estate loans. At December 31, 2007, total loans amounted to \$294,760,718 compared to \$265,142,313 at December 31, 2006, an increase of \$29,618,405, or 11.2%. The average yield earned on the loan portfolio was 8.59% for the year ended December 31, 2007 compared to 8.53% for the year ended December 31, 2006, an increase of 6 basis points. This increase is primarily due to the rising interest rate environment that evolved during the last half of 2004 and continued throughout the first half of 2006.

The following table represents the components of the loan portfolio for the dates indicated.

	2007		2006		December 31, 2005		2004		2003
	Amount	%	Amount	%	Amount	%	Amount	%	Amount
Construction loans	\$ 132,735,920	45%	\$ 125,268,871	47%	\$ 109,862,614	46%	\$ 88,027,024	42%	\$ 56,971,265
Residential real estate loans	10,088,515	3%	7,670,370	3%	8,602,975	4%	9,815,366	5%	8,059,032
Commercial and	135,128,642	46%	114,897,040	44%	104,448,196	43%	96,021,077	46%	83,840,831

commercial									
real estate									
loans									
Loans to individuals	16,324,817	6%	16,728,025	6%	16,441,994	7%	16,002,619	7%	13,236,895
Lease financing	0	0%	0	0%	21,073	0%	74,543	0%	1,054,198
Deferred loan fees	302,818	0%	404,074	0%	466,678	0%	512,416	0%	442,212
All other loans	180,006	0%	173,933	0%	170,819	0%	200,118	0%	345,873
Total	\$ 294,760,718	100%	\$ 265,142,313	100%	\$ 240,014,349	100%	\$ 210,653,163	100%	\$ 163,950,306

Commercial and commercial real estate loans averaged \$117,463,693 for the year ended December 31, 2007, an increase of \$17,942,448, or 18.0%, compared to \$99,521,245 for the year ended December 31, 2006. Commercial loans consist primarily of loans to small and middle market businesses and are typically working capital loans used to finance inventory, receivables or equipment needs. These loans are generally secured by business assets of the commercial borrower. The average yield on the commercial and commercial real estate loan portfolio increased 4 basis points to 7.78% for 2007 from 7.74% for 2006.

Construction loans averaged \$129,285,776 for the year ended December 31, 2007, an increase of \$4,263,007, or 3.4%, compared to \$125,022,769 for the year ended December 31, 2006. Generally, these loans represent owner-occupied or investment properties and usually complement a broader commercial relationship between the bank and the borrower. Construction loans are structured to provide for advances only after work is completed and inspected by qualified professionals. The average yield on the construction loan portfolio decreased 2 basis points to 8.88% for 2007 from 8.90% for 2006.

Residential loans averaged \$8,878,427 for the year ended December 31, 2007, an increase of \$806,318, or 10.0%, compared to \$8,072,109 for the year ended December 31, 2006. These loans consist primarily of residential mortgage loans secured by residential real estate. The average yield on this portfolio increased 100 basis points to 7.41% for 2007 from 6.41% for 2006.

The following table provides information concerning the interest rate sensitivity of the Bank's commercial and commercial real estate loans and construction loans at December 31, 2007.

Type	Maturity Range			Total
	Within One Year	After One But Within Five Years	After Five Years	
Commercial & commercial real estate	\$ 29,159,140	\$ 26,249,032	\$ 79,720,470	\$ 135,128,642
Construction	109,364,698	22,179,845	1,191,377	132,735,920
Total	\$ 138,523,838	\$ 48,428,876	\$ 80,911,847	\$ 267,864,562
Fixed rate loans	\$ 5,762,628	\$ 16,622,329	\$ 9,990,236	\$ 32,375,193
Floating rate loans	132,761,210	31,806,547	70,921,612	235,489,368
Total	\$ 138,523,838	\$ 48,428,876	\$ 80,911,848	\$ 267,864,562

#### Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis, (2) loans which are contractually past due 90 days or more as to interest and principal payments but have not been classified as non-accrual, and (3) loans whose terms have been restructured to provide a reduction or deferral of interest on principal because of a deterioration in the financial position of the borrower.

The Bank's policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-performing loans decreased by \$2,156,351 to \$2,036,858 at December 31, 2007 from \$4,193,209 at December 31, 2006. This decrease is primarily due to a transfer to other real estate owned of \$2,960,727 for real estate acquired in full satisfaction of a loan in foreclosure. Approximately half of the non-performing loans is an unfinished residential construction project with the majority of the remaining half being comprised of commercial loans. The table below sets forth non-performing assets and risk elements in the Bank's portfolio for the years indicated. As the table demonstrates, non-performing loans to total loans decreased to 0.67% at December 31, 2007 from 1.50% at

December 31, 2006 for the reason previously stated. Loan quality is considered to be sound, and this was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Non-performing assets increased by \$804,376 to \$4,997,585 at December 31, 2007 from \$4,193,209 at December 31, 2006. Non-performing assets represented 1.16% of total assets at December 31, 2007 and 1.07% at December 31, 2006. Non-performing loans as a percentage of total loans were 0.67% at December 31, 2007, compared to 1.50% at December 31, 2006.

The Bank had no loans classified as restructured loans at December 31, 2007 or 2006.

At December 31, 2007 and December 31, 2006, the Bank had no loans that were 90 days or more past due but still accruing interest income.

#### Non-Performing Assets and Loans

	2007	2006	2005	2004	2003
Non-Performing loans:					
Loans 90 days or more past due and still accruing	\$ 0	\$ 0	\$ 209	\$ 63,130	\$ 0
Non-accrual loans	2,036,858	4,193,209	833,150	1,049,411	330,783
Total non-performing loans	2,036,858	4,193,209	833,359	1,112,541	330,783
Other real estate owned	2,960,727	0	0	0	8,971
Total non-performing assets	\$ 4,997,585	\$ 4,193,209	\$ 833,359	\$ 1,112,541	\$ 339,754
Non-performing loans to total loans	0.67%	1.50%	0.32%	0.50%	0.20%
Non-performing assets to total assets	1.16%	1.07%	0.22%	0.33%	0.12%

Management takes a proactive approach in addressing delinquent loans. The Company's President meets weekly with all loan officers to review the status of credits past-due ten days or more. An action plan is discussed for each of the loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate and when the collateral is foreclosed upon, the real estate is carried at the lower of fair market value less estimated selling costs, or at cost. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the asset is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

#### Allowance for Loan Losses and Related Provision

The allowance for loan losses is maintained at a level sufficient to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans including construction loans. Based on the composition of the loan portfolio, the primary risks inherent in it are deteriorating credit quality, increases in interest rates, a decline in the economy, and a decline in New Jersey real estate market values. Any one or a combination of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All or part of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan and lease losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan and lease losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan and lease losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan and lease losses consists of several key elements. These elements may include a specific reserve for substandard or high risk loans, plus an allocated reserve, and possibly an unallocated portion. The Company consistently applies the following comprehensive methodology.

During the quarterly review of the allowance for loan and lease losses, the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The specific reserve for high risk loans is established for specific commercial loans, commercial real estate loans, and construction loans which have been identified by management as being high risk assets. High risk loans are assigned an adverse grade since the loans are generally characterized with having weaknesses that may result in deterioration of repayment or worse. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual high risk loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which, in turn, employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and for the various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

During the quarterly reviews, the Company may determine that an unallocated allowance is appropriate. An unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It may be prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information which is often subjective and changing rapidly. At December 31, 2007, management believed that the allowance for loan losses and non-performing loans was adequate.

While management uses the best information available to make such evaluations, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

The table below presents, for the years indicated, an analysis of the allowance for loan losses and other related data.

#### Allowance for Loan Losses

	2007	2006	2005	2004
Balance, beginning of year	\$ 3,228,360	\$ 2,361,375	\$ 2,005,169	\$ 1,786,6
Provision charged to operating expenses	130,000	893,500	405,000	240,0
Loans charged off:				
Construction loans		-	-	
Residential real estate loans		-	-	
Commercial and commercial real estate loans	(88,891)	(11,154)	(39,150)	(17,0
Loans to individuals	(1,614)	(18,314)	(13,653)	(5,2
Lease financing	(478)	-	-	
All other loans	-	-	-	
	(90,983)	(29,468)	(52,803)	(22,2
Recoveries:				
Construction loans	75,000	-	-	
Residential real estate loans	-	-	-	
Commercial and commercial real estate loans	0	153	1,498	7
Loans to individuals	5,703	2,800	2,511	
Lease financing	-	-	-	
All other loans	-	-	-	
	80,703	2,953	4,009	8
Net (charge offs) / recoveries	(10,280)	(26,515)	(48,794)	(21,4
Balance, end of year	\$ 3,348,080	\$ 3,228,360	\$ 2,361,375	\$ 2,005,1
Loans:				
At year end	\$ 305,082,723	\$ 278,751,255	\$ 256,772,083	\$ 220,580,9
Average during the year	292,371,351	271,740,647	231,418,672	198,452,4
Net (charge offs) recoveries to average loans outstanding	0.00%	(0.01%)	(0.02%)	(0.
Allowance for loan losses to:				
Total loans at year end	1.10%	1.16%	0.92%	0.
Non-performing loans	164.37%	76.99%	283.36%	180.

At December 31, 2007, the allowance for loan losses was \$3,348,080 compared to \$3,228,360 at December 31, 2006, an increase of \$119,720, or 3.7%. The ratio of the allowance for loan losses to total loans at December 31, 2007 and 2006 was 1.10% and 1.16%, respectively. The allowance for loan losses as a percentage of non-performing loans was 164.37% at December 31, 2007, compared to 76.99% at December 31, 2006. Management believes the quality of the loan portfolio remains sound and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

The provision for loan losses was \$130,000 and \$893,500, respectively, for the years ended December 31, 2007 and 2006. Management considers a complete review of the following specific factors in determining the provision for loan losses: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. The decrease in the



provision for the year ended December 31, 2007 was primarily due to inherent risk related to loan growth. Management believes the quality of the loan portfolio remains sound, and the determination of the provision for loan losses amount was primarily due to the manageable balances in non-accrual loans and management's assessment of economic conditions in the Bank's marketplace.

The following table describes the allocation of the allowance for loan losses among the various categories of loans and certain other information as of the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

#### Allocation of the Allowance for Loan Losses

	December 31, 2007		December 31, 2006		December 31, 2005		December 31, 2004
	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans	Amount
Balance at end of period applicable to:							
Domestic:							
Commercial and commercial real estate loans	\$ 1,671,059	46%	\$ 1,131,266	44%	\$ 1,393,210	43%	\$ 1,183,050
Construction loans	1,308,651	45%	1,696,175	47%	578,537	46%	491,266
Residential real estate loans	104,326	3%	61,634	3%	141,683	4%	120,310
Loans to individuals	154,437	6%	139,055	6%	236,138	7%	200,517
Lease financing	-	0%	-	0%	4,723	0%	4,010
Unallocated	109,607		200,230	N/A	7,084	N/A	6,016
	\$ 3,348,080	100%	\$ 3,228,360	100%	\$ 2,361,375	100%	\$ 2,005,169

#### Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings and time deposits, are a fundamental and cost-effective source of funding. The Bank offers a variety of products designed to attract and retain customers, with the Bank's primary focus being on building and expanding long-term relationships. Deposits in the year ended December 31, 2007 averaged \$330,387,715, an increase of \$33,290,383, or 11.2%, compared to \$297,097,332 in the year ended December 31, 2006. At December 31, 2007, total deposits were \$329,332,368, an increase of \$16,607,946, or 5.3%, from \$312,724,422 at December 31, 2006. The average rate paid on the Bank's interest-bearing deposit balances for 2007 was 3.58%, increasing from the 2.86% average rate for 2006. Total interest bearing deposits increased by \$21,857,588, or 8.8%, to \$270,276,565 at December 31, 2007 from \$248,418,977 at December 31, 2006.

The significant contributors to the increased level of deposit growth in the year ended December 31, 2007 were an increase in average savings deposit, followed by increases in certificates of deposit of \$100,000 or more, and other time deposits, offset by declines in interest-bearing demand deposits and non-interest bearing demand deposits.

Time deposits consists primarily of retail certificates of deposit and certificates of deposit of \$100,000 and over. Time deposits at December 31, 2007 were \$122,013,689, an increase of \$9,338,603, or 8.29%, from \$112,675,086 at December 31, 2006. The retail certificates of deposit component of time deposits increased by \$9,053,156, or 15.6%, to an average of \$67,236,813 for 2007 from an average of \$58,183,657 for 2006. The average cost of these deposits decreased by 28 basis points to 4.72% for 2007 from 5.00% for 2006. Certificates of deposit of \$100,000 and over increased by \$10,381,440 to an average of \$54,252,087 for 2007 from an average of \$43,870,647 for 2006. Certificates of deposit of \$100,000 and over are a less stable funding source and are used primarily as an alternative to other sources of borrowed funds.

Average non-interest bearing demand deposits decreased by \$2,148,086, or 3.4%, to \$60,892,433 for the year ended December 31, 2007 from \$63,040,519 for the year ended December 31, 2006. At December 31, 2007, non-interest bearing demand deposits totaled \$59,055,803, a decrease of 8.2% compared to \$64,305,445 at December 31, 2006. Non-interest bearing demand deposits represent a stable, interest-free source of funds.

Savings accounts increased by \$8,463,706, or 15.8%, to \$62,094,432 at December 31, 2007 from \$53,630,726 at December 31, 2006. The average balance of savings accounts for 2007 increased by \$19,541,058 to \$64,408,442 compared to an average balance of \$44,867,384 for 2006.

Interest bearing demand deposits, which include interest-bearing checking, money market and the Bank's premier money market product, 1st Choice accounts, decreased by \$2,148,086, or 3.4%, to an average of \$60,892,433 for 2007 from an average of \$63,040,519 in 2006. The average cost of interest bearing demand deposits increased 41 basis points to 2.08% for 2007 compared to 1.67% for 2006.

The following table illustrates the components of average total deposits for the dates indicated.

#### Average Deposit Balances

	2007		2006		2005	
	Average Balance	Percentage of Total	Average Balance	Percentage of Total	Average Balance	Percentage of Total
Non-interest bearing demand deposits	\$ 60,892,433	18.43%	\$ 63,040,519	21.22%	\$ 57,792,902	20.67%
Interest bearing demand deposits	83,597,940	25.30%	87,135,125	29.33%	101,189,352	36.19%
Savings deposits	64,408,442	19.49%	44,867,384	15.10%	33,671,684	12.04%
Certificates of deposit of \$100,000 or more	54,252,087	16.42%	43,870,647	14.77%	9,771,290	3.49%
Other time deposits	67,236,813	20.35%	58,183,657	19.58%	77,183,169	27.60%
Total	\$ 330,387,715	100.00%	\$ 297,097,332	100.00%	\$ 279,608,397	100.00%

#### Borrowings

Borrowings are mainly comprised of Federal Home Loan Bank ("FHLB") borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The average balance of other borrowed funds decreased by \$2,959,014, or 9.1%, to \$29,580,685 for the year ended December 31, 2007 from the average balance of \$32,539,699 for the year ended December 31, 2006. This decrease is primarily due to the fact that deposit growth exceeded loan portfolio growth. The average cost of other borrowed funds decreased 7 basis points to 5.12% for 2007 compared to 5.19% for 2006.

The balance of other borrowings was \$35,600,000 at December 31, 2007, consisting of long-term FHLB borrowings of \$30,500,000 and overnight funds purchased of \$5,100,000. The balance of other borrowings at December 31, 2006 consisted of FHLB borrowings of \$15,500,000 and overnight funds purchased of \$1,700,000. The average cost of other borrowed funds increased 7 basis points to 5.12% for 2007 compared with 5.19% for 2006.

The Bank purchased five ten-year fixed rate convertible advances from the FHLB that total \$25,500,000 in the aggregate. These advances, in the amounts of \$3,000,000, \$2,500,000, \$5,000,000, \$5,000,000 and \$10,000,000 bear interest at the rates of 5.82%, 5.50%, 5.34%, 5.06% and 4.08%, respectively. The Bank purchased one two-year advance in the amount of \$5,000,000 that bears interest at a 3.833% rate. These advances may be called by the FHLB

quarterly at the option of the FHLB if rates rise and the rate earned by the FHLB is no longer a “market” rate. These advances are fully secured by marketable securities.

#### Shareholders' Equity and Dividends

Shareholders' equity increased by \$6,026,272, or 17.2%, to \$40,972,777 at December 31, 2007, from \$34,946,505 at December 31, 2006. Book value per common share increased by \$1.45, or 16.5%, to \$10.26 at December 31, 2007 from \$8.81 at December 31, 2006. The increase in shareholders' equity and book value per share resulted primarily from net income of \$5,442,782, less the effect of stock buybacks. The ratio of shareholders' equity to total assets was 9.55% and 8.89% at December 31, 2007 and 2006, respectively.

In lieu of cash dividends, the Company (and its predecessor the Bank) has declared a stock dividend every year since 1992 and has paid such dividends every year since 1993. A 6% stock dividend was declared in 2007 and 2006 and paid in 2008 and 2007, respectively. A 5% stock dividend was declared in 2005 and paid in 2006.

The Company's common stock is quoted on the Nasdaq Global Market under the symbol “FCCY”.

The Company and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board and the Federal Deposit Insurance Corporation. For information on regulatory capital, see Note 20 of the Notes to Consolidated Financial Statements on page F-31.

#### Off-Balance Sheet Arrangements

The following table shows the amounts and expected maturities of significant commitments as of December 31, 2007. Further discussion of these commitments is included in Note 13 to the Consolidated Financial Statements.

	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Standby letters of credit	\$ 5,546,723	\$ 0	\$ 0	\$ 0	\$ 5,546,723
Commitments to extend credit	\$ 114,175,000	\$ 0	\$ 0	\$ 0	\$ 114,175,000
Commitments to sell residential loans	\$ 10,322,005	\$ 0	\$ 0	\$ 0	\$ 10,322,005

#### Liquidity

Liquidity measures the ability to satisfy current and future cash flow needs as they become due.

Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB and a correspondent bank which further supports and enhances liquidity. At December 31, 2007, the Bank maintained an Overnight Line of Credit at the FHLB in the amount of \$28,883,000 plus a One-Month Overnight Repricing Line of Credit of \$28,883,000. Advances issued under these programs are subject to FHLB stock level and collateral requirements. Pricing of these advances may fluctuate based on existing market conditions. The Bank also maintains an unsecured Federal funds line of \$13,500,000 with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At December 31, 2007, the balance of cash and cash equivalents was \$7,548,102.

Net cash provided by operating activities totaled \$9,389,262 for the year ended December 31, 2007 compared to net cash provided by operations of \$8,395,283 for the year ended December 31, 2006. The primary source of funds is net income from operations adjusted for provision for loan losses, depreciation expenses, and net amortization of premiums on securities.

Net cash used in investing activities decreased by \$1,924,047 to \$22,562,137 for the year ended December 31, 2007 from \$24,486,184 for the year ended December 31, 2006. The decrease in cash usage for 2007 compared to 2006 resulted from the added inflow of cash and cash equivalents from the February 2007 Hightstown branch acquisition.

Net cash provided by financing activities decreased by \$3,955,797 to \$10,359,165 for the year ended December 31, 2007 from \$14,314,962 for the year ended December 31, 2006. The cash provided in 2007 resulted primarily from an increase in borrowed funds.

The securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the year ended December 31, 2007, prepayments and maturities of investment securities totaled \$16,092,008. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

## Interest Rate Sensitivity Analysis

The largest component of the Bank's total income is net interest income, and the majority of the Bank's financial instruments are composed of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences in the repricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

The following tables set forth certain information relating to the Bank's financial instruments that are sensitive to changes in interest rates, categorized by expected maturity or repricing and the fair value of such instruments at December 31, 2007.

## Interest Rate Sensitivity Analysis At December 31, 2007

(\$ in thousands)

	Interest Sensitivity Period				Total Within One Year	One Year To Two Years	Non-interest Sensitive and Over Two Years	Total
	30 Day	90 Day	180 Day	365 Day				
<b>Earning Assets:</b>								
Total Investment								
Securities	\$ 8,375	\$ 5,075	\$ 8,501	\$ 11,398	\$ 33,349	\$ 15,564	\$ 49,792	\$ 98,705
Loans	174,501	5,565	10,915	13,084	204,065	18,898	71,798	294,761
Other interest-earning assets	10,527	18,000	-	-	28,527	-	7,158	35,685
	193,403	28,640	19,416	24,482	265,941	34,462	128,748	429,151
<b>Source of Funds:</b>								
Savings and time deposits	54,151	27,163	43,522	28,638	153,474	17,835	22,113	193,422
Other interest-bearing liabilities	49,456	18,000	-	-	67,456	5,366	57,632	130,454
Non-interest-bearing sources	-	-	-	-	-	-	105,275	105,275
	103,607	45,163	43,522	28,638	220,930	23,201	185,020	429,151
<b>Asset (Liability) Sensitivity Gap:</b>								
Period Gap	\$ 89,796	\$ (16,523)	\$ (24,106)	\$ (4,156)	\$ 45,011	\$ 11,261	\$ (56,272)	-
Cumulative Gap	\$ 89,796	\$ 73,273	\$ 49,167	\$ 45,011	\$ 45,011	\$ 56,272		
Cumulative Gap to Total Assets	20.9%	17.1%	11.5%	10.5%	10.5%	13.1%		



The Bank continually evaluates interest rate risk management opportunities, including the use of derivative financial instruments. Management believes that hedging instruments currently available are not cost-effective, and therefore has focused its efforts on increasing the Bank's spread by attracting lower-costing retail deposits.

In addition to utilizing the gap ratio for interest rate risk assessment, management utilizes simulation analysis whereby the model estimates the variance in net income with a change in interest rates of plus or minus 200 basis points over 12 and 24 month periods. Given recent simulations, net interest income would be within policy guidelines regardless of the direction of market rates.

Three months ended March 31, 2007 compared to three months ended March 31, 2006

## RESULTS OF OPERATIONS

### Summary

The Company reported net income of \$1,325,894 for the three months ended March 31, 2007, an increase of 24.2% over the \$1,067,543 reported for the three months ended March 31, 2006. Diluted net income per share was \$0.33 for the three months ended March 31, 2007 compared to \$0.28 reported for the three months ended March 31, 2006. All share information has been restated for the effect of a 6% stock dividend declared on December 20, 2007 and paid on February 6, 2008 to shareholders of record on January 23, 2008.

Key performance ratios remained strong for the three months ended March 31, 2007 as compared to the three months ended March 31, 2006. Return on average assets and return on average equity were 1.28% and 14.87%, respectively, for the three months ended March 31, 2007, compared to 1.18% and 14.25%, respectively, for the corresponding prior year period.

A significant factor impacting the Company's net interest income has been the rising level of market interest rates that characterized the marketplace in 2006 and has continued through the first quarter of 2007. The Federal Reserve Bank's Open Market Committee raised short-term interest rates four times during 2006, which raised the targeted Federal funds rate to the current 5.25% at March 31, 2007. These increases in short-term market rates drive up the cost of the Company's core deposits. As a result, the Company experienced a 106 basis point increase in the cost of its interest-bearing deposits to 3.90% at March 31, 2007 compared to 2.84% at March 31, 2006. The Company's net interest margin experienced a decrease of 22 basis points to 4.81% at March 31, 2007 compared to 5.03% at March 31, 2006. Despite these interest environment challenges, the Company increased net interest income by 5.3% to \$4,457,673 for the three months ended March 31, 2007 from the \$4,234,126 for the three months ended March 31, 2006. The principal factor contributing to the 2007 increase in net interest income was the 12.5% and 9.3% increases in the Securities and Loan portfolios, respectively. This was partially offset by the increase in interest expense resulting from increases in the rates paid on deposit components.

A second significant factor impacting financial results for the first quarter of 2007 was the February 27, 2007 settlement of the transaction whereby the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19.5 million in cash and new deposits to the balance sheet at March 31, 2007 in addition to the impact on most component of income/expense on the statement of income for the three months ended March 31, 2007.

### Earnings Analysis

#### Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 87.4% of the Company's net revenues for the three-month period ended March 31, 2007 and 85.3% of net revenues for the three-month period ended March 31, 2006. Net interest income also depends upon the relative amount of interest-earning assets, interest-bearing liabilities, and the interest rate earned or paid on them.

The following table sets forth the Company's consolidated average balances of assets, liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average rates for the three month periods ended March 31, 2007 and 2006, respectively. The average rates are derived by dividing interest income and

expense by the average balance of assets and liabilities, respectively.

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Average Balance Sheets with Resultant Interest and Rates  
(yields on a tax-equivalent basis)

	Three months ended March 31, 2007			Three months ended March 31, 2006		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets:</b>						
Federal Funds Sold/Short-Term Investments	\$ 2,003,236	\$ 22,544	5.20%	\$ 483,077	\$ 8,664	4.25%
<b>Securities:</b>						
Collateralized Mortgage Obligations/ Mortgage Backed Securities	77,250,121	992,327	5.14%	69,219,694	806,366	4.66%
States and Political Subdivisions	21,202,098	305,721	5.77%	18,271,322	237,970	5.21%
Total	98,452,219	1,298,048	5.27%	87,491,016	1,044,336	4.77%
<b>Loan Portfolio:</b>						
Construction	126,866,201	2,857,337	9.13%	116,086,386	2,446,316	8.55%
Residential real estate	7,156,527	212,274	12.03%	8,694,241	134,321	6.27%
Home Equity	14,392,895	270,455	7.62%	14,078,520	244,354	7.04%
Commercial and commercial real estate	110,973,830	2,147,906	7.85%	94,790,357	1,748,964	7.48%
Installment	1,573,806	33,436	8.62%	2,253,558	47,334	8.52%
All Other Loans	22,709,509	646,317	11.54%	23,616,464	555,527	9.54%
Total	283,672,768	6,167,725	8.82%	259,519,526	5,176,816	8.09%
Total Interest-Earning Assets	384,128,223	7,448,317	7.91%	347,493,619	6,229,816	7.27%
Allowance for Loan Losses	(3,051,032)			(2,435,089)		
Cash and Due From Bank	9,414,281			9,048,644		
Other Assets	16,296,108			14,861,846		
Total Assets	\$ 406,787,580			\$ 368,969,020		
<b>Interest-Bearing Liabilities:</b>						
<b>Money Market and NOW Accounts</b>						
Accounts	\$ 83,302,779	\$ 415,115	2.02%	\$ 92,090,304	\$ 319,961	1.41%
Savings Accounts	62,486,829	449,086	2.91%	45,132,485	176,325	1.58%
Certificates of Deposit	113,702,589	1,351,884	4.82%	93,253,150	854,044	3.71%
Other Borrowed Funds	22,116,111	286,339	5.25%	38,933,889	466,337	4.86%
Trust Preferred Securities	23,000,000	429,067	7.46%	5,000,000	101,844	8.15%
Total Interest-Bearing Liabilities	304,608,308	2,931,491	3.90%	274,409,828	1,918,511	2.84%
Net Interest Spread			4.01%			4.28%
Demand Deposits	60,679,465			60,211,090		
Other Liabilities	5,436,127			4,262,820		
Total Liabilities	370,723,900			338,883,738		

Shareholders' Equity	36,063,680		30,085,282	
Total Liabilities and Shareholders' Equity	406,787,580		368,969,020	
Net Interest Margin	\$ 4,556,826	4.81%	\$ 4,311,305	5.03%

The Company's net interest income on a tax-equivalent basis increased by \$245,521, or 5.7%, to \$4,556,826 for the three months ended March 31, 2007 from the \$4,311,305 reported for the three months ended March 31, 2006. The increase in net interest income was attributable to a higher volume of total interest-earning assets and an increased yield on interest-earning assets partially offset by the higher rates paid on interest-bearing liabilities.

Average interest earning assets increased by \$36,634,604, or 10.5%, to \$384,128,223 for the quarter ended March 31, 2007 from \$347,493,619 for the quarter ended March 31, 2006, with increases of \$24,153,242 in average total loans and \$10,961,203 in average total securities in the three months ended March 31, 2007 when compared to the three months ended March 31, 2006.

The Bank's average loan portfolio grew by 9.3% (where growth was focused on construction and commercial loans) when compared to the average loan portfolio for the first quarter of 2006. The yields on loans averaged 8.82% for the first quarter of 2007, increasing 73 basis points over the 8.09% yield on loans for the first quarter of 2006. The Bank's average securities portfolio increased by 12.5% and the yield on that portfolio increased by 50 basis points for the quarter ended March 31, 2007 when compared to the quarter ended March 31, 2006. Overall, the yield on interest earning assets increased 64 basis points to 7.91% for the quarter ended March 31, 2007 when compared to 7.27% for the quarter ended March 31, 2006.

Average interest bearing liabilities increased by \$30,198,480, or 11.0%, to \$304,608,308 for the quarter ended March 31, 2007 from \$274,409,828 for the quarter ended March 31, 2006. Certificates of deposit increased on average by \$20,449,439 for the three months ended March 31, 2007 when compared to the three months ended March 31, 2006. The cost of certificates of deposit increased 111 basis points to 4.82% for the first quarter of 2007 compared to 3.71% for the first quarter of 2006. During June 2006, the Company added approximately \$18 million in trust preferred securities, which helped fund the growth of the loan and securities portfolios. Overall, the cost of total interest bearing liabilities increased 106 basis points to 3.90% for the three months ended March 31, 2007 compared to 2.84% for the three months ended March 31, 2006.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 4.81% for the first three months of 2007 compared to 5.03% for the first three months of 2006.

#### Non-Interest Income

Total non-interest income for the three months ended March 31, 2007 was \$643,741, a decrease of \$66,283, or 9.3%, over non-interest income of \$710,025 for the three months ended March 31, 2006.

Service charges on deposit accounts represents a significant source of non-interest income. Service charge revenues decreased by \$36,704, or 19.7%, to \$149,855 for the three months ended March 31, 2007 from the \$186,559 for the three months ended March 31, 2006. This decrease was the result of a lower volume of uncollected and overdraft fees collected on deposit accounts during the first quarter of 2007 compared to 2006.

Gain on sales of loans decreased by \$86,912, or 27.3%, to \$231,777 for the three months ended March 31, 2007 when compared to \$318,689 for the three months ended March 31, 2006. The rising rate environment that existed throughout 2006 and continued into the first quarter of 2007 has significantly impacted the volume of sales transactions in the mortgage loan and SBA loan markets and resultant gains resulting from these transactions.

Non-interest income also includes income from bank-owned life insurance ("BOLI") which amounted to \$90,348 for the three months ended March 31, 2007 compared to \$61,039 for the three months ended March 31, 2006. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company's overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Increased customer demand for these services contributed to the other income component of non-interest income amounting to \$171,761 for the three months ended March 31, 2007, compared to \$143,738 for the three months ended March 31, 2006.

## Non-Interest Expense

Non-interest expenses decreased by \$48,885, or 1.6%, to \$3,074,224 for the three months ended March 31, 2007 from \$3,123,109 for the three months ended March 31, 2006. The following table presents the major components of non-interest expenses for the three months ended March 31, 2007 and 2006.

## Non-interest Expenses

	Three months ended March 31, 2007	2006 (Restated)
Salaries and employee benefits	\$ 1,863,252	\$ 1,709,213
Occupancy expenses	527,753	322,359
Equipment expense	125,413	121,004
Marketing	24,881	109,098
Computer services	197,076	166,635
Regulatory, professional and other fees	108,786	391,391
Office expense	142,374	102,023
All other expenses	84,689	201,386
	\$ 3,074,224	\$ 3,123,109

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$154,039, or 9.0%, to \$1,863,252 for the three months ended March 31, 2007 compared to \$1,709,213 for the three months ended March 31, 2006. The increase in salaries and employee benefits for the three months ended March 31, 2007 was a result of an increase in the number of employees, regular merit increases and increased health care costs. Staffing levels overall increased to 102 full-time equivalent employees at March 31, 2007 as compared to 89 full-time equivalent employees at March 31, 2006. The February 23, 2007 acquisition of the Hightstown branch contributed to this increase by increasing the number of full-time equivalent employees by 4 and the resultant salary and benefit expenses by approximately \$25,000.

Regulatory, professional and other fees decreased by \$282,605, or 72.2%, to \$108,786 for the three months ended March 31, 2007 compared to \$391,391 for the three months ended March 31, 2006. During 2006, the Company chose to incur additional accounting, legal and consulting fees primarily as a result of the new internal control compliance requirements contained in Section 404 of the Sarbanes-Oxley Act in anticipation of the Company's compliance in 2007.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Bank's efficiency ratio decreased to 60.3% for the three months ended March 31, 2007, compared to 63.2% for the three months ended March 31, 2006.

## Provision for Loan Losses

The provision for loan losses was \$40,000 for the three months ended March 31, 2007 and \$170,000 for the three months ended March 31, 2006. Management considers a complete review of the following specific factors in determining the provision for loan losses: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market

conditions. Net charge offs/recoveries amounted to a net recovery of \$79,703 for the three months ended March 31, 2007 compared to a net recovery of \$2,515 for the three months ended March 31, 2006. See "Allowance for Loan Losses and Related Provision" on page 25.

#### Financial Condition

##### March 31, 2007 Compared with December 31, 2006

Total consolidated assets at March 31, 2007 totaled \$421,607,485, increasing by \$28,675,305 from \$392,932,180 at December 31, 2006. On February 27, 2007, the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19 million in new deposits. In connection with such acquisition, the Company recorded \$472,726 in goodwill and \$274,604 in core deposit intangibles, which appear as "Other Assets" in the Consolidated Balance Sheet for the quarter ended March 31, 2007.



### Cash and Cash Equivalents

Cash and Cash Equivalents at March 31, 2007 totaled \$20,140,928 compared to \$10,361,812 at December 31, 2006. Cash and cash equivalents at March 31, 2007 consisted of cash and due from banks of \$9,212,906 and Federal funds sold/short term investments of \$10,928,022. The corresponding balances at December 31, 2006 were \$10,336,334 and \$25,478, respectively.

### Investment Securities

The Bank's investment securities represented 25.2% of total assets at March 31, 2007 and 22.8% at December 31, 2006. Total investment securities increased \$16,667,724, or 18.6%, at March 31, 2007 to \$106,343,528 from \$89,675,804 at December 31, 2006.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Securities available for sale consist primarily of U.S. Government and Federal agency securities as well as mortgage-backed securities. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create economically more attractive returns. At March 31, 2007, available-for-sale securities amounted to \$79,765,545, and increase of \$9,344,217, or 13.3%, from December 31, 2006.

At March 31, 2007, the securities available for sale portfolio had net unrealized losses of \$424,980 compared to net unrealized losses of \$719,367 at December 31, 2006. These unrealized losses are reflected net of tax in shareholders' equity as a component of other comprehensive income (loss).

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. The held-to-maturity portfolio consists primarily of obligations of states and political subdivisions. At March 31, 2007, securities held to maturity were \$26,577,983, an increase of \$7,323,507, or 38.0% from \$19,254,476 at December 31, 2006. The fair value of the held-to-maturity portfolio at March 31, 2007, was \$26,485,649, resulting in a net unrealized loss of \$92,334.

During the three months ended March 31, 2007, the Bank purchased securities in the amounts of \$11,920,653 and \$7,677,917 for the available for sale and held to maturity portfolios, respectively. These purchases were funded primarily by the cash received in the Hightstown branch completed in February 2007.

### Loans

The loan portfolio, which represents the Bank's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Company's primary lending focus continues to be construction loans, commercial loans, owner-occupied commercial mortgage loans and tenanted commercial real estate loans.

The following table sets forth the classification of loans by major category at March 31, 2006 and December 31, 2005.

### Loan Portfolio

Composition	March 31, 2007		December 31, 2006	
Component	Amount	% of total	Amount	% of total
Construction loans	\$ 126,342,388	47%	\$ 125,268,871	47%
Residential real estate loans	7,093,499	3%	7,670,370	3%
Commercial and commercial real estate	121,139,279	45%	114,897,040	44%
Loans to individuals	14,834,664	5%	16,728,025	6%
Deferred loan fees	419,440	0%	404,074	0%
All other loans	191,747	0%	173,933	0%
	\$ 270,021,017	100.0%	\$ 265,142,313	100.0%

The loan portfolio increased \$4,878,704, or 1.8%, at March 31, 2007 to \$270,021,017 from \$265,142,313 at December 31, 2006. The ability of the Company to enter into larger loan relationships and management's philosophy of relationship banking are key factors in the Company's strategy for loan growth. The ultimate collectability of the loan portfolio and the recovery of the carrying amount of real estate are subject to changes in the Company's market region's economic environment and real estate market.

### Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis, (2) loans which are contractually past due 90 days or more as to interest and principal payments but have not been classified as non-accrual, and (3) loans whose terms have been restructured to provide a reduction or deferral of interest on principal because of a deterioration in the financial position of the borrower.

The Bank's policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-performing loans decreased by \$627,944 to \$3,565,265 at March 31, 2007 from \$4,193,209 at December 31, 2006. The largest segment of non-accrual loans represents unfinished residential construction where litigation has commenced and workout negotiations are in process. The balance of the non-performing loans are centered in commercial loans for which litigation has commenced. The table below sets forth non-performing assets and risk elements in the Bank's portfolio by type for the years indicated. As the table demonstrates, non-performing loans to total loans decreased to 1.32% at March 31, 2007 from 1.58% at December 31, 2006 for the reasons previously stated, but loan quality is still considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Non-performing assets decreased by \$627,944 to \$3,565,265 at March 31, 2007 from \$4,193,209 at December 31, 2006. Non-performing assets represented 0.85% of total assets at March 31, 2007 and 1.07% at December 31, 2006. Non-performing loans as a percentage of total loans were 1.32% at March 31, 2007, compared to 1.58% at December 31, 2006.

The Bank had no loans classified as restructured loans at March 31, 2007 or December 31, 2006.

At March 31, 2007 and December 31, 2006, the Bank had no loans that were 90 days or more past due but still accruing interest.

Non-Performing Assets and Loans	March 31, 2007	December 31, 2006
Non-Performing loans:		
Loans 90 days or more past due and still accruing	\$ 0	\$ 0
Non-accrual loans	3,565,265	4,193,209
Total non-performing loans	3,565,265	4,193,209
Other real estate owned	0	0
Total non-performing assets	\$ 3,565,265	\$ 4,193,209
Non-performing loans to total loans	1.27%	1.58%
Non-performing assets to total assets	0.85%	1.07%

Management takes a proactive approach in addressing delinquent loans. The Company's President meets weekly with all loan officers to review the status of credits past-due ten days or more. An action plan is discussed for each of the loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate and when the collateral is foreclosed upon, the real estate is carried at the lower of fair market value less estimated selling costs, or at cost. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the asset is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

#### Allowance for Loan Losses

The allowance for loan losses is maintained at a level sufficient in the opinion of management to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans, including construction loans. Based on the composition of the loan portfolio, the primary risks inherent in it are deteriorating credit quality, increases in interest rates, a decline in the economy, and a decline in New Jersey real estate market values. Any one or a combination of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All, or part, of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan and lease losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan and lease losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan and lease losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan and lease losses consists of several key elements. These elements include a specific reserve for doubtful or high risk loans, an allocated reserve, and an unallocated portion. The Company consistently applies the following comprehensive methodology.

During the quarterly review of the allowance for loan and lease losses, management of the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The specific reserve for high risk loans is established for specific commercial loans, commercial real estate loans, and construction loans which have been identified by management as being high risk loan assets. These high risk loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and for the various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information which is often subjective and changing rapidly. At March 31, 2007, management believed that the allowance for loan losses and nonperforming loans was adequate.

The allowance for loan losses amounted to \$3,348,063 at March 31, 2007, an increase of \$19,703 from December 31, 2006. The ratio of the allowance for loan losses to total loans was 1.19% at March 31, 2007 and 1.16% at December 31, 2006, respectively. Management believes the quality of the loan portfolio remains sound and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

Allowance for Loan Losses	March 31, 2007	December 31, 2006	March 31, 2006
Balance, beginning of period	\$ 3,228,360	\$ 2,361,375	\$ 2,361,375
Provision charged to operating expenses	40,000	893,500	170,000
Loans charged off:			
Construction loans	-	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	-	(11,154)	-
Loans to individuals	-	(18,314)	(285)
Lease financing	-	-	-
All other loans	-	-	-
	0	(29,468)	(285)
Recoveries:			
Construction loans	75,000	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	-	153	-
Loans to individuals	4,703	2,800	2,800
Lease financing	-	-	-
All other loans	-	-	-
	79,703	2,953	2,800
Net (charge offs) / recoveries	79,703	(26,515)	2,515
Balance, end of period	\$ 3,348,063	\$ 3,228,360	\$ 2,533,890
Loans:			
At period end	\$ 280,685,187	\$ 278,751,255	\$ 252,810,235
Average during the period	283,672,768	271,740,647	259,519,526
Net charge offs to average loans outstanding	0.03%	(0.01%)	0.00%
Allowance for loan losses to:			
Total loans at period end	1.19%	1.16%	1.00%
Non-performing loans	93.91%	76.99%	0.00%

## Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings and time deposits, are a fundamental and cost-effective source of funding. The Company offers a variety of products designed to attract and retain customers, with the Company's primary focus being on building and expanding long-term relationships.

Total deposits increased \$28,057,223, or 9.0%, to \$340,781,645 at March 31, 2007 from \$312,724,422 at December 31, 2006. On February 27, 2007, the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19 million in new deposits.

## Borrowings

Borrowings are mainly comprised of fixed rate convertible advances from the Federal Home Loan Bank (“FHLB”) and federal funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of other borrowings at March 31, 2007 consisted of long-term FHLB borrowings of \$15,500,000. The balance of borrowings at December 31, 2006 consisted of long-term FHLB borrowings of \$15,500,000 and overnight funds purchased of \$1,700,000. FHLB advances are fully secured by marketable securities.



## Shareholders' Equity And Dividends

Shareholders' equity at March 31, 2007 totaled \$36,921,769, an increase of \$1,975,264, or 5.7%, from \$34,946,505 at December 31, 2006. Book value per common share rose to \$9.31 at March 31, 2007 from \$8.81 at December 31, 2006. The ratio of shareholders' equity to total assets was 8.76% at March 31, 2007 and 8.89% at December 31, 2006.

The increase in shareholders' equity and book value per share resulted primarily from net income of \$1,325,894 and the decrease in unrealized holding losses on available for sale securities.

The Company's stock is listed for trading on the Nasdaq Global Market System, under the symbol "FCCY."

In 2005, the Board of Directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company's shares at management's discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. A table disclosing repurchases of Company shares made during the quarter ended March 31, 2007 is set forth under Part II, Item 2 of this report, Unregistered Sales of Equity Securities and Use of Proceeds.

Actual capital amounts and ratios for the Company and the Bank as of March 31, 2007 and December 31, 2006 are as follows:

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
As of March 31, 2007 - Company						
Total Capital to Risk						
Weighted Assets	\$ 58,047,406	18.12%	\$ 25,629,680	>8%	\$ 32,037,100	N/A
Tier 1 Capital to Risk						
Weighted Assets	49,160,070	15.34%	12,814,840	>4%	19,222,260	N/A
Tier 1 Capital to Average Assets	49,160,070	12.08%	16,271,503	>4%	20,339,378	N/A
Bank						
Total Capital to Risk						
Weighted Assets	\$ 55,213,150	17.23%	\$ 25,629,680	>8%	\$ 32,037,100	>10%
Tier 1 Capital to Risk						
Weighted Assets	51,865,087	16.19%	12,814,840	>4%	19,222,260	>6%
Tier 1 Capital to Average Assets	51,865,087	12.81%	16,192,200	>4%	20,240,250	>5%

As of December 31,  
2006 - restated  
Company

Total Capital to Risk						
Weighted Assets	\$ 61,652,577	19.93%	\$ 24,751,678	>8%	\$ 30,939,598	N/A
Tier 1 Capital to Risk						
Weighted Assets	47,220,481	15.26%	12,375,839	>4%	18,563,759	N/A

Tier 1 Capital to Average Assets	47,220,481	11.99%	15,752,046	>4%	19,690,058	N/A
Bank						
Total Capital to Risk Weighted Assets	\$ 53,520,979	17.30%	\$ 24,751,040	>8%	\$ 30,938,800	>10%
Tier 1 Capital to Risk Weighted Assets	50,292,619	16.26%	12,375,520	>4%	18,563,280	>6%
Tier 1 Capital to Average Assets	50,292,619	12.80%	15,710,320	>4%	19,637,900	>5%

The minimum regulatory capital requirements for financial institutions require institutions to have a Tier 1 capital to average assets ratio of 4.0%, a Tier 1 capital to risk weighted assets ratio of 4.0% and a total capital to risk weighted assets ratio of 8.0%. To be considered “well capitalized,” an institution must have a minimum Tier 1 leverage ratio of 5.0%. At March 31, 2007, the ratios of the Company exceeded the ratios required to be considered well capitalized. It is management’s goal to monitor and maintain adequate capital levels to continue to support asset growth and continue its status as a well-capitalized institution.

## Liquidity

At March 31, 2007, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity measures the ability to satisfy current and future cash flow needs as they become due. Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB and a correspondent bank which further supports and enhances liquidity. At March 31, 2007, the Bank maintained an Overnight Line of Credit at the FHLB in the amount of \$16,176,500 plus a One-Month Overnight Repricing Line of Credit of \$10,176,500. Advances issued under these programs are subject to FHLB stock level and collateral requirements. Pricing of these advances may fluctuate based on existing market conditions. The Bank also maintains an unsecured Federal funds line of \$13,500,000 with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At March 31, 2007, the balance of cash and cash equivalents was \$20,140,928.

Net cash provided by operating activities totaled \$5,522,027 in the three months ended March 31, 2007 compared to \$8,325,217 in the three months ended March 31, 2006. The primary sources of funds are net income from operations adjusted for provision for loan losses, depreciation expenses, and net proceeds from sales of loans held for sale.

Net cash used in investing activities totaled \$2,585,895 in the three months ended March 31, 2007 compared to \$4,053,950 used in investing activities in the three months ended March 31, 2006. The current period amount was primarily the result of investment securities purchases partially offset by the cash and cash equivalents acquired with the Hightstown branch.

Net cash provided by financing activities amounted to \$6,842,984 in the three months ended March 31, 2007 compared to \$5,652,768 used in financing activities in the three months ended March 31, 2006. The current period amount resulted primarily from an increase in deposits combined with a decrease in borrowings during the three months period ended March 31, 2007.

The securities portfolio is also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. During the three months ended March 31, 2007, maturities and prepayments of investment securities totaled \$3,213,855. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

The Company anticipates that cash and cash equivalents on hand, the cash flow from assets as well as other sources of funds will provide adequate liquidity for the Company's future operating, investing and financing needs, including the April 22, 2007 redemption of the Trust I securities which required a payment of approximately \$5,388,786. Management will continue to monitor the Company's liquidity and maintain it at a level that it deems adequate and not

excessive.

42

---

Three months ended June 30, 2007 compared to three months ended June 30, 2006

## RESULTS OF OPERATIONS

### Summary

The Company realized net income of \$1,418,099 for the three months ended June 30, 2007, an increase of 16.5% from the \$1,217,716 reported for the three months ended June 30, 2006. Diluted net income per share was \$0.35 for the three months ended June 30, 2007 compared to \$0.30 per diluted share for the three months ended June 30, 2006. All share information has been restated for the effect of a 6% stock dividend declared on December 20, 2007 and paid on February 6, 2008 to shareholders of record on January 23, 2008.

Key performance ratios remained strong for the three months ended June 30, 2007. Return on average assets and return on average equity were 1.35% and 15.36% for the three months ended June 30, 2007 compared to 1.30% and 15.87%, respectively, for the three months ended June 30, 2006.

A significant factor impacting the Company's net interest income has been the rising level of market interest rates that characterized the marketplace in 2006 and has continued through the first half of 2007. The Federal Reserve Bank's Open Market Committee raised short-term interest rates four times during 2006, which raised the targeted Federal funds rate to the current 5.25% at June 30, 2007. These increases in short-term market rates drive up the cost of the Company's core deposits. As a result, the Company experienced a 92 basis point increase in the cost of its interest-bearing deposits to 3.93% at June 30, 2007 compared to 3.01% at June 30, 2006. The Company's net interest margin experienced a decrease of 54 basis points to 4.64% at June 30, 2007 compared to 5.18% at June 30, 2006.

A second significant factor impacting financial results for the first half of 2007 was the February 27, 2007 closing of a transaction whereby the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19.5 million in new deposits and \$18.8 million in cash to the balance sheet in 2007 in addition to having an impact on most components of income/expense on the statement of income for the six months ended June 30, 2007.

### Earnings Analysis

#### Interest Income

Interest income for the three months ended June 30, 2007 was \$7,445,478, increasing by 9.7% from the \$6,789,622 reported in the three months ended June 30, 2006. This is primarily attributable to a higher volume of total interest-earning assets when compared to the prior year period. For the three months ended June 30, 2007, average interest earning assets increased \$43,618,780 or 12.4%, to \$395,860,393 compared to \$352,241,613 for the three months ended June 30, 2006. For the three months ended June 30, 2007, the average yield on earning assets decreased 16 basis points to 7.65% from 7.81% for the three months ended June 30, 2006.

#### Interest Expense

Interest expense for the three months ended June 30, 2007 was \$3,130,961, an increase of \$950,448 from \$2,180,513 reported for the three months ended June 30, 2006. Total average interest bearing liabilities increased by \$43,929,636 to \$318,230,562 for the three months ended June 30, 2007 from \$274,300,926 for the three months ended June 30, 2006. The average cost of interest bearing liabilities increased 76 basis points to 3.95% for the three months ended June 30, 2007 from 3.19% for the three months ended June 30, 2006, primarily as a result of an increase in market-driven rates paid on deposits and short-term borrowed funds.

## Net Interest Income

The Company's net interest income for the three months ended June 30, 2007 was \$4,314,517, a decrease of 6.4% from the \$4,609,109 reported for June 30, 2006. The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest-earning assets, decreased 85 basis points to 4.48% for the three months ended June 30, 2007 from 5.33% for the three months ended June 30, 2006. The increased cost of deposits in the competitive New Jersey marketplace combined with a shift in the Company's deposit mix to higher cost certificates of deposit accounts has been contributed significantly to this margin compression.

## Provision for Loan Losses

Management maintains the allowance for loan losses at a level that is considered adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. Additions to the allowance are made by charges to the provision for loan losses. The evaluation considers a complete review of the following specific factors: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. Additionally, current economic conditions and local real estate market conditions are considered. As a result of this evaluation process, the Company's provision for loan losses was \$30,000 for the three months ended June 30, 2007 and \$170,000 for the three months ended June 30, 2006. See "Allowance for Loan Losses and Related Provision" on page 25.

## Non-Interest Income

Total non-interest income for the three months ended June 30, 2007 was \$648,423, an increase of \$173,714, or 36.6%, over non-interest income of \$474,709 for the three months ended June 30, 2006.

Service charges on deposit accounts represents a significant source of non-interest income. Service charge revenues increased by \$8,139, or 4.9%, to \$175,181 for the three months ended June 30, 2007 from the \$167,042 for the three months ended June 30, 2006. This increase was the result of a higher volume of uncollected and overdraft fees collected on deposit accounts during the second quarter of 2007 compared to the same period in 2006.

Gain on sales of loans increased by \$13,811, or 7.9%, to \$188,741 for the three months ended June 30, 2007 when compared to \$174,930 for the three months ended June 30, 2006. The rising rate environment that existed throughout 2006 and continued into the first half of 2007 has impacted the volume of sales transactions in the mortgage loan and SBA loan markets and resultant gains resulting from these transactions.

Non-interest income also includes income from bank-owned life insurance ("BOLI") which amounted to \$88,233 for the three months ended June 30, 2007 compared to \$82,934 for the three months ended June 30, 2006. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company's overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Increased customer demand for these services contributed to the other income component of non-interest income amounting to \$196,268 for the three months ended June 30, 2007, compared to \$149,517 for the three months ended June 30, 2006.

The Company recorded net losses on sales of investment securities of \$99,714 for the three months ended June 30, 2006. These transactions were primarily the result of modest portfolio restructurings. Their purpose was to improve the Company's longer-term interest rate risk position.

## Non-Interest Expenses

Non-interest expenses decreased by \$214,269, or 6.9%, to \$2,875,337 for the three months ended June 30, 2007 from \$3,089,606 for the three months ended June 30, 2006. The following table presents the major components of non-interest expenses for the three months ended June 30, 2007 and 2006.

Non-Interest Expenses	Three months ended	
	June 30,	
	2007	2006

		(Restated)
Salaries and employee benefits	\$ 1,687,666	\$ 1,685,372
Occupancy expenses	538,213	381,518
Equipment expense	120,796	116,163
Marketing	22,145	65,100
Computer services	215,898	175,327
Regulatory, professional and other fees	73,320	290,178
Office expense	152,408	105,630
All other expenses	64,891	270,318
Total	\$ 2,875,337	\$ 3,089,606



Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$2,294, or 0.1%, to \$1,687,666 for the three months ended June 30, 2007 compared to \$1,685,372 for the three months ended June 30, 2006. The modest increase in salaries and employee benefits for the three months ended June 30, 2007 was a result of a lower level of expenses incurred in connection with the Company's health insurance and other employee benefit plans combined with a modest increase in staffing levels. Staffing levels overall increased to 97 full-time equivalent employees at June 30, 2007 as compared to 93 full-time equivalent employees at June 30, 2006. The February 23, 2007 acquisition of the Hightstown branch contributed to this increase by increasing the number of full-time equivalent employees by 4.

Regulatory, professional and other fees decreased by \$216,858, or 74.7%, to \$73,320 for the three months ended June 30, 2007 compared to \$290,178 for the three months ended June 30, 2006. During 2006, the Company chose to incur additional accounting, legal and consulting fees primarily as a result of the new internal control compliance requirements contained in Section 404 of the Sarbanes-Oxley Act in anticipation of the Company's compliance in 2008.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Bank's efficiency ratio decreased to 57.9% for the three months ended June 30, 2007, compared to 60.8% for the three months ended June 30, 2006.

#### Financial Condition

##### June 30, 2007 Compared with December 31, 2006

Total consolidated assets at June 30, 2007 totaled \$428,116,992, increasing by \$35,716,868 from \$392,400,124 at December 31, 2006. On February 27, 2007, the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19 million in new deposits. In connection with such acquisition, the Company recorded \$472,726 in goodwill and \$274,604 in core deposit intangibles, which appear as "Other Assets" in the Consolidated Balance Sheet at June 30, 2007.

##### Cash and Cash Equivalents

Cash and Cash Equivalents at June 30, 2007 totaled \$9,580,485 compared to \$10,361,812 at December 31, 2006. Cash and cash equivalents at June 30, 2007 consisted of cash and due from banks of \$9,559,584 and Federal funds sold/short term investments of \$20,901. The corresponding balances at December 31, 2006 were \$10,336,334 and \$25,478, respectively.

##### Investment Securities

The Bank's investment securities represented 25.4% of total assets at June 30, 2007 and 22.8% at December 31, 2006. Total investment securities increased \$18,899,587, or 21.1%, at June 30, 2007 to \$108,575,391 from \$89,675,804 at December 31, 2006.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Securities available for sale consist primarily of U.S. Government and Federal agency securities as well as mortgage-backed securities. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create economically more

attractive returns. At June 30, 2007, available-for-sale securities amounted to \$82,047,134, and increase of \$11,625,806 or 16.5%, from December 31, 2006.

At June 30, 2007, the securities available for sale portfolio had net unrealized losses of \$1,648,343 compared to net unrealized losses of \$719,367 at December 31, 2006. These unrealized losses are reflected net of tax in shareholders' equity as a component of other comprehensive income (loss).

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. The held-to-maturity portfolio consists primarily of obligations of states and political subdivisions. At June 30, 2007, securities held to maturity were \$26,528,257, an increase of \$7,273,781, or 37.8% from \$19,254,476 at December 31, 2006. The fair value of the held-to-maturity portfolio at June 30, 2007, was \$26,041,037, resulting in a net unrealized loss of \$487,219.

During the six months ended June 30, 2007, the Bank purchased securities in the amounts of \$15,776,240 and \$7,677,917 for the available for sale and held to maturity portfolios, respectively. These purchases were funded primarily by the cash received in the Hightstown branch acquisition completed in February 2007.

## Loans

The loan portfolio, which represents the Bank's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Company's primary lending focus continues to be construction loans, commercial loans, owner-occupied commercial mortgage loans and tenanted commercial real estate loans.

The following table sets forth the classification of loans by major category at June 30, 2007 and December 31, 2006.

Loan Portfolio Composition			June 30, 2007			December 31, 2006		
Component	Amount	% of total				Amount	% of total	
Construction loans	\$ 130,623,738	46	%			\$ 125,268,871	47	%
Residential real estate loans	9,155,735	4	%			7,670,370	3	%
Commercial and commercial real estate	129,611,101	45	%			114,897,040	44	%
Loans to individuals	15,598,979	5	%			16,728,025	6	%
Deferred loan fees	409,494	0	%			404,074	0	%
All other loans	177,548	0	%			173,933	0	%
	\$ 285,576,595	100	%			\$ 265,142,313	100.0	%

The loan portfolio increased \$20,434,282, or 7.7%, at June 30, 2007 to \$285,576,595 from \$265,142,313 at December 31, 2006. The ability of the Company to enter into larger loan relationships and management's philosophy of relationship banking are key factors in the Company's strategy for loan growth. The ultimate collectability of the loan portfolio and the recovery of the carrying amount of real estate are subject to changes in the Company's market region's economic environment and real estate market.

## Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis, (2) loans which are contractually past due 90 days or more as to interest and principal payments but have not been classified as non-accrual, and (3) loans whose terms have been restructured to provide a reduction or deferral of interest on principal because of a deterioration in the financial position of the borrower.

The Bank's policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-performing loans decreased by \$699,453 to \$3,493,756 at June 30, 2007 from \$4,193,209 at December 31, 2006. The largest segment of non-accrual loans represents unfinished residential construction where litigation has

commenced and workout negotiations are in process. The balance of the non-performing loans are centered in commercial loans for which litigation has commenced. The table below sets forth non-performing assets and risk elements in the Bank's portfolio by type for the years indicated. As the table demonstrates, non-performing loans to total loans decreased to 1.23% at June 30, 2007 from 1.58% at December 31, 2006 for the reasons previously stated, but loan quality is still considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Non-performing assets decreased by \$679,453 to \$3,513,756 at June 30, 2007 from \$4,193,209 at December 31, 2006. Non-performing assets represented 0.82% of total assets at June 30, 2007 and 1.07% at December 31, 2006. Non-performing loans as a percentage of total loans were 1.23% at June 30, 2007, compared to 1.58% at December 31, 2006.

The Bank had no loans classified as restructured loans at June 30, 2007 or December 31, 2006.

At June 30, 2007 and December 31, 2006, the Bank had no loans that were 90 days or more past due but still accruing interest.

Non-Performing Assets and Loans	June 30, 2007	December 31, 2006
Non-Performing loans:		
Loans 90 days or more past due and still accruing	\$ 0	\$ 0
Non-accrual loans	3,493,756	4,193,209
Total non-performing loans	3,493,756	4,193,209
Other real estate owned	0	0
Total non-performing assets	\$ 3,493,756	\$ 4,193,209
Non-performing loans to total loans	1.23 %	1.58 %
Non-performing assets to total assets	0.82 %	1.07 %

Management takes a proactive approach in addressing delinquent loans. The Company's President meets weekly with all loan officers to review the status of credits past-due ten days or more. An action plan is discussed for each of the loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate and when the collateral is foreclosed upon, the real estate is carried at the lower of fair market value less estimated selling costs, or at cost. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the asset is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

#### Allowance for Loan Losses

The allowance for loan losses is maintained at a level sufficient in the opinion of management to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans, including construction loans. Based on the composition of the loan portfolio, the primary risks inherent in it are deteriorating credit quality, increases in interest rates, a decline in the economy, and a decline in New Jersey real estate market values. Any one or a combination of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All, or part, of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan and lease losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan and lease losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan and lease losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan and lease losses consists of several key elements. These elements include a specific reserve for doubtful or high risk loans, an allocated reserve, and an unallocated portion. The Company consistently applies the following comprehensive methodology.

During the quarterly review of the allowance for loan and lease losses, management of the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The specific reserve for high risk loans is established for specific commercial loans, commercial real estate loans, and construction loans which have been identified by management as being high risk loan assets. These high risk loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and for the various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable.

It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information which is often subjective and changing rapidly. At June 30, 2007, management believed that the allowance for loan losses and non-performing loans was adequate.

The allowance for loan losses amounted to \$3,310,080 at June 30, 2007, an increase of \$81,720 from December 31, 2006. The ratio of the allowance for loan losses to total loans was 1.12% at June 30, 2007 and 1.16% at December 31, 2006, respectively. Management believes the quality of the loan portfolio remains sound and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

Allowance for Loan Losses	June 30, 2007	December 31, 2006	June 30, 2006
Balance, beginning of period	\$ 3,228,360	\$ 2,361,375	\$ 2,361,375
Provision charged to operating expenses	70,000	893,500	340,000
Loans charged off:			
Construction loans	-	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	(65,891 )	(11,154 )	(11,154 )
Loans to individuals	(1,614 )	(18,314 )	(285 )
Lease financing	(478 )	-	-
All other loans	-	-	-
	(67,983 )	(29,468 )	(11,439 )
Recoveries:			
Construction loans	75,000	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	-	153	-
Loans to individuals	4,703	2,800	2,800
Lease financing	-	-	-
All other loans	-	-	-
	79,703	2,953	2,800
Net (charge offs) / recoveries	11,720	(26,515 )	(8,639 )
Balance, end of period	\$ 3,310,080	\$ 3,228,360	\$ 2,692,736
Loans:			
At period end	\$294,514,117	\$278,751,255	\$277,471,033
Average during the period	285,094,544	271,740,647	264,896,605
Net charge offs to average loans outstanding	0.00 %	(0.01 %)	0.00 %
Allowance for loan losses to:			
Total loans at period end	1.12 %	1.16 %	0.97 %
Non-performing loans	94.74 %	76.99 %	325.25 %

Deposits



Deposits, which include demand deposits (interest bearing and non-interest bearing), savings and time deposits, are a fundamental and cost-effective source of funding. The Company offers a variety of products designed to attract and retain customers, with the Company's primary focus being on building and expanding long-term relationships.

Total deposits increased \$13,226,061, or 4.2%, to \$325,950,483 at June 30, 2007 from \$312,724,422 at December 31, 2006. On February 27, 2007, the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19 million in new deposits.

#### Borrowings

Borrowings are mainly comprised of fixed rate convertible advances from the Federal Home Loan Bank ("FHLB") and federal funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of other borrowings at June 30, 2007 consisted of long-term FHLB borrowings of \$15,500,000 and overnight funds purchased of \$27,500,000. The balance of borrowings at December 31, 2006 consisted of long-term FHLB borrowings of \$15,500,000 and overnight funds purchased of \$1,700,000. FHLB advances are fully secured by marketable securities.

#### Shareholders' Equity And Dividends

Shareholders' equity at June 30, 2007 totaled \$37,312,137, an increase of \$2,365,632, or 6.8%, from \$34,946,505 at December 31, 2006. Book value per common share rose to \$9.43 at June 30, 2007 from \$8.81 at December 31, 2006. The ratio of shareholders' equity to total assets was 8.72% at June 30, 2007 and 8.89% at December 31, 2006.

The increase in shareholders' equity and book value per share resulted primarily from net income of \$2,903,205 partially offset by the increase in unrealized holding losses on available for sale securities.

The Company's stock is listed for trading on the Nasdaq Global Market System, under the symbol "FCCY."

In 2005, the Board of Directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company's shares at management's discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. A table disclosing repurchases of Company shares made during the quarter ended June 30, 2007 is set forth under Part II, Item 2 of this report, Unregistered Sales of Equity Securities and Use of Proceeds.

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Actual capital amounts and ratios for the Company and the Bank as of June 30, 2007 and December 31, 2006 are as follows:

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	Ratio	To Be Well Capitalized Under Prompt Corrective Action Provision Amount	Ratio
As of June 30, 2007 - Company						
Total Capital to Risk Weighted Assets	\$ 59,153,637	17.50 %	\$ 27,048,560	> 8%	\$ 33,810,700	N/A
Tier 1 Capital to Risk Weighted Assets	50,671,266	14.99 %	13,524,280	> 4%	20,286,420	N/A
Tier 1 Capital to Average Assets	50,671,266	12.08 %	16,788,365	> 4%	20,985,457	N/A
Bank						
Total Capital to Risk Weighted Assets	\$ 56,560,992	16.73 %	\$ 27,048,560	> 8%	\$ 33,810,700	>10%
Tier 1 Capital to Risk Weighted Assets	53,250,912	15.75 %	13,524,280	> 4%	20,286,420	> 6%
Tier 1 Capital to Average Assets	53,250,912	12.72 %	16,749,000	> 4%	20,936,250	> 5%
As of December 31, 2006 - restated Company						
Total Capital to Risk Weighted Assets	\$ 61,652,577	19.93 %	\$ 24,751,678	>8%	\$ 30,939,598	N/A
Tier 1 Capital to Risk Weighted Assets	47,220,481	15.26 %	12,375,839	>4%	18,563,759	N/A
Tier 1 Capital to Average Assets	47,220,481	11.99 %	15,752,046	>4%	19,690,058	N/A
Bank						
Total Capital to Risk Weighted Assets	\$ 53,520,979	17.30 %	\$ 24,751,040	>8%	\$ 30,938,800	>10%
Tier 1 Capital to Risk Weighted Assets	50,292,619	16.26 %	12,375,520	>4%	18,563,280	>6%
Tier 1 Capital to Average Assets	50,292,619	12.80 %	15,710,320	>4%	19,637,900	>5%

The minimum regulatory capital requirements for financial institutions require institutions to have a Tier 1 capital to average assets ratio of 4.0%, a Tier 1 capital to risk weighted assets ratio of 4.0% and a total capital to risk weighted assets ratio of 8.0%. To be considered “well capitalized,” an institution must have a minimum Tier 1 leverage ratio of 5.0%. At June 30, 2007, the ratios of the Company exceeded the ratios required to be considered well capitalized. It is management’s goal to monitor and maintain adequate capital levels to continue to support asset growth and continue its status as a well-capitalized institution.

## Liquidity

At June 30, 2007, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity measures the ability to satisfy current and future cash flow needs as they become due. Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB and a correspondent bank which further supports and enhances liquidity. At June 30, 2007, the Bank maintained an Overnight Line of Credit at the FHLB in the amount of \$16,176,500 plus a One-Month Overnight Repricing Line of Credit of \$10,176,500. Effective August 1, 2007, these lines were renewed by FHLB at the amount of \$28,883,000 for the Overnight Line of Credit and the One-Month Overnight Repricing Line of Credit. Advances issued under these programs are subject to FHLB stock level and collateral requirements. Pricing of these advances may fluctuate based on existing market conditions. The Bank also maintains an unsecured Federal funds line of \$13,500,000 with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At June 30, 2007, the balance of cash and cash equivalents was \$9,580,485.

Net cash provided by operating activities totaled \$6,840,786 in the six months ended June 30, 2007 compared to \$7,359,712 in the six months ended June 30, 2006. The primary sources of funds are net income from operations adjusted for provision for loan losses, depreciation expenses, and net proceeds from sales of loans held for sale.

Net cash used in investing activities totaled \$21,781,630 in the six months ended June 30, 2007 compared to \$17,062,006 used in investing activities in the six months ended June 30, 2006. The current period amount was primarily the result of investment securities purchases partially offset by the cash and cash equivalents acquired with the Hightstown branch.

Net cash provided by financing activities amounted to \$14,159,517 in the six months ended June 30, 2007 compared to \$6,582,386 provided by financing activities in the six months ended June 30, 2006. The current period amount resulted primarily from an increase in borrowings combined with a decrease in demand, savings and time deposits plus the repayment of redeemable subordinated debentures during the six months period ended June 30, 2007.

The securities portfolio is also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. During the six months ended June 30, 2007, maturities and prepayments of investment securities totaled \$3,563,962. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

The Company anticipates that cash and cash equivalents on hand, the cash flow from assets as well as other sources of funds will provide adequate liquidity for the Company's future operating, investing and financing needs. Management will continue to monitor the Company's liquidity and maintain it at a level that it deems adequate and not excessive.

Three months ended September 30, 2007 compared to three months ended September 30, 2006

## RESULTS OF OPERATIONS

### Summary

The Company realized net income of \$1,435,730 for the three months ended September 30, 2007, an increase of 15.8% from the \$1,239,568 reported for the three months ended September 30, 2006. Diluted net income per share was \$0.36 for the three months ended September 30, 2007 compared to \$0.31 per diluted share for the three months ended September 30, 2006. All share information has been restated for the effect of a 6% stock dividend declared on December 20, 2007 and paid on February 6, 2008 to shareholders of record on January 23, 2008.

Key performance ratios remained strong for the three months ended September 30, 2007. Return on average assets and return on average equity were 1.32% and 14.84% for the three months ended September 30, 2007 compared to 1.26% and 15.08%, respectively, for the three months ended September 30, 2006.

A significant factor impacting the Company's net interest income has been the rising level of market interest rates that characterized the marketplace in 2006 and has continued through the first nine months of 2007. The Federal Reserve Bank's Open Market Committee ("FOMC") raised short-term interest rates four times during 2006, which raised the targeted Federal funds rate to 5.25%, the level that continued through mid-September 2007. In response to reduced inflation pressures and a level of instability in financial markets, the FOMC reduced the Federal funds rate 50 basis points to 4.75% on September 18, 2007. Prior to this rate cut, the increases in short-term market rates drove up the cost of the Company's deposits. As a result, the Company experienced a 34 basis point increase in the cost of its interest-bearing deposits to 4.02% for the three months ended September 30, 2007 compared to 3.68% for the three months ended September 30, 2006. In addition, the yield on the Company's interest-earning assets decreased 6 basis points to 7.77% for the three months ended September 30, 2007 compared to 7.83% for the three months ended September 30, 2006. The Company's net interest margin experienced a decrease of 43 basis points to 4.51% for the three months ended September 30, 2007 compared to 4.94% for the three months ended September 30, 2006.

A second significant factor impacting financial results for the first nine months of 2007 was the February 27, 2007 closing of a transaction whereby the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19.5 million in new deposits and \$18.8 million in cash to the balance sheet in 2007 in addition to having an impact on most components of income/expense on the statement of income for the nine months ended September 30, 2007.

## Earnings Analysis

### Interest Income

Interest income for the three months ended September 30, 2007 was \$7,825,738, increasing by 9.2% from the \$7,163,273 reported in the three months ended September 30, 2006. This is primarily attributable to a higher volume of total interest-earning assets when compared to the prior year period. For the three months ended September 30, 2007, average interest earning assets increased \$40,378,192 or 11.0%, to \$407,061,783 compared to \$366,683,591 for the three months ended September 30, 2006. For the three months ended September 30, 2007, the average yield on earning assets decreased 10 basis points to 7.73% from 7.83% for the three months ended September 30, 2006.

### Interest Expense

Interest expense for the three months ended September 30, 2007 was \$3,307,196, an increase of \$653,443 from \$2,653,753 reported for the three months ended September 30, 2006. Total average interest bearing liabilities increased by \$39,332,097 to \$326,796,485 for the three months ended September 30, 2007 from \$287,464,388 for the three months ended September 30, 2006. The average cost of interest bearing liabilities increased 34 basis points to 4.02% for the three months ended September 30, 2007 from 3.68% for the three months ended September 30, 2006, primarily as a result of an increase in market-driven rates paid on deposits and short-term borrowed funds.

### Net Interest Income

The Company's net interest income for the three months ended September 30, 2007 was \$4,518,542, increasing from the \$4,509,520 reported for September 30, 2006. The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest-earning assets, decreased 43 basis points to 4.51% for the three months ended September 30, 2007 from 4.94% for the three months ended September 30, 2006. The increased cost of deposits in the competitive New Jersey marketplace combined with a shift in the Company's deposit mix to higher cost certificates of deposit accounts has been contributed significantly to this margin compression.

### Provision for Loan Losses

Management maintains the allowance for loan losses at a level that is considered adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. Additions to the allowance are made by charges to the provision for loan losses. The evaluation considers a complete review of the following specific factors: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. Additionally, current economic conditions and local real estate market conditions are considered. As a result of this evaluation process, the Company's provision for loan losses was \$30,000 for the three months ended September 30, 2007 and \$100,000 for the three months ended September 30, 2006. See "Allowance for Loan Losses and Related Provision" on page 25.



## Non-Interest Income

Total non-interest income for the three months ended September 30, 2007 was \$645,706, a decrease of \$111,979, or 14.8%, over non-interest income of \$757,685 for the three months ended September 30, 2006.

Service charges on deposit accounts represents a significant source of non-interest income. Service charge revenues increased by \$15,841, or 10.4%, to \$168,578 for the three months ended September 30, 2007 from the \$152,737 for the three months ended September 30, 2006. This increase was the result of a higher volume of uncollected and overdraft fees collected on deposit accounts during the third quarter of 2007 compared to the same period in 2006.

Gain on sales of loans decreased by \$153,864, or 45.6%, to \$183,750 for the three months ended September 30, 2007 when compared to \$337,614 for the three months ended September 30, 2006. The rising rate environment that existed throughout 2006 and continued into the first nine months of 2007 has impacted the volume of sales transactions in the SBA loan secondary market and resultant gains resulting from these sales transactions.

Non-interest income also includes income from bank-owned life insurance ("BOLI") which amounted to \$95,446 for the three months ended September 30, 2007 compared to \$108,138 for the three months ended September 30, 2006. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company's overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Increased customer demand for these services contributed to the other income component of non-interest income amounting to \$197,932 for the three months ended September 30, 2007, compared to \$159,196 for the three months ended September 30, 2006.

## Non-Interest Expense

Non-interest expenses decreased by \$113,604, or 3.6%, to \$3,011,371 for the three months ended September 30, 2007 from \$3,124,975 for the three months ended September 30, 2006. The following table presents the major components of non-interest expenses for the three months ended September 30, 2007 and 2006.

## Non-interest Expenses

	Three months ended September 30,	
	2007	2006
		(Restated)
Salaries and employee benefits	\$ 1,810,573	\$ 1,670,169
Occupancy expenses	431,888	413,679
Equipment expense	109,336	133,116
Marketing	27,141	103,152
Computer services	213,763	199,035
Regulatory, professional and other fees	112,286	179,313
Office expense	142,749	127,151
All other expenses	163,635	299,360
Total	\$ 3,011,371	\$ 3,124,975

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$140,404, or 8.4%, to \$1,810,573 for the three months ended September 30, 2007 compared to \$1,670,169 for the three months



ended September 30, 2006. The increase in salaries and employee benefits for the three months ended September 30, 2007 was a result of an increase in staffing levels partially offset by a lower level of expenses incurred in connection with the Company's health insurance and other employee benefit plans. Staffing levels overall increased to 104 full-time equivalent employees at September 30, 2007 as compared to 90 full-time equivalent employees at September 30, 2006. The February 23, 2007 acquisition of the Hightstown branch contributed to this increase by increasing the number of full-time equivalent employees by 4.

Marketing expense decreased by \$76,011, or 73.7% to \$27,141 for the three months ended September 30, 2007 compared to \$103,152 for the three months ended September 30, 2006 as the Company ran fewer broadcast media promotions during 2007.

Regulatory, professional and other fees decreased by \$67,027, or 37.4%, to \$112,286 for the three months ended September 30, 2007 compared to \$179,313 for the three months ended September 30, 2006. During 2006, the Company chose to incur additional accounting and consulting fees primarily as a result of the new internal control compliance requirements contained in Section 404 of the Sarbanes-Oxley Act.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Bank's efficiency ratio decreased to 58.3% for the three months ended September 30, 2007, compared to 59.3% for the three months ended September 30, 2006.

#### Financial Condition

##### September 30, 2007 Compared with December 31, 2006

Total consolidated assets at September 30, 2007 totaled \$429,889,889, increasing by \$36,957,709 from \$392,932,180 at December 31, 2006. On February 27, 2007, the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19 million in new deposits. In connection with such acquisition, the Company recorded \$472,726 in goodwill and \$274,604 in core deposit intangibles, which appear as "Other Assets" in the Consolidated Balance Sheet at September 30, 2007.

#### Cash and Cash Equivalents

Cash and Cash Equivalents at September 30, 2007 totaled \$9,562,789 compared to \$10,361,812 at December 31, 2006. Cash and cash equivalents at September 30, 2007 consisted of cash and due from banks of \$8,743,801 and Federal funds sold/short term investments of \$818,988. The corresponding balances at December 31, 2006 were \$10,336,334 and \$25,478, respectively.

#### Investment Securities

The Bank's investment securities represented 24.6% of total assets at September 30, 2007 and 22.8% at December 31, 2006. Total investment securities increased \$16,251,915, or 18.1%, at September 30, 2007 to \$105,927,719 from \$89,675,804 at December 31, 2006.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Securities available for sale consist primarily of U.S. Government and Federal agency securities as well as mortgage-backed securities. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create economically more attractive returns. At September 30, 2007, available-for-sale securities amounted to \$79,815,933, and increase of \$9,394,605 or 13.3%, from December 31, 2006.

At September 30, 2007, the securities available for sale portfolio had net unrealized losses of \$759,345 compared to net unrealized losses of \$719,367 at December 31, 2006. These unrealized losses are reflected net of tax in shareholders' equity as a component of other comprehensive income (loss).

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. The held-to-maturity portfolio consists primarily of obligations of states and political subdivisions. At September 30, 2007, securities held to maturity were \$26,111,786, an increase of

\$6,857,310, or 35.6% from \$19,254,476 at December 31, 2006. The fair value of the held-to-maturity portfolio at September 30, 2007, was \$25,825,988, resulting in a net unrealized loss of \$285,798.

During the nine months ended September 30, 2007, the Bank purchased securities in the amounts of \$15,776,240 and \$7,677,917 for the available for sale and held to maturity portfolios, respectively. These purchases were funded primarily by the cash received in the Hightstown branch acquisition completed in February 2007.

## Loans

The loan portfolio, which represents the Bank's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Company's primary lending focus continues to be construction loans, commercial loans, owner-occupied commercial mortgage loans and tenanted commercial real estate loans.

The following table sets forth the classification of loans by major category at September 30, 2007 and December 31, 2006.

## Loan Portfolio

Composition	September 30, 2007		December 31, 2006	
Component	Amount	% of total	Amount	% of total
Construction loans	\$ 128,518,664	44 %	\$ 125,268,871	47 %
Residential real estate loans	10,265,971	4 %	7,670,370	3 %
Commercial and commercial real estate	130,731,644	46 %	114,897,040	44 %
Loans to individuals	17,019,860	6 %	16,728,025	6 %
Deferred loan fees	431,871	0 %	404,074	0 %
All other loans	164,861	0 %	173,933	0 %
	\$ 287,132,871	100 %	\$ 265,142,313	100 %

The loan portfolio increased \$21,990,558, or 8.3%, at September 30, 2007 to \$287,132,871 from \$265,142,313 at December 31, 2006. The ability of the Company to enter into larger loan relationships and management's philosophy of relationship banking are key factors in the Company's strategy for loan growth. The ultimate collectability of the loan portfolio and the recovery of the carrying amount of real estate are subject to changes in the Company's market region's economic environment and real estate market.

## Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis, (2) loans which are contractually past due 90 days or more as to interest and principal payments but have not been classified as non-accrual, and (3) loans whose terms have been restructured to provide a reduction or deferral of interest on principal because of a deterioration in the financial position of the borrower.

The Bank's policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-performing loans decreased by \$172,383 to \$4,020,826 at September 30, 2007 from \$4,193,209 at December 31, 2006. The largest segment of non-accrual loans represents unfinished residential construction where litigation has commenced and workout negotiations are in process. The balance of the non-performing loans are centered in commercial loans for which litigation has commenced. The table below sets forth non-performing assets and risk

elements in the Bank's portfolio by type for the years indicated. As the table demonstrates, non-performing loans to total loans decreased to 1.40% at September 30, 2007 from 1.58% at December 31, 2006 for the reasons previously stated, but loan quality is still considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Non-performing assets decreased by \$172,383 to \$4,020,826 at September 30, 2007 from \$4,193,209 at December 31, 2006. Non-performing assets represented 0.93% of total assets at September 30, 2007 and 1.07% at December 31, 2006. Non-performing loans as a percentage of total loans were 1.40% at September 30, 2007, compared to 1.58% at December 31, 2006.

The Bank had no loans classified as restructured loans at September 30, 2007 or December 31, 2006.

At September 30, 2007 the Bank had one loan for \$302 that was 90 days or more past due but still accruing interest. The Bank had no such loans at December 31, 2006.

Non-Performing Assets and Loans	September 30, 2007	December 31, 2006
Non-Performing loans:		
Loans 90 days or more past due and still accruing	\$ 302	\$ 0
Non-accrual loans	4,020,524	4,193,209
Total non-performing loans	4,020,826	4,193,209
Other real estate owned	0	0
Total non-performing assets	\$ 4,020,826	\$ 4,193,209
Non-performing loans to total loans	1.40%	1.58%
Non-performing assets to total assets	0.93%	1.07%

Management takes a proactive approach in addressing delinquent loans. The Company's President meets weekly with all loan officers to review the status of credits past-due ten days or more. An action plan is discussed for each of the loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate and when the collateral is foreclosed upon, the real estate is carried at the lower of fair market value less estimated selling costs, or at cost. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the asset is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

#### Allowance for Loan Losses

The allowance for loan losses is maintained at a level sufficient in the opinion of management to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans, including construction loans. Based on the composition of the loan portfolio, the primary risks inherent in it are deteriorating credit quality, increases in interest rates, a decline in the economy, and a decline in New Jersey real estate market values. Any one or a combination of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All, or part, of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan and lease losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan and lease losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan and lease losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan and lease losses consists of several key elements. These elements include a specific reserve for doubtful or high risk loans, an allocated reserve, and an unallocated portion. The Company consistently applies the following comprehensive methodology.

During the quarterly review of the allowance for loan and lease losses, management of the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The specific reserve for high risk loans is established for specific commercial loans, commercial real estate loans, and construction loans which have been identified by management as being high risk loan assets. These high risk loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and for the various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information which is often subjective and changing rapidly. At September 30, 2007, management believed that the allowance for loan losses and non-performing loans was adequate.

The allowance for loan losses amounted to \$3,318,080 at September 30, 2007, an increase of \$89,720 from December 31, 2006. The ratio of the allowance for loan losses to total loans was 1.11% at September 30, 2007 and 1.16% at December 31, 2006, respectively. Management believes the quality of the loan portfolio remains sound and that the allowance for loan losses is adequate in relation to credit risk exposure levels.



The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

Allowance for Loan Losses	September 30, 2007	December 31, 2006	September 30, 2006
Balance, beginning of period	\$ 3,228,360	\$ 2,361,375	\$ 2,361,375
Provision charged to operating expenses	100,000	893,500	440,000
Loans charged off:			
Construction loans	-	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	(88,891 )	(11,154 )	(11,154 )
Loans to individuals	(1,614 )	(18,314 )	(285 )
Lease financing	(478 )	-	-
All other loans	-	-	-
	(90,983 )	(29,468 )	(11,439 )
Recoveries:			
Construction loans	75,000	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	-	153	-
Loans to individuals	5,703	2,800	2,800
Lease financing	-	-	153
All other loans	-	-	-
	80,703	2,953	2,953
Net (charge offs) / recoveries	(10,280 )	(26,515 )	(8,486 )
Balance, end of period	\$ 3,318,080	\$ 3,228,360	\$ 2,792,889
Loans:			
At period end	\$299,834,417	\$278,751,255	\$277,480,859
Average during the period	289,702,788	271,740,647	277,151,149
Net charge offs to average loans outstanding	0.00%	(0.01 %)	0.00%
Allowance for loan losses to:			
Total loans at period end	1.11 %	1.16 %	1.00 %
Non-performing loans	82.52 %	76.99 %	337.34 %

## Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings and time deposits, are a fundamental and cost-effective source of funding. The Company offers a variety of products designed to attract and retain customers, with the Company's primary focus being on building and expanding long-term relationships.

Total deposits increased \$20,220,635, or 6.5%, to \$332,945,057 at September 30, 2007 from \$312,724,422 at December 31, 2006. On February 27, 2007, the Bank acquired all of the deposit liabilities and related assets of the Hightstown, New Jersey branch banking office of another financial institution. This acquisition added approximately \$19 million in new deposits.

## Borrowings

Borrowings are mainly comprised of fixed rate convertible advances from the Federal Home Loan Bank (“FHLB”) and federal funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of other borrowings at September 30, 2007 consisted of long-term FHLB borrowings of \$25,500,000 and overnight funds purchased of \$7,800,000. The balance of borrowings at December 31, 2006 consisted of long-term FHLB borrowings of \$15,500,000 and overnight funds purchased of \$1,700,000. On July 27, 2007, the Bank contracted a 4.08% 10 year fixed rate advance with the FHLB in the amount of \$10,000,000. The proceeds of this advance were used to reduce the level of higher rate overnight borrowings. FHLB advances are fully secured by marketable securities.

## Shareholders' Equity And Dividends

Shareholders' equity at September 30, 2007 totaled \$39,471,721, an increase of \$4,525,216, or 12.9%, from \$34,946,505 at December 31, 2006. Book value per common share rose to \$9.94 at September 30, 2007 from \$8.81 at December 31, 2006. The ratio of shareholders' equity to total assets was 9.18% at September 30, 2007 and 8.89% at December 31, 2006.

The Company's stock is listed for trading on the Nasdaq Global Market System, under the symbol "FCCY."

In 2005, the Board of Directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company's shares at management's discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. A table disclosing repurchases of Company shares made during the quarter ended September 30, 2007 is set forth under Part II, Item 2 of this report, Unregistered Sales of Equity Securities and Use of Proceeds.

Actual capital amounts and ratios for the Company and the Bank as of September 30, 2007 and December 31, 2006 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2007						
-						
Company						
Total Capital to Risk						
Weighted Assets	\$ 60,725,294	18.04 %	\$ 26,936,560	>8%	\$ 33,670,700	N/A
Tier 1 Capital to Risk						
Weighted Assets	52,772,565	15.67 %	13,468,280	>4%	20,202,420	N/A
Tier 1 Capital to Average Assets	52,772,565	12.24 %	17,245,170	>4%	21,556,463	N/A
Bank						
Total Capital to Risk						
Weighted Assets	\$ 58,356,510	17.33 %	\$ 26,936,560	>8%	\$ 33,670,700	>10%
Tier 1 Capital to Risk						
Weighted Assets	55,038,430	16.35 %	13,468,280	>4%	20,202,420	>6%
Tier 1 Capital to Average Assets	55,038,430	12.77 %	17,204,360	>4%	21,505,450	>5%
As of December 31, 2006 - restated						
Company						
Total Capital to Risk						
Weighted Assets	\$ 61,652,577	19.93 %	\$ 24,751,678	>8%	\$ 30,939,598	N/A
Tier 1 Capital to Risk						
Weighted Assets	47,220,481	15.26 %	12,375,839	>4%	18,563,759	N/A
	47,220,481	11.99 %	15,752,046	>4%	19,690,058	N/A

Tier 1 Capital to Average Assets					
Bank					
Total Capital to Risk					
Weighted Assets	\$	53,520,979	17.30 %	\$	24,751,040 >8%
Tier 1 Capital to Risk					
Weighted Assets		50,292,619	16.26 %		12,375,520 >4%
Tier 1 Capital to Average Assets					
		50,292,619	12.80 %		15,710,320 >4%
					19,637,900 >5%

The minimum regulatory capital requirements for financial institutions require institutions to have a Tier 1 capital to average assets ratio of 4.0%, a Tier 1 capital to risk weighted assets ratio of 4.0% and a total capital to risk weighted assets ratio of 8.0%. To be considered “well capitalized,” an institution must have a minimum Tier 1 leverage ratio of 5.0%. At September 30, 2007, the ratios of the Company exceeded the ratios required to be considered well capitalized. It is management’s goal to monitor and maintain adequate capital levels to continue to support asset growth and continue its status as a well-capitalized institution.

### Liquidity

At September 30, 2007, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity measures the ability to satisfy current and future cash flow needs as they become due. Liquidity management refers to the Company’s ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank’s ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB and a correspondent bank which further supports and enhances liquidity. At September 30, 2007, the Bank maintained an Overnight Line of Credit at the FHLB in the amount of \$28,883,000 plus a One-Month Overnight Repricing Line of Credit of \$28,883,000. Advances issued under these programs are subject to FHLB stock level and collateral requirements. Pricing of these advances may fluctuate based on existing market conditions. The Bank also maintains an unsecured Federal funds line of \$13,500,000 with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At September 30, 2007, the balance of cash and cash equivalents was \$9,562,789.

Net cash provided by operating activities totaled \$7,509,418 in the nine months ended September 30, 2007 compared to \$8,623,748 in the nine months ended September 30, 2006. The primary sources of funds are net income from operations adjusted for provision for loan losses, depreciation expenses, and net proceeds from sales of loans held for sale.

Net cash used in investing activities totaled \$19,954,444 in the nine months ended September 30, 2007 compared to \$24,040,280 used in investing activities in the nine months ended September 30, 2006. The current period amount was primarily the result of the net increase in the loan portfolio plus investment securities purchases partially offset by the cash and cash equivalents acquired with the Hightstown branch.

Net cash provided by financing activities amounted to \$11,646,003 in the nine months ended September 30, 2007 compared to \$13,870,237 provided by financing activities in the nine months ended September 30, 2006. The current period amount resulted primarily from an increase in borrowings combined with the repayment of redeemable subordinated debentures during the nine months period ended September 30, 2007.

The securities portfolio is also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. During the nine months ended September 30, 2007, maturities and prepayments of investment securities totaled \$7,148,037. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

The Company anticipates that cash and cash equivalents on hand, the cash flow from assets as well as other sources of funds will provide adequate liquidity for the Company's future operating, investing and financing needs. Management will continue to monitor the Company's liquidity and maintain it at a level that it deems adequate and not excessive.

## Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations (revised 2007)." FAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This Statement is broader than SFAS 141, which only applied to business combinations in which control was obtained by transferring consideration. SFAS 141(R) applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses including combinations achieved without the transfer of consideration. SFAS 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the Statement. This replaces SFAS 141's cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. SFAS 141 required the acquirer to include the costs incurred to effect the acquisition (acquisition-related costs) in the cost of the acquisition that was allocated to the assets acquired and the liabilities assumed. SFAS 141 (R) requires those costs to be recognized separately from the acquisition. In accordance with SFAS 141, restructuring costs that the acquirer expected but was not obligated to incur were recognized as if they were a liability assumed at the acquisition date. SFAS 141(R) requires the acquirer to recognize those restructuring costs that do not meet the criteria in SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" as an expense as incurred. Acquisition related transaction costs will be expensed as incurred. SFAS 141(R) requires an acquirer to recognize assets or liabilities arising from all other contingencies (contractual contingencies) as of the acquisition date, measured at their acquisition-date fair values only if it is more likely than not that they meet the definition of an asset or a liability on the acquisition date. Under SFAS 141(R), changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. Additionally, under SFAS 141(R), the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of the adoption of this FAS 141(R) on its financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." FAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. Its intention is to eliminate the diversity in practice regarding the accounting for transactions between an entity and noncontrolling interests. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of the adoption of SFAS 160 on its financial statements.

In November 2007, the SEC issued SAB 109, "Written Loan Commitments Recorded at Fair Value through Earnings." SAB 109 revises and rescinds portions of SAB 105, "Application of Accounting Principles to Loan Commitments." The SEC staff's current view is that the expected net future cash flows related to the associated servicing of a loan should be included in the measurement of derivative and other written loan commitments that are accounted for at fair value through earnings. That view is consistent with the guidance in Financial Accounting Standards Board (FASB) No. 156, "Accounting for Servicing of Financial Assets" and FASB No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SAB 109 retains the view expressed in SAB 105 that internally developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment. The guidance in SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The adoption of SAB 109 is not expected to have a material impact on the Company's financial statements.

In June 2007, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." EITF06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for nonvested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007. The Company does not expect EITF 06-11 will have a material impact on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115." SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 provides entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Statement also establishes presentation and disclosure requirements. The entity shall report the effect of the first re-measurement to fair value as a cumulative-effective adjustment to the opening balance of retained earnings. At each subsequent reporting date, unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The fair value option may be applied instrument by instrument, with a few exceptions, is irrevocable and is applied only to entire instruments. Most of the provisions of SFAS 159 apply only to entities that elect the fair value option. However, the amendment to SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities," applies to all entities with available-for-sale and trading securities. If the fair value option is elected for any available-for-sale or held-to-maturity securities at the effective date, the cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption was permitted as of the beginning of a fiscal year that began on or before November 15, 2007, provided that the entity also elected to apply the provisions of SFAS 157, "Fair Value Measurements." The Company is not currently electing to measure any additional financial instruments at fair value under this Statement and the adoption of FAS 159 is not expected to have a material impact on its financial statements.



In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." The Statement will require the Company to apply valuation techniques that (1) place greater reliance on observable inputs and less reliance on unobservable inputs and (2) are consistent with the market approach, the income approach, and/or the cost approach. The definition and framework apply to both items recognized and reported at fair value in the financial statements and items disclosed at fair value in the notes to the financial statements. The Statement also requires expanded disclosure in interim and annual financial statements about how the Company uses fair value. The disclosures focus on items measured at fair value based on significant unobservable inputs and the effect of fair value measurements on earnings. The disclosures are only required for items recognized and reported at fair value in the financial statements. The Statement does not change existing accounting rules governing what can or what must be recognized and reported at fair value in the Company's financial statements, or disclosed at fair value in the Company's notes to the financial statements. Additionally, SFAS 157 does not eliminate practicability exceptions that exist in accounting pronouncements amended by this Statement when measuring fair value. As a result, the Company will not be required to recognize any new instruments at fair value. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application was encouraged. Prospective application of the provisions of SFAS 157 is required as of the beginning of the fiscal year in which it is initially applied, except for certain circumstances specified in the Statement that require retrospective application. In March 2008, the FASB issued FSP FAS 157-2 to partially delay the effective implementation of SFAS 157 until fiscal years beginning after November 15, 2008 for all nonfinancial assets and liabilities except those that are recognized or disclosed at fair value in financial statements on a recurring basis (at least annually). Assets and liabilities currently reported or disclosed at fair value on a recurring basis in the Company's financial statements include investment securities, impaired loans, residential mortgage loans held for sale, mortgage servicing rights and derivatives. The Company does not anticipate any material impact on its financial statements upon partial adoption of FAS 157 for its fiscal year beginning January 1, 2008. The Company is in the process of assessing the impact of the adoption of SFAS 157 for its fiscal year beginning January 1, 2009 relating to nonfinancial assets and liabilities on the Company's financial statements including goodwill and other intangible assets.

At its September 2006 meeting, the EITF reached a final consensus on Issue 06-05, "Accounting for Purchases of Life Insurance—Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin No. 85-4." Issue 06-05 concludes that in determining the amount that could be realized under an insurance contract accounted for under FASB Technical Bulletin No. 85-4, "Accounting for Purchases of Life Insurance," the policyholder should (1) consider any additional amounts included in the contractual terms of the policy; (2) assume the surrender value on a individual-life by individual-life policy basis; and (3) not discount the cash surrender value component of the amount that could be realized when contractual restrictions on the ability to surrender a policy exist. Issue 06-05 should be adopted through either (1) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (2) a change in accounting principle through retrospective application to all prior periods. Issue 06-05 is effective for fiscal years beginning after December 15, 2006. The application of Issue 06-05 did not have a material effect on the Company's financial position or results of operations.

At its September 2006 meeting, the EITF reached a final consensus on Issue 06-04, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." In accordance with the EITF consensus, an agreement by an employer to share a portion of the proceeds of a life insurance policy with an employee during the postretirement period is a postretirement benefit arrangement required to be accounted for under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions" or APB Opinion No. 12, "Omnibus Opinion 1967." Furthermore, the purchase of a split-dollar life insurance policy does not constitute a settlement under SFAS No. 106 and, therefore, a liability for the postretirement obligation must be recognized under SFAS No. 106 if the benefit is offered under an arrangement that constitutes a plan or under APB No. 12 if it is not part of a plan. The provisions of Issue 06-04 are to be applied through either a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or retrospective application. Issue 06-04 is effective for annual or interim reporting periods beginning after December 15, 2007. The application of Issue 06-04 is not expected to have a material effect on the Company's financial statements.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet a "more-likely-than-not" recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 are to be reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year. The new interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company's implementation of this interpretation did not have a material impact on the Company's financial position or results of operations and did not result in an adjustment to opening retained earnings.

In May 2007, the FASB issued FIN 48-1, "Definition of Settlement in FIN 48" to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FIN 48-1 is effective retroactively to January 1, 2007. The implementation of this standard did not have any impact on the Company's consolidated financial position or results of operations.

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

Not required.

#### Item 8. Financial Statements and Supplementary Data.

Reference is made to Item 15(a)(1) and (2) on page F-1 for a list of financial statements and supplementary data required to be filed pursuant to this Item 8. The information required by this Item 8 is provided beginning on page F-1 hereof.

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

Not applicable.



Item 9A. Controls and Procedures.

The Company conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (“Disclosure Controls”), as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (“Exchange Act”) as of December 31, 2007. The evaluation was done under the supervision and with the participation of management, including the principal executive officer and the principal financial officer, and included a review of the controls’ objectives, design and operating effectiveness with respect to the information generated for use in this Annual Report. In the course of the evaluation, we sought to identify data errors, control problems or acts of fraud and confirm that appropriate corrective actions, including process improvements, were being undertaken. This type of Disclosure Controls evaluation is performed on a quarterly basis so that the conclusions of management, including the principal executive officer and the principal financial officer, concerning the effectiveness of controls can be reported in our Quarterly Reports on Form 10-Q and in our Annual Reports on Form 10-K. Many of the components of our Disclosure Controls are also evaluated on an ongoing basis by other personnel in our accounting, internal audit and compliance functions. The overall goals of these various evaluation activities are to monitor our Disclosure Controls and to modify them on an ongoing basis as necessary.

A control system can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Based upon the evaluation of our Disclosure Controls, and in light of the material weaknesses described below under “Management’s Report on Internal Control over Financial Reporting,” our principal executive officer and the principal financial officer concluded that the Company’s Disclosure Controls were not effective as of December 31, 2007 to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported in accordance with generally accepted accounting principles and within the time periods specified in the Securities and Exchange Commission’s rules and forms. The Company’s Disclosure Controls were not effective as of December 31, 2007 due to material weaknesses in our internal control over financial reporting that existed as of December 31, 2007, as described below.

Management’s Report on Internal Control over Financial Reporting

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

The Company’s internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the receipts and expenditures of the Company are being made only in accordance with authorizations of its management and directors; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on its financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

Material weaknesses in internal control over financial reporting that existed as of December 31, 2007 resulted in the following:

- Errors made in accounting for (i) current tax liabilities principally related to the Company's trust preferred securities and (ii) deferred tax assets, in both cases in 2007 and 2006 and prior periods, resulting in an underestimate of current tax liabilities and an overestimate of deferred tax assets;
- Overestimation of liabilities related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan in connection with the implementation of FAS 158 in 2006 resulting in an increase in expenses, and an underestimation of liabilities related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan, resulting in a reduction of expenses in the first three quarters of 2007; and
- Failure to adequately evaluate estimation of certain non-interest operating expenses for, among other things, professional fees, advertising and business development, resulting in an over-accrual of certain non-interest operating expenses in 2006 and a resultant decrease in tax expense for 2006.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Management's assessment identified the following material weakness in internal control over financial reporting, which in all instances are impacted by the lack of adequate staffing and procedural breakdowns in compliance with the Company's internal policies and procedures. Based on their assessment using those criteria, management concluded that, as of December 31, 2007, the Company's internal control over financial reporting is not effective.

As of the date of the filing of this Form 10-K, the Company has taken the following steps to remediate the material weakness described above:

- **Current and Deferred Tax Accounting** – The Company has implemented an internal policy pursuant to which the Company will retain external tax preparation and compliance consultants to assist it with analyzing the Company's accounting for income taxes and tax compliance for compliance with generally accepted accounting principles and reviewing the results with the Company's principal executive officer and financial officer on a quarterly basis.
- **Supplemental Executive Retirement Plan** – The Company's principal executive officer, financial officer and human resources officer will review on a quarterly basis with the plan's administrator and actuarial consultant to determine that all liability balances and expense levels are properly recorded and reflect the current life circumstances of all participants in the plan.

- Accrued Liabilities – The Company’s principal executive officer and principal financial officer will meet at the end of each fiscal quarter to review documentation in support of all major operating expense accruals to determine if expense accruals are properly supported by documentation and that these expense accruals are consistent with generally accepted accounting principles.

## Attestation Report

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the SEC that permit the Company to provide only management's report in this annual report.

## Item 9B. Other Information.

None.

## PART III

## Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this item is incorporated by reference to the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders under the captions "Directors and Executive Officers" and "Corporate Governance".

## Item 11. Executive Compensation.

The information required by this item is incorporated by reference to the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders under the caption "Executive Compensation."

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

## Equity Compensation Plan Information

The following table provides information about the Company's common stock that may be issued upon the exercise of options, warrants and rights under all of the Company's equity compensation plans as of December 31, 2007. The information in the table has been adjusted for the 6% stock dividend declared December 20, 2007 and paid February 6, 2008 to shareholders of record on January 23, 2008.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders (1)	90,876	\$ 13.40	335,119
Equity compensation plans not approved by security holders (2)	65,962	\$ 6.12	-
Total	156,838	\$ 10.48	335,119

(1) Includes the Company's 1990 Employee Stock Option Plan for Key Employees, 1996 Employee Stock Option Plan, 2000 Employee Stock Option and Restricted Stock Plan, 2005 Equity Incentive Plan and 2006 Directors



Stock Plan.

The 1990 Employee Stock Option Plan for Key Employees was adopted by the Board of the Bank and approved by the shareholders of the Bank in March 1990. The 1996 Employee Stock Option Plan was adopted by the Board of the Bank and approved by shareholders of the Bank in March 1997. In 1999, as part of the formation of the Company as a holding company for the Bank, these plans were each amended so that no further grants may be made thereunder, and each option to purchase one share of Bank common stock was converted into an option to purchase one share of Company common stock.

The Company's 2000 Employee Stock Option and Restricted Stock Plan was adopted by the Board of the Company and approved by the shareholders in April 2000, the Company's 2005 Equity Incentive Plan was adopted by the Board of the Company on February 17, 2005 and approved by the shareholders in May 2005 and the Company's 2006 Directors Stock Plan was adopted by the Board of the Company on March 23, 2006 and approved by the shareholders in May 2006.

(2) Directors Stock Option and Restricted Stock Plan.

The Company's Directors Stock Option and Restricted Stock Plan was adopted by the Board, and became effective, on April 22, 1999, prior to the listing of the Company's common stock on the Nasdaq National Market System. The plan provides for grants of non-qualified stock options and restricted stock awards to directors of the Company and its subsidiaries. Participants in the plan may be granted non-qualified stock options or restricted stock. All stock option grants have an exercise price per share of no less than the fair market value per share of common stock on the grant date and may have a term of no longer than 10 years after the grant date.

The additional information required by this item is incorporated by reference from the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders under the caption "Stock Ownership of Management and Principal Shareholders."

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

This information required by this item is incorporated by reference from the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders under the captions "Certain Transactions With Management" and "Director Independence".

Item 14. Principal Accounting Fees and Services.

The information regarding principal accounting fees and services and the Company's pre-approval policies and procedures for audit and non-audit services provided by the Company's independent accountants is incorporated by reference to the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders under the caption "Principal Accounting Fees and Services."

## PART IV

### Item 15. Exhibits and Financial Statement Schedules.

#### (a) Financial Statements and Financial Statement Schedules

The following documents are filed as part of this report:

#### 1. Financial Statements of 1st Constitution Bancorp.

Consolidated Balance Sheet – December 31, 2007 and 2006.

Consolidated Statements of Income – For the Years Ended December 31, 2007, 2006 and 2005.

Consolidated Statements of Changes in Shareholders' Equity – For the Years Ended December 31, 2007, 2006 and 2005.

Consolidated Statements of Cash Flows – For the Years Ended December 31, 2007, 2006, and 2005.

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

These statements are incorporated by reference to the Company's Annual Report to Shareholders for the year ended December 31, 2007.

2. All schedules are omitted because either they are inapplicable or not required, or because the information required therein is included in the Consolidated Financial Statements and Notes thereto.

#### 3. Exhibits

Exhibit No.	Description
3 (i)	Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3(i) to the Company's Form 10-K filed with the SEC on March 24, 2005)
3 (ii)(A)	Bylaws of the Company (conformed copy) (incorporated by reference to Exhibit 3(ii)(A) to the Company's Form 8-K filed with the SEC on October 22, 2007)
3 (ii)(B)	Amendment No. 2 to By-laws of the Company (incorporated by reference to Exhibit 3(ii)(B) to the Company's Form 8-K filed with the SEC on October 22, 2007)
4.1	Specimen Share of Common Stock (incorporated by reference to the Company's Form 10-KSB filed with the SEC on March 22, 2002)
4.2	

Amended and Restated Declaration of Trust of 1st Constitution Capital Trust I dated as of April 10, 2002 among the Registrant, as sponsor, Wilmington Trust Company, as Delaware and institutional trustee, and the Administrators named therein (incorporated by reference to the Company's Form 10-QSB filed with the SEC on May 8, 2002)

- 4.3 Indenture dated as of April 10, 2002 between the Registrant, as issuer, and Wilmington Trust Company, as trustee, relating to the Floating Rate Junior Subordinated Debt Securities due 2032 (incorporated by reference to the Company's Form 10-QSB filed with the SEC on May 8, 2002)

Exhibit No.	Description
4.4	Guarantee Agreement dated as of April 10, 2002 between the Registrant and the Wilmington Trust Company, as guarantee trustee (incorporated by reference to the Company's Form 10-QSB filed with the SEC on May 8, 2002)
4.5	Rights Agreement, dated as of March 18, 2004, between 1st Constitution Bancorp and Registrar and Transfer Company, as Rights Agent, including the form of Certificate of Amendment to the Company's Certificate of Incorporation as Exhibit A thereto, the form of Rights Certificates as Exhibit B thereto, and the Summary of Rights as Exhibit C thereto. Pursuant to the Rights Agreement, printed Rights Certificates will not be mailed until after the Distribution Date (as such term is defined in the Rights Agreement) (incorporated by reference to the Company's Form 8-A12G filed with the SEC on March 18, 2004)
10.1	# 1st Constitution Bancorp Supplemental Executive Retirement Plan, dated as of October 1, 2002 (Incorporated by reference to the Company's Form 10-QSB filed with the SEC on November 13, 2002)
10.2	# Amended and Restated 1st Constitution Bancorp Directors' Insurance Plan, effective as of June 16, 2005 (incorporated by reference to Exhibit No. 10 to the Company's Form 8-K filed with the SEC on March 24, 2006)
10.3	# 1st Constitution Bancorp Form of Executive Life Insurance Agreement (Incorporated by reference to the Company's Form 10-QSB filed with the SEC on November 13, 2002)
10.4	# Amended and Restated 1990 Stock Option Plan for Key Employees, as amended (incorporated by reference to Exhibit No. 10.1 to the Company's Form 10-QSB filed with the SEC on August 9, 2002)
10.5	# 1996 Employee Stock Option Plan, as amended (incorporated by reference to Exhibit No. 10.2 to the Company's Form 10-QSB filed with the SEC on August 9, 2002)
10.6	# 2000 Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit No. 6.3 to the Company's Form 10-SB filed with the SEC on June 15, 2001)
10.7	# Directors Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit No. 6.4 to the Company's Form 10-SB filed with the SEC on June 15, 2001)
10.8	# Employment Agreement between the Company and Robert F. Mangano dated April 22, 1999 (incorporated by reference to Exhibit No. 6.5 to the Company's Form 10-SB filed with the SEC on June 15, 2001)
10.9	#

Amendment No. 1 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective January 1, 2004 (incorporated by reference to Exhibit 10.12 to the Company's Form 10-Q filed with the SEC on August 11, 2004)

10.10 # Change of Control Agreement, effective as of April 1, 2004, by and between the Company and Joseph M. Reardon (incorporated by reference to Exhibit 10.13 to the Company's Form 10-Q filed with the SEC on August 11, 2004)

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Exhibit No.	Description
10.11	# Form of Stock Option Agreement under the 1st Constitution Bancorp Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit 10.14 to the Company's Form 8-K filed with the SEC on December 22, 2004)
10.12	# Form of Restricted Stock Agreement under the 1st Constitution Bancorp Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit 10.15 to the Company's Form 8-K filed with the SEC on December 22, 2004)
10.13	# Employment Agreement between the Company and Robert F. Mangano dated February 22, 2005 (incorporated by reference to Exhibit No. 10.16 to the Company's Form 8-K filed with the SEC on February 24, 2005)
10.14	# The 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Appendix A of the Company's proxy statement filed on April 15, 2005)
10.15	# Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.18 to the Company's Form 10-Q filed with the SEC on August 8, 2005)
10.16	# Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.19 to the Company's Form 10-Q filed with the SEC on August 8, 2005)
10.17	# Form of Incentive Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.20 to the Company's Form 10-Q filed with the SEC on August 8, 2005)
10.18	# 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on May 19, 2006)
10.19	# Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed with the SEC on May 19, 2006)
10.20	# Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed with the SEC on May 19, 2006)
10.21	Amended and Restated Declaration of Trust of 1st Constitution Capital Trust II, dated as of June 15, 2006, among 1st Constitution Bancorp, as sponsor, the Delaware and institutional trustee named therein, and the administrators named therein (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on June 16, 2006)

10.22	Indenture, dated as of June 15, 2006, between 1st Constitution Bancorp, as issuer, and the trustee named therein, relating to the Floating Rate Junior Subordinated Debt Securities due 2036 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed with the SEC on June 16, 2006)
10.23	Guarantee Agreement, dated as of June 15, 2006, between 1st Constitution Bancorp and the guarantee trustee named therein (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed with the SEC on June 16, 2006)



Exhibit No.	Description
10.24	*# Amendment No. 2 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective as of December 31, 2004
10.25	# 1st Constitution Bancorp 2005 Supplemental Executive Retirement Plan, effective as of January 1, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on December 28, 2006)
10.26	Branch Purchase and Assumption Agreement, dated as of November 6, 2006, by and between 1st Constitution Bank and Sun National Bank (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on November 13, 2006)
14	Code of Business Conduct and Ethics (incorporated by reference to Exhibit 14 to the Company's Form 10-K filed with the SEC on March 25, 2004)
21	* Subsidiaries of the Company
23.1	* Consent of Independent Registered Public Accounting Firm
31.1	* Certification of the principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
31.2	* Certification of the principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
32	* Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by the principal executive officer and the principal financial officer of the Company

\* Filed herewith.

# Management contract or compensatory plan or arrangement.

(b) Exhibits.

Exhibits required by Section 601 of Regulation S-K (see (a) above)

(c) Financial Statement Schedules

See the notes to the Consolidated Financial Statements included in this report.

1st CONSTITUTION BANCORP

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets – December 31, 2007 and 2006	F-3
Consolidated Statements of Income – For the Years Ended December 31, 2007 and 2006	F-4
Consolidated Statements of Changes in Shareholders' Equity - For the Years Ended December 31, 2007 and 2006	F-5
Consolidated Statements of Cash Flows - For the Years Ended December 31, 2007 and 2006	F-6
Notes to Consolidated Financial Statements	F-7

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders  
1st Constitution Bancorp:

We have audited the accompanying consolidated balance sheets of 1st Constitution Bancorp and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of 1st Constitution Bancorp and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company's consolidated financial statements as of and for the year ended December 31, 2006 have been restated.

As discussed in Note 1 to the financial statements, the Company has adopted Financial Accounting Standards Board Statement (FASB) No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - An Amendment of FASB Statements No. 87, 88, 106 and 132(R), in 2006.

/s/ GRANT THORNTON LLP  
Philadelphia, Pennsylvania  
April 14, 2008

1st CONSTITUTION BANCORP  
CONSOLIDATED BALANCE SHEETS  
December 31, 2007 and 2006

	2007	2006 (Restated)
<b>ASSETS</b>		
CASH AND DUE FROM BANKS	\$ 7,517,158	\$ 10,336,334
FEDERAL FUNDS SOLD / SHORT TERM INVESTMENTS	30,944	25,478
Total cash and cash equivalents	7,548,102	10,361,812
<b>INVESTMENT SECURITIES</b>		
Available for sale, at fair value	75,192,137	70,421,328
Held to maturity (fair value of \$23,411,269 and \$19,164,679 in 2007 and 2006, respectively)	23,512,346	19,254,476
Total securities	98,704,483	89,675,804
LOANS HELD FOR SALE	10,322,005	13,608,942
LOANS	294,760,718	265,142,313
Less- Allowance for loan losses	(3,348,080)	(3,228,360)
Net loans	291,412,638	261,913,953
PREMISES AND EQUIPMENT, net	2,760,203	3,033,618
ACCRUED INTEREST RECEIVABLE	2,495,732	2,235,671
BANK-OWNED LIFE INSURANCE	9,545,009	9,179,408
OTHER REAL ESTATE OWNED	2,960,727	-
OTHER ASSETS	3,402,640	2,921,496
Total assets	\$ 429,151,539	\$ 392,930,704
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
<b>Deposits</b>		
Non-interest bearing	\$ 59,055,803	\$ 64,305,445
Interest bearing	270,276,565	248,418,977
Total deposits	329,332,368	312,724,422
BORROWINGS	35,600,000	17,200,000
REDEEMABLE SUBORDINATED DEBENTURES	18,557,000	23,712,000

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

ACCRUED INTEREST PAYABLE	1,992,187	1,957,574
ACCRUED EXPENSES AND OTHER LIABILITIES	2,696,667	2,389,663
Total liabilities	388,178,222	357,983,659
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
Common stock, no par value; 30,000,000 shares authorized; 3,993,905 and 3,967,431 shares issued and 3,992,715 and 3,967,222 shares outstanding as of December 31, 2007 and 2006, respectively	32,514,936	28,886,105
Retained earnings	9,009,955	7,010,211
Treasury Stock, at cost, 1,190 shares and 209 shares at December 31, 2007 and 2006, respectively	(18,388)	(3,545)
Accumulated other comprehensive loss	(533,186)	(945,726)
Total shareholders' equity	40,973,317	34,947,045
Total liabilities and shareholders' equity	\$ 429,151,539	\$ 392,930,704

The accompanying notes are an integral part of these financial statements

1st CONSTITUTION BANCORP  
CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2007 and 2006

	2007	2006 (Restated)
<b>INTEREST INCOME:</b>		
Loans, including fees	\$ 25,113,488	\$ 23,166,544
Securities:		
Taxable	4,278,288	3,448,780
Tax-exempt	875,697	604,846
Federal funds sold and short-term investments	101,171	85,012
Total interest income	30,368,644	27,305,182
<b>INTEREST EXPENSE:</b>		
Deposits	9,636,856	6,688,080
Securities sold under agreements to repurchase and other borrowed funds	1,514,907	1,687,749
Redeemable subordinated debentures	1,438,876	1,141,668
Total interest expense	12,590,639	9,517,497
Net interest income	17,778,005	17,787,685
PROVISION FOR LOAN LOSSES	130,000	893,500
Net interest income after provision for loan losses	17,648,005	16,894,185
<b>NON-INTEREST INCOME:</b>		
Service charges on deposit accounts	673,826	668,071
Gain on sales of loans	761,004	1,072,731
(Losses) gains on sales of investment securities, net	0	(99,714)
Income on Bank-owned life insurance	265,601	330,915
Other income	857,898	599,445
Total other income	2,558,329	2,571,448
<b>NON-INTEREST EXPENSES:</b>		
Salaries and employee benefits	7,196,552	6,741,050
Occupancy expense	1,658,820	1,448,227
Data processing expenses	829,037	733,954
Other operating expenses	2,416,859	3,091,616
Total other expenses	12,101,268	12,014,847
Income before income taxes	8,105,066	7,450,786
<b>INCOME TAXES</b>		
Net income	\$ 5,442,782	\$ 4,724,962

NET INCOME PER SHARE

Basic	\$	1.37	\$	1.21
Diluted	\$	1.35	\$	1.18

WEIGHTED AVERAGE SHARES  
OUTSTANDING

Basic	3,969,943	3,894,898
Diluted	4,025,429	3,998,513

The accompanying notes are an integral part of these financial statements

F-4

---

1st CONSTITUTION BANCORP  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
For the Years Ended December 31, 2007 and 2006  
Restated for the year ended December 31, 2006

	Common Stock	Retained Earnings (Restated)	Treasury Stock	Accumulated Other Comprehensive (Loss) Income (Restated)	Total Shareholders' Equity (Restated)
Original reported balance, January 1, 2006	\$ 25,589,320	\$ 5,981,802	\$ (1,008,998)	\$ (765,258)	\$ 29,796,866
Cumulative effect of restatement on prior periods	-	327,177	-	5,607	332,784
Restated opening balance, January 1, 2006	25,589,320	6,308,979	(1,008,998)	(759,651)	30,129,650
Exercise of stock options, net and issuance of vested shares under employee benefit programs	(822,175)		1,418,000		595,825
Treasury Stock, 21,749 shares at cost			(412,547)		(412,547)
FAS 123R share-based compensation	95,230				95,230
6% stock dividend declared December 2006, including fractional share cash payments	4,023,730	(4,023,730)			-
Adjustment to initially apply FASB Statement No. 158 net of tax benefit of \$302,088				(454,266)	(454,266)
Comprehensive Income:					
Net income – 2006		4,724,962			4,724,962
Unrealized gain on securities available for sale net of tax expense of \$287,139				268,191	268,191
Comprehensive Income					4,993,153
BALANCE, December 31, 2006	\$ 28,886,105	\$ 7,010,211	\$ (3,545)	\$ (945,726)	\$ 34,947,045
Exercise of stock options, net and issuance of vested	78,773		232,060		310,833



shares under employee benefit programs						
FAS 123R share-based compensation	107,020					107,020
Acquisition of Treasury Stock, 13,548 shares at cost				(246,903)		(246,903)
6% stock dividend declared December 2007, including fractional share cash payments	3,443,038	(3,443,038)				-
<b>Comprehensive Income:</b>						
Net income – 2007		5,442,782				5,442,782
Minimum pension liability net of tax benefit of \$24,758				(37,231)		(37,231)
Unrealized loss on interest rate swap contract net of tax benefit of \$39,842				(59,912)		(59,912)
Unrealized gain on securities available for sale net Of tax expense of \$240,247				509,683		509,683
Comprehensive Income						5,855,322
BALANCE, December 31, 2007	\$ 32,514,936	\$ 9,009,955	\$ (18,388)	\$ (533,186)	\$ 40,973,317	

The accompanying notes are an integral part of these financial statements

1st CONSTITUTION BANCORP  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Years Ended December 31, 2007 and 2006

	2007	2006 (Restated)
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 5,442,782	\$ 4,724,962
Adjustments to reconcile net income to net cash provided by operating activities-		
Provision for loan losses	130,000	893,500
Depreciation and amortization	747,647	627,833
Net amortization of premiums on securities	14,188	41,405
Gains on sales of loans	(761,004)	(1,072,731)
Losses on sale of investment securities, net	-	99,714
Originations of loans held for sale	(67,164,044)	(58,696,245)
Income on Bank-owned life insurance	(365,601)	(330,915)
Proceeds from sales of loans held for sale	71,211,985	62,917,768
Share-based compensation expense	107,020	95,230
Deferred tax benefit	(204,967)	(539,809)
(Increase) decrease in accrued interest receivable	(260,061)	(330,009)
Decrease (increase) in other assets	211,689	(294,866)
Increase in accrued interest payable	34,613	669,534
Increase (decrease) in accrued expenses and other liabilities	245,015	(410,088)
Net cash provided by (used in) operating activities	9,389,262	8,395,283
<b>INVESTING ACTIVITIES:</b>		
Purchases of securities -		
Available for sale	(16,707,027)	(17,386,472)
Held to maturity	(7,677,917)	-
Proceeds from maturities and prepayments of securities -		
Available for sale	12,704,423	13,736,214
Held to maturity	3,387,585	2,483,768
Proceeds from sales of securities available for sale	-	2,899,385
Net increase in loans	(32,589,412)	(25,154,480)
Capital expenditures	(446,698)	(1,064,599)
Cash consolidation paid to acquire branch	(747,330)	-
Cash and cash equivalents acquired from branch	19,514,239	-
Net cash used in investing activities	(22,562,137)	(24,486,184)
<b>FINANCING ACTIVITIES:</b>		
Stock compensation tax benefit	(43,472)	(40,271)
Exercise of stock options, net	310,833	595,825

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Purchase of Treasury Stock	(246,903)	(412,547)
Net (decrease) increase in demand, savings and time deposits	(2,906,293)	6,914,955
Net advances (repayments) in other borrowings	18,400,000	(11,300,000)
(Repayments) proceeds from issuance of redeemable subordinated debentures	(5,155,000)	18,557,000
Net cash provided by financing activities	10,359,165	14,314,962
(Decrease) increase in cash and cash equivalents	(2,813,710)	(1,775,938)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	10,361,812	12,137,750
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 7,548,102	\$ 10,361,812
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for -		
Interest	\$ 12,052,481	\$ 8,847,963
Income taxes	2,421,600	3,563,872
Non-cash investing activities		
Real estate acquired in full satisfaction of loans in foreclosure	\$ 2,960,727	-

The accompanying notes are an integral part of these financial statements

1st CONSTITUTION BANCORP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

1. Summary of Significant Accounting Policies

1st Constitution Bancorp (the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and was organized under the laws of the State of New Jersey. The Company is parent to 1st Constitution Bank (the “Bank”), a state chartered commercial bank. The Bank provides community banking services to a broad range of customers, including corporations, individuals, partnerships and other community organizations in the central New Jersey area. The Bank conducts its operations through its main office located in Cranbury, New Jersey, and operates ten additional branch offices in downtown Cranbury, Fort Lee, Hamilton Square, Hightstown, Jamesburg, Montgomery, Perth Amboy, Plainsboro, West Windsor, and Princeton, New Jersey.

Restatement

The Consolidated Financial Statements as of and for the year ended December 31, 2006 and the related Notes to the Consolidated Financial Statements reflect restated amounts as a result of the adjustments described in Note 2, “Restatement of Consolidated Financial Statements For the Year Ended and As At December 31, 2006”.

Basis of Presentation

The accounting and reporting policies of the Company conform to accounting principals generally accepted in the United States of America and to the accepted practices within the banking industry. The following is a description of the more significant of these policies and practices.

Principles of Consolidation

The accompanying consolidated financial statements include the Company and its wholly-owned subsidiary, the Bank, and the Bank’s wholly-owned subsidiaries, 1st Constitution Investment Company of Delaware, Inc., FCB Assets Holdings, Inc. and 1st Constitution Title Agency, LLC. 1st Constitution Capital Trust II, a subsidiary of the Company (“Trust II”), and 1st Constitution Capital Trust I, which was a subsidiary of the Company until April 2007 (“Trust I”), are not included in the Company’s consolidated financial statements as they are variable interest entities and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform with accounting principles generally accepted in the United States and general practices within the financial services industry.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investment Securities

Investment Securities which the Bank has the intent and ability to hold until maturity are classified as held to maturity and are recorded at cost, adjusted for amortization of premiums and accretion of discounts using the interest method.

Investment Securities which are held for indefinite periods of time, which management intends to use as part of its asset/liability management strategy, or that may be sold in response to changes in interest rates, changes in prepayment risk, increased capital requirements or other similar factors, are classified as available for sale and are carried at estimated market value, except for Federal Home Loan Bank stock, which is carried at cost. Unrealized gains and losses on such securities are recorded as a separate component of shareholders' equity. Realized gains and losses, which are computed using the specific identification method, are recognized on a trade date basis.

In November 2005, the FASB issued FASB Staff Position (FSP) FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." This FSP provides guidance on determining if an investment is considered to be impaired, if the impairment is other-than-temporary and the measurement of an impairment loss. It also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. This FSP was effective for reporting periods beginning after December 15, 2005. At December 31, 2007 and 2006, the Company had no unrecognized losses on investments that would be defined as other than temporary under FSP 115-1.

### Bank-Owned Life Insurance

The Company invests in bank-owned life insurance (BOLI). BOLI involves the purchasing of life insurance by the Company on a chosen group of employees. The Company is the owner and beneficiary of the policies. This pool of insurance, due to the advantages of the Bank, is profitable to the Company. This profitability is used to offset a portion of future benefit cost increases. The Bank's deposits fund BOLI and the earnings from BOLI are recognized as non-interest income.

### Loans And Loans Held For Sale

Loans that management intended to hold to maturity are stated at the principal amount outstanding, net of unearned income. Unearned income is recognized over the lives of the respective loans, principally using the effective interest method. Income from direct financing leases is recorded over the life of the lease under the financing method of accounting. The investment includes the sum of aggregate rentals receivable and the estimated residual value of leased equipment, less deferred income. Interest income is generally not accrued on loans, including impaired loans, where interest or principal is 90 days or more past due, unless the loans are adequately secured and in the process of collection, or on loans where management has determined that the borrowers may be unable to meet contractual principal and/or interest obligations. When it is probable that, based upon current information, the Bank will not collect all amounts due under the contractual terms of the loan, the loan is reported as impaired. Smaller balance homogenous type loans, such as residential loans and loans to individuals, which are collectively evaluated, are excluded from consideration for impairment. Loan impairment is measured based upon the present value of the expected future cash flows discounted at the loan's effective interest rate or the underlying value of collateral for collateral dependent loans. When a loan, including an impaired loan, is placed on non-accrual, interest accruals cease and uncollected accrued interest is reversed and charged against current income. Non-accrual loans are generally not returned to accruing status until principal and interest payments have been brought current and full collectibility is reasonably assured. Cash receipts on non-accrual and impaired loans are applied to principal, unless the loan is deemed fully collectible. Loans held for sale are carried at the aggregate lower of cost or market value. Realized gains and losses on loans held for sale are recognized at settlement date and are determined based on the cost, including deferred net loan origination fees and the costs of the specific loans sold.

The Bank accounts for its transfers and servicing financial assets in accordance with Statement of Financial Accounting Standards ("SFAS") No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The Bank originates mortgages under a definitive plan to sell or securitize those loans and service the loans owned by the investor. Upon the transfer of the mortgage loans in a sale or a securitization, the Bank records the servicing assets retained in accordance with SFAS No. 140. The Bank records mortgage servicing rights and the loans based on relative fair values at the date of origination.

Mortgage loans originated and intended for sale in the secondary market are carried at the lower aggregate cost or estimated fair value. Gains and losses on sales are also accounted for in accordance with SFAS No. 134, "Accounting for Mortgage Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise". This statement requires that an entity engage in mortgage banking activities classify the retained mortgage-backed security or other interest, which resulted from the securitizations of a mortgage loan held for sale, based upon its ability and intent to sell or hold these investments.

The Bank enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (rate lock commitments). Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Time elapsing between the issuance of a loan commitment and closing and sale of the loan generally ranges from 30 to 120 days. The Bank protects itself from changes in interest rates through the use of best efforts forward delivery contracts, whereby the Bank commits to sell a loan at the time the borrower commits to

an interest rate with the intent that the buyer has assumed interest rate risk on the loan. As a result, the Bank is not exposed to losses nor will it realize significant gains related to its rate lock commitments due to changes in interest rates.

The market value of rate lock commitments and best efforts contracts is not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded in stand-alone markets. The Bank determines the fair value of rate lock commitments and best efforts contracts by measuring the change in the value of the underlying asset while taking into consideration the probability that the rate lock commitments will close. Due to high correlation between rate lock commitments and best efforts contracts, no gain or loss occurs on the rate lock commitments.

The Bank adopted FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), on January 1, 2003. FIN 45 requires a guarantor entity, at the inception of a guarantee covered by the measurement provisions of the interpretation, to record a liability for the fair value of the obligation undertaken in issuing the guarantee.

#### Allowance for Loan Losses

The allowance for loan losses is a valuation reserve available for losses or expected on extensions of credit. Management maintains the allowance for loan losses at a level that is considered adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the portfolio. Additions to the allowance are made by charges to the provision for loan losses. The evaluation considers a complete review of the following specific factors: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. Additionally, current economic conditions and local real estate market conditions are considered.

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful, and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans are determined, whenever possible, and used to establish loan loss reserves. In general, for non-homogeneous loans not individually assessed, and for homogeneous groups, such as residential mortgages and consumer credits, the loans are collectively evaluated based delinquency status, loan type, and industry historical losses. These loan groups are then internally risk rated.

The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans criticized special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in nonaccrual status. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

Loans are placed in a nonaccrual status when the ultimate collectibility of principal or interest in whole, or part, is in doubt. Past-due loans contractually past-due 90 days or more for either principal or interest are also placed in nonaccrual status unless they are both well secured and in the process of collection. Impaired loans, in accordance with SFAS 114, are evaluated individually.

All, or part, of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible.

#### Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed primarily on the straight-line method over the estimated useful lives of the related assets for financial reporting purposes and using the mandated methods by asset type for income tax purposes. Building, furniture and fixtures, equipment and leasehold improvements are depreciated or amortized over the estimated useful lives of the assets or lease terms, as applicable. Estimated useful lives of building is forty years, furniture and fixtures and equipment are three to fifteen years, and three to ten years for leasehold improvements. Expenditures for maintenance and repairs are charged to expense as incurred.

The Bank accounts for impairment of long lived assets in accordance with SFAS No. 144, "Accounting for the Impairment of Disposal of Long-Lived Assets". The standard requires recognition and measurement for the



impairment of long lived assets to be held and used or to be disposed of by sale. The Bank had no impaired long lived assets at December 31, 2007 and 2006.

#### Derivative Contracts

Derivative contracts are carried at fair value with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity, net of related income tax effects. Gains and losses on derivative contracts are recognized upon realization utilizing the specific identification method.

The Company follows SFAS No. 133, which was amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities", SFAS No. 149, "Amendment of Statement on Derivative Instruments and Hedging Activities", and SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", (collectively SFAS No. 133). SFAS No. 133, as amended, requires that entities recognize all derivatives as either assets or liabilities in the statement of financial condition and measure those instruments at fair value.

## Income Taxes

There are two components of income tax expense: current and deferred. Current income tax expense approximates cash to be paid or refunded for taxes for the applicable period. Deferred tax assets and liabilities are recognized due to differences between the basis of assets and liabilities as measured by tax laws and their basis as reported in the financial statements. Deferred tax assets are subject to management's judgment based upon available evidence that future realizations are likely. If management determines that the Corporation may not be able to realize some or all of the net deferred tax asset in the future, a charge to income tax expense may be required to reduce the value of the net deferred tax asset to the expected realizable value. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax expense or benefit is recognized for the change in deferred tax liabilities.

## Other Real Estate

Other real estate is carried at the lower of fair value of the related property, as determined by current appraisals less estimated costs to sell, or the recorded investment in the property. Write-downs on these properties, which occur after the initial transfer from the loan portfolio, are recorded as operating expenses. Costs of holding such properties are charged to expense in the current period. Gains, to the extent allowable, and losses on the disposition of these properties are reflected in current operations.

## Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired entity over the fair value of the identifiable net assets acquired in accordance with the purchase method of accounting. Goodwill is not amortized but is reviewed for potential impairment on an annual basis, or more often if events or circumstances indicated that there may be impairment, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Core deposit intangibles are a measure of the value of checking and savings deposits acquired in business combinations accounted for under the purchase method. Core deposit intangibles are amortized on a straight-line basis over their estimated lives (ranging from five to ten years) and identifiable intangible assets are evaluated for impairment if events and circumstances indicate a possible impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Company employs general industry practices in evaluating the fair value of its goodwill and other intangible assets. The Company calculates the fair value using a combination of the following valuation methods: dividend discount analysis under the income approach, which calculates the present value of all excess cash flows plus the present value of a terminal value and price/earnings multiple under the market approach. Any impairment loss related to goodwill and other intangible assets is reflected as other non-interest expense in the statement of operations in the period in which the impairment was determined. No assurance can be given that future impairment tests will not result in a charge to earnings. See Note 3 – Acquisition and Note 10 – Goodwill and Other Intangibles for additional information.

## Share-Based Compensation

The Company recognizes compensation expense for stock options in accordance with SFAS 123 (revised 2004), "Share-Based Payment (SFAS 123R) adopted at January 1, 2006 under the modified prospective application method of transition. The expense of the option is generally measured at fair value at the grant date with compensation expense recognized over the service period, which is usually the vesting period. The Company utilizes the Black-Scholes option-pricing model (as used under SFAS 123) to estimate the fair value of each option on the date of grant. The Black-Scholes model takes into consideration the exercise price and expected life of the options, the current price of

the underlying stock and its expected volatility, the expected dividends on the stock and the current risk-free interest rate for the expected life of the option. The Company's estimate of the fair value of a stock option is based on expectations derived from historical experience and may not necessarily equate to its market value when fully vested. In accordance with SFAS 123R, the Company estimates the number of options for which the requisite service is expected to be rendered. Prior to January, 2006, the Company followed SFAS 123 and Accounting Principles Board (APB) Opinion No. 25 "Accounting for Stock Issued to Employees," with pro forma disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS 123 had been applied. See Note 17 – Stock-Based compensation for additional information.

In December 2007, the SEC issued Staff Accounting Bulletin (SAB) No. 110, "Certain Assumptions Used in Valuation Methods." SAB 110 expresses the views of the staff regarding the use of a "simplified" method as discussed in SAB No. 107, "Share-Based Payment," in developing an estimate of expected term of "plain vanilla" share options in accordance with FAS 123R. The staff stated in SAB 107 that it would not expect a company to use the simplified method for share option grants after December 31, 2007. Under SAB 110, the SEC staff will continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007 to help public companies, mostly small firms, that lack historical data on the exercising of options by employees. SAB 110 is not expected to have any material impact on the Company's financial statements.

## Benefit Plans

The Company provides certain retirement benefits to employees under a 401(k) plan. The Company's contributions to the 401(k) plan are expensed as incurred.

The Company also provides retirement benefits to certain employees under a supplemental executive retirement plan. The plan is unfunded and the Company accrues actuarial determined benefit costs over the estimated service period of the employees in the plan. The Company follows SFAS No. 132, as revised in December 2003, "Employers' Disclosures about Pensions and Other Post-retirement Benefits" and SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Post-retirement Plans-an amendment of FASB Statements No. 87, 88, 106 and 132(R)". SFAS No. 132 revised employers' disclosures about pension and other post-retirement benefit plans. It requires additional information about changes in the benefit obligation and the fair values of plan assets. It also standardized the requirements for pensions and other postretirement benefit plans to the extent possible, and illustrates combined formats for the presentation of pension plan and other post-retirement benefit plan disclosures. SFAS 158 requires an employer to recognize the over funded or under funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income.

The incremental effect of apply SFAS No. 158 on individual line items in the Consolidated Balance Sheets is as follows (In Thousands):

	Before Application of Statement 158 (Restated)	Adjustments (Restated)	After Application of Statement 158 (Restated)
Deferred income taxes	\$1,905	\$302	\$2,207
Total Assets	392,421	302	392,723
Other liabilities	1,131	756	1,887
Total liabilities	356,725	756	357,481
Accumulated other comprehensive loss	(478)	(454)	(932)
Total shareholders' equity	\$35,696	(\$454)	\$35,242

## Cash And Cash Equivalents

Cash and cash equivalents includes cash on hand, interest and non-interest bearing amounts due from banks, Federal funds sold and short-term investments. Generally, Federal funds are sold and short-term investments are made for a one or two-day period.

## Reclassifications

Certain reclassifications have been made to the prior period amounts to conform with the current period presentation.

## Advertising Costs

It is the Company's policy to expense advertising costs in the period in which they are incurred.

## Earnings Per Share

Basic net income per common share is calculated by dividing net income by the weighted average number of shares outstanding during each period.

Diluted net income per common share is calculated by dividing net income by the weighted average number of shares outstanding, as adjusted for the assumed exercise of potential common stock options, using the treasury stock method. All share information has been restated for the effect of a 6% stock dividend declared on December 20, 2007 and paid on February 6, 2008 to shareholders of record on January 23, 2008.

F-11

---

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per share (EPS) calculations:

Year Ended December 31, 2007			
	Income	Weighted- average shares	Per share Amount
<b>Basic EPS</b>			
Net income available to common shareholders	\$ 5,442,751	3,969,943	\$ 1.37
<b>Effect of dilutive securities</b>			
Options and Grants	-	55,486	(0.02)
<b>Diluted EPS</b>			
Net income available to common shareholders plus assumed conversion	\$ 5,442,751	4,025,429	\$ 1.35

All options have been included in the computation of diluted earnings per share.

Year Ended December 31, 2006 (Restated)			
	Income	Weighted- average shares	Per share Amount
<b>Basic EPS</b>			
Net income available to common stockholders	\$ 4,724,963	3,894,897	\$ 1.21
<b>Effect of dilutive securities</b>			
Options and Grants	-	103,616	(0.03)
<b>Diluted EPS</b>			
Net income available to common stockholders plus assumed conversion	\$ 4,724,963	3,998,513	\$ 1.18

### Comprehensive Income

The Company follows SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 established standards to provide prominent disclosure of comprehensive income items. Comprehensive income is the charge in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources.

### Variable Interest Entities

Management has determined that Trust I and Trust II (the "Trusts") qualify as variable interest entities under FASB Interpretation 46 ("FIN 46"). The Trusts issued mandatorily redeemable preferred stock to investors and loaned the proceeds to the Company. Trust II holds, as its sole asset, subordinated debentures issued by the Company. Trust I held, as its sole asset, subordinated debentures issued by the Company until such debentures were redeemed by the Company, and Trust I was terminated, in April 2007. Subsequent to the issuance of FIN 46 and the establishment of

Trust I, the FASB issued a revised interpretation, FIN 46(R), the provisions of which were required to be applied to certain variable interest entities, including Trust I, by March 31, 2004, at which time Trust I was deconsolidated. Because Trust II was formed in 2006, subsequent to the adoption of FIN 46(R), its Balance Sheet and Statement of Operations have never been consolidated with those of the Company.

In March 2005, the Federal Reserve Board adopted a final rule that would continue to allow the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under the final rule, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. Based on the final rule, the Company included all of its \$18.0 million in trust preferred securities in Tier 1 capital at December 31, 2007.

## Segment Information

SFAS No. 131, “Segment Reporting”, establishes standards for public business enterprises to report information about operating segments in their annual financial statements and requires that those enterprises report selected information about operating segments in subsequent interim financial reports issued to shareholders. It also established standards for related disclosure about products and services, geographic areas, and major customers. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision-maker in deciding how to allocate and assess resources and performance. The Company’s chief operating decision-maker is the President and Chief Executive Officer. The Company has applied the aggregation criteria set forth in SFAS No. 131 for its operating segments to create one reportable segment, “Community Banking.”

The Company’s Community Banking segment consists of construction, commercial, retail and mortgage banking. The Community Banking segment is managed as a single strategic unit, which generates revenue from a variety of products and services provided by the Company. For example, construction and commercial lending is dependent upon the ability of the Company to fund itself with retail deposits and other borrowings and to manage interest rate and credit risk. This situation is also similar for consumer and residential real estate lending.

## Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141(R), “Business Combinations (revised 2007).” FAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This Statement is broader than SFAS 141, which only applied to business combinations in which control was obtained by transferring consideration. SFAS 141(R) applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses including combinations achieved without the transfer of consideration. SFAS 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the Statement. This replaces SFAS 141’s cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. SFAS 141 required the acquirer to include the costs incurred to effect the acquisition (acquisition-related costs) in the cost of the acquisition that was allocated to the assets acquired and the liabilities assumed. SFAS 141 (R) requires those costs to be recognized separately from the acquisition. In accordance with SFAS 141, restructuring costs that the acquirer expected but was not obligated to incur were recognized as if they were a liability assumed at the acquisition date. SFAS 141(R) requires the acquirer to recognize those restructuring costs that do not meet the criteria in SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities” as an expense as incurred. Acquisition related transaction costs will be expensed as incurred. SFAS 141(R) requires an acquirer to recognize assets or liabilities arising from all other contingencies (contractual contingencies) as of the acquisition date, measured at their acquisition-date fair values only if it is more likely than not that they meet the definition of an asset or a liability on the acquisition date. Under SFAS 141(R), changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. Additionally, under SFAS 141(R), the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of the adoption of this FAS 141(R) on its financial statements.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interest in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51, “Consolidated Financial Statements.” FAS 160 requires all entities



to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. Its intention is to eliminate the diversity in practice regarding the accounting for transactions between an entity and noncontrolling interests. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of the adoption of SFAS 160 on its financial statements.

In November 2007, the SEC issued SAB 109, "Written Loan Commitments Recorded at Fair Value through Earnings." SAB 109 revises and rescinds portions of SAB 105, "Application of Accounting Principles to Loan Commitments." The SEC staff's current view is that the expected net future cash flows related to the associated servicing of a loan should be included in the measurement of derivative and other written loan commitments that are accounted for at fair value through earnings. That view is consistent with the guidance in Financial Accounting Standards Board (FASB) No. 156, "Accounting for Servicing of Financial Assets" and FASB No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SAB 109 retains the view expressed in SAB 105 that internally developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment. The guidance in SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The adoption of SAB 109 is not expected to have a material impact on the Company's financial statements.

In June 2007, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." EITF06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for nonvested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007. The Company does not expect EITF 06-11 will have a material impact on its financial statements.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115.” SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 provides entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Statement also establishes presentation and disclosure requirements. The entity shall report the effect of the first re-measurement to fair value as a cumulative-effective adjustment to the opening balance of retained earnings. At each subsequent reporting date, unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The fair value option may be applied instrument by instrument, with a few exceptions, is irrevocable and is applied only to entire instruments. Most of the provisions of SFAS 159 apply only to entities that elect the fair value option. However, the amendment to SFAS 115, “Accounting for Certain Investments in Debt and Equity Securities,” applies to all entities with available-for-sale and trading securities. If the fair value option is elected for any available-for-sale or held-to-maturity securities at the effective date, the cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment. SFAS 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. Early adoption was permitted as of the beginning of a fiscal year that began on or before November 15, 2007, provided that the entity also elected to apply the provisions of SFAS 157, “Fair Value Measurements.” The Company is not currently electing to measure any additional financial instruments at fair value under this Statement and the adoption of FAS 159 is not expected to have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements.” SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” The Statement will require the Company to apply valuation techniques that (1) place greater reliance on observable inputs and less reliance on unobservable inputs and (2) are consistent with the market approach, the income approach, and/or the cost approach. The definition and framework apply to both items recognized and reported at fair value in the financial statements and items disclosed at fair value in the notes to the financial statements. The Statement also requires expanded disclosure in interim and annual financial statements about how the Company uses fair value. The disclosures focus on items measured at fair value based on significant unobservable inputs and the effect of fair value measurements on earnings. The disclosures are only required for items recognized and reported at fair value in the financial statements. The Statement does not change existing accounting rules governing what can or what must be recognized and reported at fair value in the Company’s financial statements, or disclosed at fair value in the Company’s notes to the financial statements. Additionally, SFAS 157 does not eliminate practicability exceptions that exist in accounting pronouncements amended by this Statement when measuring fair value. As a result, the Company will not be required to recognize any new instruments at fair value. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application was encouraged. Prospective application of the provisions of SFAS 157 is required as of the beginning of the fiscal year in which it is initially applied, except for certain circumstances specified in the Statement that require retrospective application. In March 2008, the FASB issued FSP FAS 157-2 to partially delay the effective implementation of SFAS 157 until fiscal years beginning after November 15, 2008 for all nonfinancial assets and liabilities except those that are recognized or disclosed at fair value in financial statements on a recurring basis (at least annually). Assets and liabilities currently reported or disclosed at fair value on a recurring basis in the Company’s financial statements include investment securities, impaired loans, residential mortgage loans held for sale, mortgage servicing rights and derivatives. The Company does not anticipate any material impact on its financial statements upon partial adoption of FAS 157 for its fiscal year beginning January 1, 2008. The Company is in the process of assessing the impact of the adoption of SFAS 157 for its fiscal year beginning January 1, 2009 relating to nonfinancial assets and liabilities on the Company’s financial statements including goodwill and other intangible assets.

At its September 2006 meeting, the EITF reached a final consensus on Issue 06-05, "Accounting for Purchases of Life Insurance—Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin No. 85-4." Issue 06-05 concludes that in determining the amount that could be realized under an insurance contract accounted for under FASB Technical Bulletin No. 85-4, "Accounting for Purchases of Life Insurance," the policyholder should (1) consider any additional amounts included in the contractual terms of the policy; (2) assume the surrender value on a individual-life by individual-life policy basis; and (3) not discount the cash surrender value component of the amount that could be realized when contractual restrictions on the ability to surrender a policy exist. Issue 06-05 should be adopted through either (1) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (2) a change in accounting principle through retrospective application to all prior periods. Issue 06-05 is effective for fiscal years beginning after December 15, 2006. The application of Issue 06-05 did not have a material effect on the Company's financial position or results of operations.

At its September 2006 meeting, the EITF reached a final consensus on Issue 06-04, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." In accordance with the EITF consensus, an agreement by an employer to share a portion of the proceeds of a life insurance policy with an employee during the postretirement period is a postretirement benefit arrangement required to be accounted for under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions" or APB Opinion No. 12, "Omnibus Opinion 1967." Furthermore, the purchase of a split-dollar life insurance policy does not constitute a settlement under SFAS No. 106 and, therefore, a liability for the postretirement obligation must be recognized under SFAS No. 106 if the benefit is offered under an arrangement that constitutes a plan or under APB No. 12 if it is not part of a plan. The provisions of Issue 06-04 are to be applied through either a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or retrospective application. Issue 06-04 is effective for annual or interim reporting periods beginning after December 15, 2007. The application of Issue 06-04 is not expected to have a material effect on the Company's financial statements.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet a "more-likely-than-not" recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 are to be reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year. The new interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company's implementation of this interpretation did not have a material impact on the Company's financial position or results of operations and did not result in an adjustment to opening retained earnings.

In May 2007, the FASB issued FIN 48-1, "Definition of Settlement in FIN 48" to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FIN 48-1 is effective retroactively to January 1, 2007. The implementation of this standard did not have any impact on the Company's consolidated financial position or results of operations.

## 2. Restatement of Consolidated Financial Statements For the Year Ended and As At December 31, 2006

On March 14, 2008, the Company filed a Current Report on Form 8-K with the SEC disclosing that (i) the Company's consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, and the interim financial statements included in the Company's Quarterly Reports on Form 10-Q for the three-month periods ended March 31, 2007 and March 31, 2006, the three- and six-month periods ended June 30, 2007 and June 30, 2006, and the three- and nine-month periods ended September 30, 2007 and September 30, 2006 (collectively, the "Previously Issued Financial Statements") previously filed with the SEC should no longer be relied upon and (ii) the Previously Issued Financial Statements should be restated because of errors in such financial statements. The Previously Issued Financial Statements for the year ended and as at December 31, 2006 contained the following errors, which are described in more detail below:

- Errors made in accounting for (i) current tax liabilities principally related to the Company's trust preferred securities and (ii) deferred tax assets in 2006 and prior periods, resulting in an underestimate of current tax liabilities and an overestimate of deferred tax assets;
- Overestimation of liabilities related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan in connection with the implementation of FAS 158 in 2006, resulting in an increase in expenses; and
- Failure to adequately evaluate estimation of certain non-interest operating expenses for, among other things, professional fees, advertising and business development, resulting in an over-accrual of certain non-interest operating expenses in 2006 and a resultant decrease in tax expense for 2006.

The following sets forth the effect of the restatement adjustments on the applicable line items with the Company's Consolidated Statement of Income for the year ended December 31, 2006:

1st CONSTITUTION BANCORP  
CONSOLIDATED STATEMENTS OF INCOME

For the Year Ended December 31, 2006 – Restated

	2006 ( as filed )	Restatement Adjustments	2006 ( restated )
<b>INTEREST INCOME:</b>			
Interest and fees on loans	\$ 23,166,544		\$ 23,166,544
Interest on securities:			
Taxable	3,448,780		3,448,780
Tax- exempt	604,846		604,846
Interest on Federal funds sold and short-term investments	85,012		85,012
<b>Total interest income</b>	<b>27,305,182</b>		<b>27,305,182</b>
<b>INTEREST EXPENSE:</b>			
Interest on deposits	6,688,080		6,688,080
Interest on securities sold under agreements to repurchase and other borrowed funds	1,687,749		1,687,749
Interest on redeemable subordinated debentures	1,141,668		1,141,668
<b>Total interest expense</b>	<b>9,517,497</b>		<b>9,517,497</b>
<b>Net interest income</b>	<b>17,787,685</b>		<b>17,787,685</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>893,500</b>		<b>893,500</b>
Net interest income after provision for loan losses	16,894,185		16,894,185
<b>NON-INTEREST INCOME:</b>			
Service charges on deposit accounts	668,071		668,071
Gain on sale of loans held for sale	1,072,731		1,072,731
(Loss)/gain on sale of securities available for sale	(99,714)		(99,714)
Income on Bank-owned life insurance (1)	350,476	(19,561)	330,915
Other income	599,445		599,445
<b>Total other income</b>	<b>2,591,009</b>	<b>(19,561)</b>	<b>2,571,448</b>
<b>NON-INTEREST EXPENSES:</b>			
Salaries and employee benefits (2)	6,799,619	(58,569)	6,741,050
Occupancy expense (3)	1,434,728	13,499	1,448,227

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Other operating expenses (4)	3,803,509	22,061	3,825,570
Total other expenses	12,037,856	(23,009)	12,014,847
Income before income taxes	7,447,338	3,448	7,450,786
INCOME TAXES (5)	2,114,494	611,330	2,725,824
Net Income	\$ 5,332,844	\$ (607,882)	\$ 4,724,962
NET INCOME PER SHARE			
Basic	\$ 1.37	\$	1.21
Diluted	\$ 1.33	\$	1.18

F-16

---

(1) Income on Bank-owned life insurance was reduced by \$19,561 to reconcile the cash surrender value of the policies with the balances subsequently provided by the benefit plan administrator. (2) Salaries and employee benefits was reduced by \$58,569 which is the net result of (a) an increase of \$51,778 to accrue additional 2006 charges for employee health insurance premiums and (b) a decrease of \$110,347 to correct an over-accrual of the costs related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan. (3) Occupancy Expense was restated by \$13,499 to record additional rent expense under the straight-line method in accordance with Statement of Financial Accounting Standards no. 13, "Accounting for Leases", (4) Other operating expenses was restated by \$22,061 which is the net result of (a) an increase of \$168,000 to increase 2006 expense for the impact of over-accrued expenses from prior periods that were reversed into income during 2006 and (b) a decrease of \$145,939 to reverse current year over-accruals of certain operating expenses. (5) Income taxes were increased by \$611,330 which is the net result of (a) an increase of \$702,202 to restate the current tax liability related to the Company's trust preferred securities and deferred tax assets and (b) a reduction of \$90,872 for the tax benefits attributable to the increased expense level resulting from the restatement adjustments.

The following sets forth the effect of the restatement adjustments on the applicable line items with the Company's Consolidated Balance Sheet as at December 31, 2006:

1st CONSTITUTION BANCORP  
CONSOLIDATED BALANCE SHEET  
December 31, 2006 – Restated

ASSETS	2006 ( as filed )	Restatement Adjustments	2006 ( restated )
CASH AND DUE FROM BANKS	\$ 10,336,334		\$ 10,336,334
FEDERAL FUNDS SOLD/SHORT TERM INVESTMENTS	25,478		25,478
Total cash and cash equivalents	10,361,812		10,361,812
SECURITIES			
Available for sale, at fair value	70,421,328		70,421,328
Held to maturity (fair value of \$19,164,679 and \$21,521,026 in 2006 and 2005, respectively)	19,254,476		19,254,476
Total securities	89,675,804		89,675,804
LOANS HELD FOR SALE	13,608,942		13,608,942
LOANS	265,142,313		265,142,313
Less- Allowance for loan losses	(3,228,360)		(3,228,360)
Net loans	261,913,953		261,913,953
PREMISES AND EQUIPMENT, net	3,033,618		3,033,618
ACCRUED INTEREST RECEIVABLE	2,235,671		2,235,671
BANK-OWNED LIFE INSURANCE	9,179,408		9,179,408
OTHER ASSETS (1)	2,668,338	253,158	2,921,496
Total Assets	\$ 392,677,546	\$ 253,158	\$ 392,930,704
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES:			
Deposits			
Non-interest bearing	\$ 64,305,445		\$ 64,305,445
Interest bearing	248,418,977		248,418,977
Total deposits	312,724,422		312,724,422



Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

OTHER BORROWINGS	17,200,000		17,200,000
REDEEMABLE SUBORDINATED DEBENTURES	23,712,000		23,712,000
ACCRUED INTEREST PAYABLE	1,957,574		1,957,574
ACCRUED EXPENSES AND OTHER LIABILITIES (2)	1,886,980	502,683	2,389,663
Total liabilities	357,480,976	502,683	357,983,659
COMMITMENTS AND CONTINGENCIES			
SHAREHOLDERS' EQUITY			
Common Stock, no par value; 30,000,000 shares authorized; 3,967,431 shares issued and 3,967,222 shares outstanding as of December 31, 2006.	28,886,105		28,886,105
Retained earnings (3)	7,290,916	(280,705)	7,010,211
Treasury Stock, at cost, 209 shares at December 31, 2006	(3,545)		(3,545)
Accumulated other comprehensive (loss) (4)	(976,906)	31,180	(945,726)
Total shareholders' equity	35,196,570	(249,525)	34,947,045
Total liabilities and shareholders' equity	\$ 392,677,546	\$ 253,158	\$ 392,930,704

1) Other Assets was increased by \$253,158 of which \$247,815 represents the restatement of the Company's deferred tax assets due to adjustments relating to (a) the Company's trust preferred securities and (b) the Company's Supplemental Executive Retirement Plan. (2) Accrued Expenses and Other Liabilities increased by \$502,683 which consists primarily of increases to accrued liability balances of \$1,163,660 for income taxes and \$37,349 for deferred rent expense partially offset by reductions in the balance due primarily to \$698,327 of accrual reversals for over-accrued operating expenses. (3) Retained Earnings was restated by \$280,705 which represents the net of the negative impact of 2006 adjustments of \$607,882 partially offset by the cumulative effect of restatement on prior periods of \$327,177 as disclosed in the Consolidated Statements of Changes in Shareholders' Equity on page F-5. (4) Accumulated other comprehensive (loss) was reduced by \$31,180 primarily as a result of the adjustment to restate balances relating to the Company's Supplemental Executive Retirement Plan.

The following sets forth the effect of the restatement on the applicable line items in the Company's Consolidated Statement of Cash Flows for the year ended December 31, 2006:

	2006 (as filed)	Restatement Adjustments(1)	2006 (restated)
Operating Activities:			
Net income	\$ 5,332,844	\$ (607,882)	\$ 4,724,962
Income on Bank-owned life insurance	(350,476)	19,561	(330,915)
Deferred tax benefit	(471,367)	(68,442)	(539,809)
(Increase) in other assets	(1,370,830)	1,075,964	(294,866)
Increase (decrease) in accrued expenses and other liabilities	64,073	346,015	(410,088)
Share-based compensation expense	-	95,230(2)	95,230
Net cash provided by operating activities	\$ 8,355,013	40,270	\$ 8,395,283

(1) The restatement adjustments to the Company's Consolidated Statement of Cash Flows are summarized as follows:

(a) Net income represents the impact on operations from the 2006 restatement adjustments; (b) Income on Bank-owned life insurance was restated to reconcile the cash surrender value of the policies with the balances subsequently provided by the benefit plan administrator; (c) Other assets was increased primarily due to the restatement of the Company's deferred tax assets; and (d) Accrued expenses and other liabilities was affected primarily by the restatement of the Company's income tax liabilities.

(2) Represents a reclassification of share-based compensation expense from Financing Activities in the 2006 Consolidated Statement of Cash Flows as filed to Operating Activities in the 2006 Consolidated Statement of Cash Flows as restated.

### 3. Acquisition of Unaffiliated Branch

On February 27, 2007, the Company, through the Bank, completed its acquisition of the Hightstown, New Jersey branch of another financial institution for a purchase price of \$747,330.

As a result of the acquisition, the Hightstown branch became a branch of the Bank. Included in the acquisition of the branch were deposit liabilities of \$19.5 million, mostly in certificates of deposit, cash of approximately \$18.8 million, net of assets acquired, cash on hand of approximately \$137,000, fixed and other assets of approximately \$91,000 and the assumption of the lease of the branch premises. The cash received in the transaction was utilized to repay short term borrowings used to purchase investment securities prior to, and in contemplation of, the completion of the acquisition.

In addition, the Bank recorded goodwill of \$472,726 and a deposit intangible asset of \$274,604.

### 4. Investment Securities

Amortized cost, gross unrealized gains and losses, and the estimated fair value by security type are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2007				
Available for sale-				
U. S. Treasury securities				
and				
obligations of U.S.				
Government				
sponsored corporations and				
agencies	\$ 29,561,717	\$ 317,245	\$ (421,604)	\$ 29,457,359
Mortgage backed securities	37,769,517	457,725	(57,365)	38,169,877
Obligations of State and				
Political subdivisions	3,446,517	14,778	(7,713)	3,453,582
FHLB stock and other				
securities	4,383,823	0	(272,504)	4,111,319
	\$ 75,161,574	\$ 789,748	\$ (759,185)	\$ 75,192,137
Held to maturity-				
Mortgage backed securities	\$ 4,502,574	\$ 2,132	\$ (121,197)	\$ 4,383,509
Obligations of State and				
Political subdivisions	18,013,721	142,232	(4,718)	18,151,235
Other Securities	996,051	0	(119,526)	876,525
	\$ 23,512,346	\$ 144,364	\$ (245,441)	\$ 23,411,269

2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	\$ 35,625,182	\$ 124,144	\$ (694,261)	\$ 35,055,065
Mortgage backed securities	28,305,557	113,353	(216,111)	28,202,799
Obligations of State and Political subdivisions	3,655,197	15,902	(31,749)	3,639,350
FHLB stock and other securities	3,554,759	304	(30,949)	3,524,114
	\$ 71,140,695	\$ 253,703	\$ (973,070)	\$ 70,421,328
Held to maturity-				
Mortgage backed securities	\$ 5,540,670	\$ 2,015	\$ (175,826)	\$ 5,366,859
Obligations of State and Political subdivisions	13,713,806	131,955	(47,941)	13,797,820
	\$ 19,254,476	\$ 133,970	\$ (223,767)	\$ 19,164,679

The amortized cost, estimated fair value and weighted average yield of investment securities at December 31, 2007, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Federal Home Loan Bank stock is included in "Held to maturity - Due in one year or less."

	Amortized Cost	Fair Value	Weighted Average Yield*
Available for sale-			
Due in one year or less	\$ 5,748,287	\$ 5,734,053	4.88%
Due after one year through five years	13,613,468	13,845,942	5.09%
Due after five years through ten years	10,654,348	10,736,895	5.12%
Due after ten years	45,145,471	44,875,247	5.39%
Total	\$ 75,161,574	\$ 75,192,137	5.25%
Held to maturity-			
Due in one year or less	\$ 7,519,727	\$ 7,521,621	4.49%
Due after one year through five years	1,904,665	1,917,828	5.56%
Due after five years through ten years	5,371,683	5,421,885	5.54%
Due after ten years	8,716,271	8,549,935	5.70%
Total	\$ 23,512,346	\$ 23,411,269	5.27%

\* computed on a tax equivalent basis.

Gross unrealized losses on securities and the estimated market value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2007 and December 31, 2006 are as follows:

2007	Number of Securities	Less than 12 months		12 months or longer		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unre Lo
U.S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	25	\$ 1,491,803	\$ (33,117)	\$ 9,418,035	\$ (388,486)	\$ 10,909,838	\$ (4
Mortgage backed securities	15	4,278,329	(121,197)	5,230,207	(57,365)	9,508,536	(1
Obligations of State and Political Subdivisions	16	0	0	3,260,125	(12,431)	3,260,125	(
FHLB stock and other securities	5	2,596,788	(354,198)	458,355	(37,832)	3,055,143	(3
Total temporarily impaired securities	61	\$ 8,366,920	\$ (508,512)	\$ 18,366,722	\$ (496,114)	\$ 26,733,642	\$ (1,0

F-21

2006		Less than 12 months		12 months or longer		Total	
	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unre Lo
U.S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	28	\$ 83,506	\$ (22)	\$ 22,760,194	\$ (694,238)	\$ 22,843,700	\$ (6
Mortgage backed securities	33	6,274,180	(26,241)	13,608,019	(365,697)	19,882,199	(3
Obligations of State and Political Subdivisions	30	2,395,099	(12,271)	7,274,761	(67,419)	9,669,860	(
FHLB stock and other securities	3	967,328	(13,411)	967,960	(17,538)	1,935,288	(
Total temporarily impaired securities	94	\$ 9,720,113	\$ (51,945)	\$ 44,610,934	\$ (1,144,892)	\$ 54,331,047	\$ (1,1

U.S. Treasury obligations and direct obligations of U.S. Government agencies: The unrealized losses on investments in these securities were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than temporarily impaired.

Mortgage-backed securities: The unrealized losses on investments in mortgage-backed securities were caused by interest rate increases. The contractual cash flows of these securities are guaranteed by the issuer, primarily government or government sponsored agencies. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

FHLB stock and other securities: The investments in these securities with unrealized losses are comprised of corporate trust preferred securities that mature in 2027. The unrealized losses on these securities were caused by interest rate increases. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company has the intent and ability to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

The Company recorded no gains or losses on sales of securities available for sale in 2007 and gross losses on sales of securities available for sale of \$99,714 in 2006.

As of December 31, 2007 and 2006, securities having a book value of \$50,917,850 and \$28,824,981, respectively, were pledged to secure public deposits, other borrowings and for other purposes required by law.

## 5. Loans and Loans Held for Sale

Loans are as follows:

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

	2007	2006
Construction loans	\$ 132,735,920	\$ 125,268,871
Residential real estate loans	10,088,515	7,670,370
Commercial and commercial real estate loans	135,128,642	114,897,040
Loans to individuals	16,324,817	16,728,025
Deferred loan fees	302,818	404,074
All other	180,006	173,933
	\$ 294,760,718	\$ 265,142,313

The Bank's business is concentrated in New Jersey, particularly Middlesex, Mercer and Somerset counties. A significant portion of the total loan portfolio is secured by real estate or other collateral located in these areas.

F-22

---

The Bank had residential mortgage loans held for sale of \$10,322,005 at December 31, 2007 and \$13,608,942 at December 31, 2006. The Bank sells residential mortgage loans in the secondary market on a non-recourse basis. The related loan servicing rights are generally released to the purchaser. Loans held for sale at December 31, 2007 and 2006 are residential mortgage loans that the Bank intends to sell under forward contracts providing for delivery to purchasers generally within a two month period. Changes in fair value of the forward sales contracts, and the related loan origination commitments and closed loans, were not significant at December 31, 2007 and 2006.

#### 6. Allowance for Loan Losses

A summary of the allowance for loan losses is as follows:

	2007	2006
Balance, beginning of year	\$ 3,228,360	\$ 2,361,375
Provision charged to operations	130,000	893,500
Loans charged off	(90,983)	(29,468)
Recoveries of loans charged off	80,703	2,953
Balance, end of year	\$ 3,348,080	\$ 3,228,360

The amount of loans which were not accruing interest amounted to \$2,153,420 and \$4,193,209 at December 31, 2007 and 2006, respectively. Impaired loans totaled \$3,304,510 and zero at December 31, 2007 and 2006, respectively. There was a valuation allowance of \$400,876 on impaired loans at December 31, 2007. There were no loans 90 days or more past due and still accruing interest at December 31, 2007 or December 31, 2006.

Additional income before taxes amounting to \$129,967 and \$348,344 would have been recognized in 2007 and 2006, respectively, if interest on all loans had been recorded based upon original contract terms. No interest was recognized on non-accrual loans in 2007 or 2006. The average recorded investment in impaired loans for the years ended December 31, 2007 and 2006 was approximately \$899,014 and zero, respectively.

#### 7. Loans to Related Parties

Activity related to loans to directors, executive officers and their affiliated interests during 2007 and 2006 is as follows:

	2007	2006
Balance, beginning of year	\$ 5,124,060	\$ 2,632,162
Loans granted	140,000	3,154,202
Repayments of loans	(1,407,630)	(662,304)
Balance, end of year	\$ 3,856,430	\$ 5,124,060

All such loans were made under customary terms and conditions and were current as to principal and interest payments as of December 31, 2007 and 2006.

#### 8. Premises And Equipment

Premises and equipment consist of the following:

Estimated Useful Lives	2007	2006
---------------------------	------	------



Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Land		241,784	\$	241,784
Building	40 Years	735,579		735,579
Leasehold improvements	10 Years	2,187,879		2,011,056
Furniture and equipment	3 – 15 Years	2,634,361		2,364,917
		5,799,603		5,353,336
Less Accumulated depreciation		(3,039,400)		(2,319,718)
		\$ 2,760,203	\$	3,033,618

Depreciation expense was \$720,113 and \$627,833 for the years ended December 31, 2007 and 2006, respectively.

F-23

---

## 9. Other Real Estate Owned

The Bank held one property valued at \$2,960,727 as Other Real Estate owned at December 31, 2007 and held no Other Real Estate Owned property at December 31, 2006. The Company did not incur any write downs on foreclosed properties during the years ended December 31, 2007 and 2006. There was no impairment on this property at December 31, 2007. Further declines in real estate values may result in increased foreclosed real estate expense in the future. Routine holding costs are charged to expense as incurred and improvements to real estate owned that enhance the value of the real estate are capitalized.

## 10. Intangible Assets

Intangible assets at December 31, 2007 are summarized as follows:

	2007
Goodwill	\$ 472,726
Core deposits intangible	247,070
Total	\$ 719,796

The Company had no intangible assets at December 31, 2006.

Amortization expense of intangible assets was \$27,534 for the year ended December 31, 2007.

Scheduled amortization of the core deposits intangible for each of the next five years is as follows:

2008	\$ 36,712
2009	36,712
2010	36,712
2011	36,712
2012	36,712
Thereafter	63,510

## 11. Deposits

Deposits consist of the following:

	2007	2006
Demand		
Non-interest bearing	\$ 59,055,803	\$ 64,305,445
Interest bearing	86,168,444	82,113,165
Savings	62,094,432	53,630,726
Time	122,013,689	112,675,086
	\$ 329,332,368	\$ 312,724,422

Individual time deposits \$100,000 or greater amounted to \$53,855,542 and \$48,074,279 at December 31, 2007 and 2006, respectively. As of December 31, 2007, time certificates of deposit in amounts of \$100,000 or more have remaining maturity time as follows:

Maturity Range	Amount
Three months or less	\$ 16,677,115
Over three months through six months	17,988,814

Over six months through twelve months	14,942,550
Over twelve months	4,247,063
	\$ 53,855,542

## 12. Borrowings

The balance of borrowings was \$35,600,000 at December 31, 2007, consisting of long-term FHLB borrowings of \$30,500,000 and overnight funds purchased of \$5,100,000. The balance of borrowings at December 31, 2006 consisted of FHLB borrowings of \$15,500,000 and overnight funds purchased of \$1,700,000.

At December 31, 2007, the Bank maintained an Overnight Line of Credit at the FHLB in the amount of \$23,783,000 and a One Month Overnight Repricing Line of Credit of \$28,883,000. Advances issued under these programs are subject to FHLB stock level and collateral requirements. Pricing of these advances may fluctuate based on existing market conditions. The Bank also maintains an unsecured federal funds line of \$13,500,000 with a correspondent bank.

F-24

---

The Bank purchased five ten-year fixed rate convertible advances from the FHLB that total \$25,500,000 in the aggregate. These advances, in the amounts of \$3,000,000, \$2,500,000, \$5,000,000, \$5,000,000 and \$10,000,000 bear interest at the rates of 5.82%, 5.50%, 5.34%, 5.06% and 4.08%, respectively. The Bank purchased one two-year advance in the amount of \$5,000,000 that bears interest at a 3.833% rate. These advances are convertible quarterly at the option of the FHLB. These advances are fully secured by marketable securities.

The FHLB advances mature as follows:

	2007
2008	-
2009	\$ 8,000,000
2010	12,500,000
2011	-
2012	-
Thereafter	10,000,000
	\$ 30,500,000

These callable advances have original maturity dates of ten years and call dates of one year to five years. After the original call period expires, the borrowings are callable quarterly. Due to the call provisions, expected maturities could differ from contractual maturities.

### 13. Redeemable Subordinated Debentures

On April 10, 2002, 1st Constitution Capital Trust I (“Trust I”), a statutory business trust and a wholly-owned subsidiary of the Company, issued \$5.0 million of variable rate trust preferred securities (the “Trust Preferred Securities”) in a pooled institutional placement transaction maturing April 22, 2032. Trust I utilized the \$5.0 million proceeds along with \$155,000 invested in Trust I by the Company to purchase \$5,155,000 of floating rate subordinated debentures issued by the Company and due to mature on April 22, 2032 (the “Subordinated Debentures”). The Subordinated Debentures constituted the sole assets of Trust I, had terms that mirrored the Trust Preferred Securities and were redeemable in whole or part prior to maturity after April 22, 2007. Trust I was obligated to distribute all proceeds of a redemption of the Subordinated Debentures, whether voluntary or upon maturity, to holders of the Trust Preferred Securities. The Company’s obligation with respect to the Trust Preferred Securities and the Subordinated Debentures, when taken together, provided a full and unconditional guarantee on a subordinated basis by the Company of the obligations of Trust I to pay amounts when due on the Trust Preferred Securities. On February 23, 2007, the Company notified Wilmington Trust Company, as Indenture Trustee, of the Company’s intention to redeem the Subordinated Debentures on April 22, 2007, and the Company redeemed the Subordinated Debentures on that date, as discussed below.

On May 30, 2006, 1st Constitution Bancorp established 1st Constitution Capital Trust II, a Delaware business trust subsidiary (“Trust II”), for the sole purpose of issuing \$18 million of trust preferred securities (the “Capital Securities”). The Capital Securities were issued in connection with a pooled offering involving approximately 50 other financial institution holding companies. All of the Capital Securities were sold to a single pooling vehicle.

The proceeds from the sale of the Capital Securities were loaned to the Company under 30-year floating rate junior subordinated debentures issued to Trust II by the Company. The debentures are the only asset of Trust II. Interest payments on the debentures flow through Trust II to the pooling vehicle. Payments of distributions by Trust II to the pooling vehicle are guaranteed by the Company.

Effective April 22, 2007, the Company redeemed all of the Subordinated Debentures. The redemption price was 100% of the aggregate \$5,155,000 principal amount of the Subordinated Debentures, plus approximately \$236,882 of

accrued interest thereon through the redemption date. As a result of the redemption of the Subordinated Debentures, a like amount of capital securities issued by 1st Constitution Capital Trust I will also be redeemed under the same terms and conditions. This redemption does not impact the Capital Securities issued by the Company's wholly-owned subsidiary 1st Constitution Capital Trust II on May 30, 2006.

F-25

---

## 14. Income Taxes

The components of income tax expense (benefit) are summarized as follows:

	2007	2006 (Restated)
Federal-		
Current	\$ 2,464,723	\$ 2,658,827
Deferred	(192,456)	(449,182)
	2,272,267	2,209,645
State-		
Current	446,000	647,076
Deferred	(55,983)	(130,897)
	390,017	516,179
	\$ 2,662,284	\$ 2,725,824

A comparison of income tax expense at the Federal statutory rate in 2007 and 2006 to the Company's provision for income taxes is as follows:

	2007	2006 (Restated)
Federal income tax	\$ 2,755,722	\$ 2,533,267
Add (deduct) effect of:		
State income taxes net of federal income tax effect	256,015	340,678
Tax-exempt interest income	(297,737)	(205,648)
Bank-owned life insurance	(124,304)	(119,162)
Other items, net	72,588	176,689
Provision for income taxes	\$ 2,662,284	\$ 2,725,824

The tax effects of existing temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	2007	2006 (Restated)
Deferred tax assets-		
Allowance for loan losses	\$ 1,337,223	\$ 1,289,407
Employee benefits	85,670	40,271
Unrealized loss on securities available for sale	(12,880)	227,367
SERP Liability	1,018,988	801,311
Other	(94,415)	(56,720)
Net deferred tax assets	2,334,586	2,301,636

Based upon the current facts, management has determined that it is more likely than not that there will be sufficient taxable income in future years to realize the deferred tax assets. However, there can be no assurances about the level of future earnings.



## 15. Comprehensive Income and Accumulated Other Comprehensive Income

The components of other comprehensive income (loss) are as follows:

For the year ended December 31, 2007	Before tax Amount	Tax Benefit (Expense)	Net of Tax amount
Net unrealized gains on available for sale securities:			
Net unrealized holding gains arising during period	749,930	\$ (240,247)	\$ 509,683
Minimum pension liability	(61,989)	24,758	(37,231)
Change in fair value of interest rate swap contract	(99,754)	39,842	(59,912)
Other comprehensive income, net	\$ 588,187	\$ (175,647)	\$ 412,540

For the year ended December 31, 2006 (Restated)	Before Tax Amount	Tax Benefit (Expense)	Net of Tax amount
Net unrealized gains on available for sale securities:			
Net unrealized holding gains arising during period	\$ 455,076	\$ (253,236)	\$ 201,840
Less reclassification adjustment for net gains			
realized in net income	(99,714)	33,903	(65,811)
Net unrealized gains	554,790	(287,139)	267,651
Other comprehensive income, net	\$ 554,790	\$ (287,139)	\$ 267,651

The components of other accumulated comprehensive income (loss), net of tax, which is a component of shareholders' equity were as follows:

	Net unrealized Gains (Losses) On Available For Sale Securities	Net Change in Fair Value of Interest Rate Swap Contract	Net Change Related to Defined Benefit Pension Plans	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2006 (Restated)	\$ (492,000)	-	\$ (454,266)	\$ (945,726)
Net Change	509,683	(59,912)	(37,231)	412,540
Balance, December 31, 2007	\$ 17,683	\$ (59,912)	\$ (491,497)	\$ (533,186)

## 16. Benefit Plans



#### Retirement Savings Plan

The Bank has a 401(K) plan which covers substantially all employees with six months or more of service. The plan permits all eligible employees to make basic contributions to the plan up to 12% of base compensation. Under the plan, the Bank provided a matching contribution of 50% in 2007 and 2006 up to 6% of base compensation. Employer contributions to the plan amounted to \$105,621 in 2007, and \$85,899 in 2006.

#### Benefit Plans

The Company also provides retirement benefits to certain employees under a supplemental executive retirement plan. The plan is unfunded and the Company accrues actuarial determined benefit costs over the estimated service period of the employees in the plan. The present value of the benefits accrued under these plans as of December 31, 2007 and 2006 is approximately \$2,551,295 and \$2,006,288, respectively, and is included in other liabilities and accumulated other comprehensive income in the accompanying consolidated balance sheet. Compensation expense of \$483,019 and \$423,991 is included in the accompanying consolidated statement of income for the years ended December 31, 2007 and 2006, respectively.

In connection with the benefit plans, the Bank purchased \$6.0 million in life insurance policies on the lives of its executives, directors and divisional officers. The Bank is the owner and beneficiary of the policies. The cash surrender values of the policies are approximately \$9.5 million and \$9.2 million as of December 31, 2007 and 2006, respectively.

F-27

---

The following table sets forth the changes in benefit obligations and plan assets of the Company's supplemental executive retirement plan.

	2007	2006
Change in Benefit Obligation		
Liability for pension, beginning	\$ 2,006,288	\$ 1,536,624
Service cost	227,165	210,773
Interest cost	131,555	101,633
Actuarial (gain) loss	186,288	-
Benefits paid	-	-
Plan amendments		157,258
Liability for pension, ending	\$ 2,551,295	\$ 2,006,288
(Accrued liability) prepaid benefit cost		
included in balance sheet	\$ (1,732,952)	\$ (1,249,934)
Amount Recognized in Consolidated Balance Sheets		
Liability for pension	\$ (2,551,295)	\$ (2,006,288)
Unrecognized net actuarial loss included in other comprehensive income	312,736	151,315
Unrecognized prior service cost included in other comprehensive income	505,607	605,039
Net recognized pension cost	\$ (1,732,952)	\$ (1,249,934)
Information for pension plans with an accumulated benefit obligation in excess of plan assets		
Projected benefit obligation	\$ 2,551,295	\$ 2,006,288
Accumulated benefit obligation	2,221,495	1,684,094
Fair value of plan assets	-	-

#### Components of Net Periodic Benefit Cost

	2007	2006
Service cost	\$ 227,165	\$ 210,773
Interest cost	131,555	101,633
Expected return on plan assets	-	-
Amortization of prior service cost	99,432	111,585
Recognized net actuarial gain	24,867	-
Net periodic benefit cost	\$ 483,019	\$ 423,991

The net periodic benefit cost for the year ended December 31, 2008 is projected to be \$535,425.

No amounts were recognized in other comprehensive income during the year ended December 31, 2006.

Weighted-Average Assumptions, December 31	2007	2006
Discount Rate	6.00%	6.00%
Expected Return on Plan Assets	N/A	N/A

Salary Scale	4.00%	4.00%
--------------	-------	-------

F-28

---

## Projected Annual Benefit Payments

2008	\$	0
2009	\$	37,180
2010	\$	284,650
2011	\$	284,650
2012	\$	284,650
2013-2017	\$	1,771,228

## 17. Share Based Compensation

Share-based compensation is accounted for in accordance with SFAS No. 123 (revised 2004) (“SFAS No. 123R”), Share-Based Payment. The Company adopted SFAS No. 123R on January 1, 2006 using the modified prospective approach. The Company establishes fair value for its equity awards to determine its cost and recognized the related expense for stock options over the vesting period using the straight-line method. The grant date fair value for stock options is calculated using the Black-Scholes option valuation model. Prior to January 1, 2006, the Company accounted for stock-based compensation in accordance with SFAS No. 124, Accounting for Stock-Based Compensation, as adopted prospectively on January 1, 2003 and in accordance with Accounting Principles Board Opinion (“APB”) No. 25, Accounting for Stock Issued to Employees.

The Company’s Stock Plans authorize the issuance of shares of common stock pursuant to awards that may be granted in the form of stock options to purchase common stock (“options”) and awards of shares of common stock (“stock awards”). The purpose of the Company’s stock-based incentive plans is to attract and retain personnel for positions of substantial responsibility and to provide additional incentive to certain officers, directors, employees and other persons to promote the success of the Company. Under the Company’s Stock Plans, options expire ten years after the date of grant. Options are granted at the then fair market value of the Company’s stock. The grant date fair value is calculated using the Black-Scholes option valuation model.

Stock-based compensation expense related to stock options was \$107,020 and \$95,230 for the years ended December 31, 2007 and 2006, respectively.

Transactions under the Company’s stock option plans during the year ended December 31, 2007 are summarized as follows:

Stock Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2007	140,822	\$ 9.98		
Granted	16,960	14.02		
Exercised	(944)	3.11		
Forfeited	-	-		
Expired	-	-		
Outstanding at December 31, 2007	156,838	\$ 10.43	5.3	\$ 876,204
Exercisable at December 31, 2007	121,066	\$ 8.94	4.2	\$ 862,463

The Company granted a total of 16,960 stock options during the year ended December 31, 2007. The total intrinsic value (market value on date of exercise less grant price) of options exercised during the year ended December 31, 2007 was \$13,357.

Cash received from option exercises under the plans for the year ended December 31, 2007 was \$ 2,812. The impact of these cash receipts is included in financing activities in the accompanying consolidated statements of cash flows.

F-29

---

As of December 31, 2007, there was approximately \$246,390 of unrecognized compensation cost related to non-vested stock option-based compensation arrangements granted under the Company's stock incentive plans. That cost is expected to be recognized over the next four years.

Significant assumptions used to calculate the fair value of the options granted for the year ended December 31, 2007 are as follows:

		August 2007	December 2007
Fair value of options granted	\$	7.08	\$ 5.33
Risk-free rate of return		4.43 %	3.49%
Expected option life in years		7	7
Expected volatility		26.60 %	26.60%
Expected dividends (1)		-	-

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

The following table summarizes nonvested restricted shares outstanding as of December 31, 2007:

Nonvested Shares	Number of Shares	Average Grant-Date Fair Value
Nonvested at January 1, 2007	45,346	\$ 15.13
Granted	19,981	14.71
Vested	(17,334)	14.38
Forfeited	-	-
Nonvested at December 31, 2007	47,993	\$ 15.35

During the year ended December 31, 2007, 17,334 shares of common stock granted as stock awards vested. These vested shares were valued at an aggregate amount of \$204,020 at the time of grants. The value of these shares is based upon the closing price of the common stock on the date of grant. The shares vest over a four year service period with compensation expense recognized on a straight-line respectively. During the year ended December 31, 2007, stock grant awards were issued for a total of 19,981 shares valued at \$293,883 in the aggregate.

Stock based compensation expense related to stock grants was \$247,346 and \$499,808 for the year ended December 31, 2007 and 2006.

As of December 31, 2007, there was approximately \$593,876 of unrecognized compensation cost related to non-vested stock grants that will be recognized over the next four years.

## 18. Commitments and Contingencies

As of December 31, 2006, future minimum rental payments under non-cancelable operating leases are as follows:

2008	\$ 783,122
2009	685,397
2010	678,552
2011	502,151

2012	520,254
Thereafter	2,258,892
	\$ 5,428,368

Rent expense aggregated \$772,439, and \$876,983 for the years ended December 31, 2007 and 2006, respectively.

#### Commitments With Off-Balance Sheet Risk

The statement of condition does not reflect various commitments relating to financial instruments which are used in the normal course of business. Management does not anticipate that the settlement of those financial instruments will have a material adverse effect on the Company's financial position. These instruments include commitments to extend credit and letters of credit. These financial instruments carry various degrees of credit risk, which is defined as the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract. As these off-balance sheet financial instruments have essentially the same credit risk involved in extending loans, the Bank generally uses the same credit and collateral policies in making these commitments and conditional obligations as it does for on-balance sheet investments. Additionally, as some commitments and conditional obligations are expected to expire without being drawn or returned, the contractual amounts do not necessarily represent future cash requirements.

Commitments to extend credit are legally binding loan commitments with set expiration dates. They are intended to be disbursed, subject to certain conditions, upon request of the borrower. The Bank receives a fee for providing a commitment. The Bank was committed to advance \$114,175,000 and \$104,050,000 to its borrowers as of December 31, 2007 and December 31, 2006, respectively.

The Bank issues financial standby letters of credit that are within the scope of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". These are irrevocable undertakings by the Bank to guarantee payment of a specified financial obligation. Most of the Bank's financial standby letters of credit arise in connection with lending relationships and have terms of one year or less. The maximum potential future payments the Bank could be required to make under these standby letters of credit amounted to \$5,546,723 at December 31, 2007 and \$5,999,658 at December 31, 2006.

The Bank also enters into forward contracts to sell residential mortgage loans it has closed (loans held for sale) or that it expects to close (commitments to originate loans held for sale). These contracts are used to reduce the Bank's market price risk during the period from the commitment date to the sale date. The notional amount of the Bank's forward sales contracts was approximately \$10.3 million at December 31, 2007 and \$13.6 million at December 31, 2006. Changes in fair value of the forward sales contracts, and the related loan origination commitments and closed loans, were not significant at December 31, 2007 and 2006.

### Litigation

The Company may, in the ordinary course of business, become a party to litigation involving collection matters, contract claims and other legal proceedings relating to the conduct of its business. The Company may also have various commitments and contingent liabilities which are not reflected in the accompanying consolidated statement of condition. Management is not aware of any present legal proceedings or contingent liabilities and commitments that would have a material impact on the Company's financial position or results of operations.

### 19. Other Operating Expenses

The components of other operating expenses for the years ended December 31, 2007 and 2006 are as follows:

	2007	2006 (Restated)
Equipment expense	\$ 485,792	\$ 507,402
Marketing	106,862	258,012
Regulatory, professional and other fees	435,464	824,370
Office expense	572,293	470,211
All other expenses	816,448	1,031,621
	\$ 2,416,859	\$ 3,091,616

### 20. Regulatory Requirements

The Bank is subject to various regulatory capital requirements administered by the Federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's and the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.



Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). As of December 31, 2007, the Bank met all capital adequacy requirements to which it is subject.

To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. As of December 31, 2007, the most recent notification from the Bank's primary regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category. Certain bank regulatory limitations exist on the availability of Bank assets available for the payment of dividends without prior approval of bank regulatory authorities.

F-31

---

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Actual capital amounts and ratios for the Company and the Bank as of December 31, 2007 and 2006 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2007 -						
Company						
Total Capital (to Risk Weighted Assets)	\$ 62,006,573	17.75%	\$ 27,949,600	>8%	\$ 34,937,000	>10%
Tier I Capital (to Risk Weighted Assets)	54,437,463	15.58%	13,974,800	>4%	20,962,200	>6%
Tier I Capital (to Average Assets)	54,437,463	12.66%	17,196,222	>4%	21,495,277	>5%
Bank						
Total Capital (to Risk Weighted Assets)	\$ 59,961,320	17.16%	\$ 27,949,600	>8%	\$ 34,937,000	>10%
Tier I Capital (to Risk Weighted Assets)	56,613,240	16.20%	13,974,800	>4%	20,962,200	>6%
Tier I Capital (to Average Assets)	56,613,240	13.20%	17,152,520	>4%	21,440,650	>5%
As of December 31, 2006 – restated						
Company						
Total Capital (to Risk Weighted Assets)	\$ 61,652,577	19.93%	\$ 24,751,678	>8%	\$ 30,939,598	N/A
Tier I Capital (to Risk Weighted Assets)	47,220,481	15.26%	12,375,839	>4%	18,563,759	N/A
Tier I Capital (to Average Assets)	47,220,481	11.99%	15,752,046	>4%	19,690,058	N/A
Bank						
Total Capital (to Risk Weighted Assets)	\$ 53,520,979	17.30%	\$ 24,751,040	>8%	\$ 30,938,800	>10%
Tier I Capital (to Risk Weighted Assets)	50,292,619	16.26%	12,375,520	>4%	18,563,280	>6%
Tier I Capital (to Average Assets)	50,292,619	12.80%	15,710,320	>4%	19,637,900	>5%

The primary source of dividends paid to the Company's shareholders is dividends paid to the Company by the Bank. Dividend payments by the Bank to the Company are subject to the New Jersey Banking Act of 1948 (the "Banking Act") and the Federal Deposit Insurance Act (the "FDIA"). Under the Banking Act and the FDIA, the Bank may not pay any dividends if after paying the dividend, it would be undercapitalized under applicable capital requirements. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

## 21. Stock Repurchase Program

In July, 2005, the Board of Directors of the Company authorized a stock repurchase program under which the Company may repurchase in open market or privately negotiated transactions up to 5%, or 185,787 shares, adjusted for stock dividends, of its common shares. The Company established this repurchase program in order to increase shareholder value. During the year ended December 31, 2007, the Company repurchased 13,548 shares for an aggregate price of approximately \$246,900.

## 22. Estimated Fair Value of Financial Instruments

The following is a summary of fair value versus the carrying value of the Bank's financial instruments. For the Bank, as for most financial institutions, the bulk of its assets and liabilities are considered financial instruments. Many of the

Bank's financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimations and present value calculations were used by the Bank for the purpose of this note. Changes in assumptions could significantly affect these estimates.

Estimated fair values have been determined by the Bank using the best available data and an estimation methodology suitable for each category of financial instruments. Financial instruments, such as securities available for sale and securities held to maturity, actively traded in the secondary market have been valued using available market prices. Carrying values of cash and cash equivalents and securities sold under agreements to repurchase approximate fair value due to the short-term nature of these instruments. Other borrowings are valued on a discounted cash flow method utilizing current discount rates for instruments of similar remaining terms.

Financial instruments with stated maturities have been valued using a present value discounted cash flow with a discount rate approximating current market for similar assets and liabilities. For those loans and deposits with floating interest rates, it is assumed that estimated fair values generally approximate the recorded book balances.

F-32

---

The estimated fair values, and the recorded book balances, were as follows:

	Carrying Value	December 31, 2007 Estimated Fair Value	Carrying Value	December 31, 2006 Estimated Fair Value
Securities available for sale	\$ 75,192,137	\$ 75,192,137	\$ 70,421,328	\$ 70,421,328
Securities held to maturity	23,512,346	23,411,269	19,254,476	19,164,679
Loans held for sale	10,322,005	10,321,000	13,608,942	13,608,942
Gross loans	294,760,718	294,845,000	265,142,313	264,695,000
Deposits	329,332,368	329,561,000	312,724,422	312,154,000
Other borrowings	35,600,000	36,630,000	17,200,000	17,224,000
Redeemable subordinated debentures	18,557,000	18,557,013	23,712,000	23,712,022
Interest rate swap contract	(99,754)	(99,754)	-	-

Loan commitments and standby letters of credit as of December 31, 2007 and 2006 are based on fees charged for similar agreements; accordingly, the estimated fair value of loan commitments and standby letters of credit is nominal.

### 23. Condensed Financial Statements of 1st Constitution Bancorp (Parent Company Only)

The following financial statements of the Company should be read in conjunction with the notes to the consolidated financial statements and reflect the restatement discussed in Note 2 "Restatement of Consolidated Financial Statements For the Year Ended and As At December 31, 2006".

#### CONDENSED STATEMENTS OF CONDITION

	December 31, 2007	December 31, 2006 (Restated)
<b>Assets:</b>		
Cash	\$ 938,826	\$ 7,449,167
Investment securities available for sale	557,000	712,000
Investment in subsidiaries	56,927,524	49,814,996
Other assets	1,106,427	682,342
<b>Total Assets</b>	<b>\$ 59,529,777</b>	<b>\$ 58,658,505</b>
<b>Liabilities And Shareholders' Equity</b>		
Subordinated debentures	18,557,000	23,712,000
Shareholders' equity	40,972,777	34,946,505
<b>Total Liabilities and Shareholder's Equity</b>	<b>\$ 59,529,777</b>	<b>\$ 58,658,505</b>

#### CONDENSED STATEMENTS OF INCOME

	Year ended December 31, 2007	2006 (Restated)
<b>Income:</b>		
Interest	\$ 76,123	\$ 79,744
<b>Total Income</b>	<b>76,123</b>	<b>79,744</b>
<b>Expense:</b>		
Interest	1,483,399	1,177,020
Other	11,481	32,004

Total Expense	1,494,880	1,209,024
Loss before income taxes and equity in undistributed income of		
Subsidiaries	(1,418,757)	(1,129,280)
Federal income tax benefit	(432,258)	(382,988)
Loss before equity in undistributed income of subsidiaries	(986,499)	(746,292)
Equity in undistributed income of subsidiaries	6,429,281	5,471,254
Net Income	\$ 5,442,782	\$ 4,724,962

F-33

## CONDENSED STATEMENTS OF CASH FLOWS

	Year ended December 31,	
	2007	2006
Operating Activities:		(Restated)
Net Income	\$ 5,442,782	\$ 4,724,962
Adjustments:		
Decrease (increase) in investment securities available for sale	155,000	(557,000)
(Increase) decrease in other assets	(587,772)	(467,044)
Equity in undistributed income of subsidiaries	(6,429,281)	(5,471,254)
Net cash (used in) provided by Operating Activities	(1,419,271)	(1,770,336)
Investing Activities:		
Investment in subsidiaries	-	(10,000,000)
Repayment of investments in subsidiaries	-	447,898
Net cash (used in) provided by Investing Activities	-	(9,552,102)
Financing Activities:		
Issuance of common stock, net	310,833	595,825
Purchase of treasury stock	(246,903)	(412,547)
Proceeds from issuance of subordinated debentures	(5,155,000)	18,557,000
Net cash (used in) provided by financing activities	(5,091,070)	18,740,278
Net (decrease) increase in cash	(6,510,341)	7,417,839
Cash as of beginning of year	7,449,167	31,328
Cash as of end of year	\$ 938,826	\$ 7,449,167

## 24. Unaudited Quarterly Financial Data and Restatement of Interim Financial Statements

The Previously Issued Financial Statements covering the quarters ended on March 31, June 30 and September 30, 2007 and 2006, and the quarter ended December 31, 2006, contain the following errors, which are described in more detail below:

- Errors made in accounting for (i) current tax liabilities principally related to the Company's trust preferred securities and (ii) deferred tax assets, in both cases in 2007 and 2006 and prior periods, resulting in an underestimate of current tax liabilities and an overestimate of deferred tax assets;
- Overestimation of liabilities related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan in connection with the implementation of FAS 158 in 2006 resulting in an increase in expenses, and an underestimation of liabilities related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan, resulting in a reduction of expenses in the first three quarters of 2007; and
- Failure to adequately evaluate estimation of certain non-interest operating expenses for, among other things, professional fees, advertising and business development, resulting in an over-accrual of certain non-interest operating expenses in 2006 and a resultant decrease in tax expense for 2006.

The following sets forth the effect of the restatement adjustments on the applicable line items with the Company's Consolidated Statement of Income for the periods indicated:

	2007			
	Dec. 31	Sept. 30 (Restated)	June 30 (Restated)	March 31 (Restated)
Summary of Operations				
Interest income	\$ 7,708,264	\$ 7,825,738	\$ 7,445,478	\$ 7,389,164
Interest expense	3,220,991	3,307,196	3,130,961	2,931,491
Net interest income	4,487,273	4,518,542	4,314,517	4,457,673
Provision for loan losses	30,000	30,000	30,000	40,000
Net interest income after provision				
For loan losses	4,457,273	4,488,542	4,284,517	4,417,673
Non-interest income	620,459	645,706	648,423	643,741
Non-interest expense	3,140,326	3,011,371	2,875,337	3,074,224
Income before income taxes	1,937,406	2,122,877	2,057,603	1,987,190
Income taxes	674,337	687,147	639,504	661,296
Net income	\$ 1,263,069	\$ 1,435,730	\$ 1,418,099	\$ 1,325,894
Net income per share :				
Basic	\$ 0.32	\$ 0.36	\$ 0.36	\$ 0.33
Diluted	\$ 0.31	\$ 0.36	\$ 0.35	\$ 0.33

	2006			
	Dec. 31 (Restated)	Sept. 30 (Restated)	June 30 (Restated)	March 31 (Restated)
Summary of Operations				
Interest income	\$ 7,199,650	\$ 7,163,273	\$ 6,789,622	\$ 6,152,637
Interest expense	2,764,720	2,653,753	2,180,513	1,918,511
Net interest income	4,434,930	4,509,520	4,609,109	4,234,126
Provision for loan losses	453,500	100,000	170,000	170,000
Net interest income after provision				
For loan losses	3,981,430	4,409,520	4,439,109	4,064,126
Non-interest income	629,029	757,685	474,709	710,025
Non-interest expense	2,677,157	3,124,975	3,089,606	3,123,109
Income before income taxes	1,933,302	2,042,230	1,824,212	1,651,042
Income taxes	733,166	802,662	606,496	583,499
Net income	\$ 1,200,136	\$ 1,239,568	\$ 1,217,716	\$ 1,067,543
Net income per share :				
Basic	\$ 0.30	\$ 0.32	\$ 0.31	\$ 0.28
Diluted	\$ 0.29	\$ 0.31	\$ 0.30	\$ 0.28

The following tables present unaudited financial information for each quarter within the two most recent years. Included herein is the restated financial information for interim periods of 2007 and 2006. As a result, the quarterly data presented herein does not agree to previously issued quarterly statements covering periods beginning on or after January 1, 2006.

The Company believes that all necessary adjustments have been included in the amounts stated below to present fairly the following quarterly results when read in conjunction with the financial statements included elsewhere in this

report. Results of operations for any particular quarter are not necessary indicative of results of operations for a full fiscal year.

F-35

---



The following table presents the effects of adjustments made to the Company's previously reported consolidated statements of income for interim periods in 2006:

1st Constitution Bancorp Consolidated Statements Of Income (unaudited)						
	Three Months Ended March 31, 2006 (as filed)		Three Months Ended June 30, 2006 (as filed)		Three Months Ended Sept. 30, 2006 (as filed)	
	2006 (restated)	2006 (restated)	2006 (restated)	2006 (restated)	2006 (restated)	2006 (restated)
INTEREST INCOME:						
Interest and fees on loans	\$ 5,176,816	\$ 5,176,816	\$ 5,822,356	\$ 5,822,356	\$ 6,082,710	\$ 6,082,710
Interest on securities:						
Taxable	806,366	806,366	795,540	795,540	916,025	916,025
Tax Exempt	160,791	160,791	147,052	147,052	146,864	146,864
Interest on Federal funds sold and short-term investments	8,664	8,664	24,674	24,674	17,674	17,674
Total interest income	6,152,637	6,152,637	6,789,622	6,789,622	7,163,273	7,163,273
INTEREST EXPENSE:						
Interest on deposits	1,350,330	1,350,330	1,524,009	1,524,009	1,804,271	1,804,271
Interest on securities sold under agreements to repurchase and other borrowed funds	466,337	466,337	490,796	490,796	414,918	414,918
Interest on redeemable subordinated debentures	101,844	101,844	165,708	165,708	434,564	434,564
Total interest expense	1,918,511	1,918,511	2,180,513	2,180,513	2,653,753	2,653,753
Net interest income	4,234,126	4,234,126	4,609,109	4,609,109	4,509,520	4,509,520
PROVISION FOR LOAN LOSSES	170,000	170,000	170,000	170,000	100,000	100,000
Net interest income after provision for loan losses	4,064,126	4,064,126	4,439,109	4,439,109	4,409,520	4,409,520
NON-INTEREST INCOME:						
Service charges on deposit accounts	186,559	186,559	167,042	167,042	152,737	152,737
Gain on sale of loans held for sale	318,689	318,689	174,930	174,930	337,614	337,614
(Loss)gain on sale of securities available for sale	0	0	(99,714)	(99,714)	0	0
Income on Bank-owned life insurance (1)	80,600	61,039	82,934	82,934	108,138	108,138
Other income	143,738	143,738	149,517	149,517	159,196	159,196
Total other income	729,586	710,025	474,709	474,709	757,685	757,685
NON-INTEREST EXPENSES:						
Salaries and employee benefits (2)	1,685,022	1,709,213	1,712,959	1,685,372	1,697,756	1,697,756
Occupancy expense (3)	318,984	322,359	378,143	381,518	410,304	410,304
Other operating expenses (4)	1,086,022	1,091,537	1,017,201	1,022,716	1,035,612	1,035,612

Total other expenses	3,090,028	3,123,109	3,108,303	3,089,606	3,143,672	3,143,672
Income before income taxes	1,703,684	1,651,042	1,805,515	1,824,212	2,023,533	2,023,533
INCOME TAXES (5)	448,926	583,499	448,251	606,496	644,417	844,417
Net Income	\$ 1,254,758	\$ 1,067,543	\$ 1,357,264	\$ 1,217,716	\$ 1,379,116	\$ 1,179,116
NET INCOME PER SHARE						
Basic	\$ 0.32	\$ 0.28	\$ 0.35	\$ 0.31	\$ 0.36	\$ 0.36
Diluted	\$ 0.31	\$ 0.28	\$ 0.34	\$ 0.30	\$ 0.34	\$ 0.34

The adjusted balances are primarily the result of the Company restatement of (1) Income on Bank-owned Life Insurance was reduced by \$19, 561 in the quarter ended March 31, 2006 to reconcile the cash surrender value of the policies with the balances subsequently provided by the benefit plan administrator; (2) Salaries and employee benefits was increased by a net amount of \$24,191 for the quarter ended March 31, 2006 which resulted from an expense increase of \$51,778 to accrue additional 2006 charges for employee health insurance premiums which was partially offset by an expense credit of \$27,587 to correct an over-accrual of the costs related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan. This credit was applied to the quarters June 30 and September 30, 2006; (3) Occupancy expense was increased to \$3,375 in the quarters ended March 31, June 30, September 30 and December 31 to record additional rent expense under the straight-line method in accordance with Statement of Financial Accounting Standards Number 13, "Accounting for Leases;" (4) Other Operating expenses was increased by a net amount of \$5,515 for the quarter ended March 31, June 30, September 31 and December 31 which resulted from adjustments of \$168,000 to increase 2006 expense for the impact of over-accrued expenses from prior periods that were reversed into income during 2006 which was partially offset by the reversal of \$145,939 in current year over-accruals of operating expenses; (5) Income tax expense was restated by a net increase of \$134,573, for the quarter ended March 31, which consisted of \$175,550 in additional expense to restate the current and deferred tax liabilities related to the Company's trust preferred securities partially offset by a reduction of \$40,472 for the tax benefits attributable to the increased expense level resulting from the restatement adjustments.

The following table presents the effects of adjustments made to the Company's previously reported interim balance sheets for 2006:

1st CONSTITUTION BANCORP  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

ASSETS	March 31, 2006 (as filed)	March 31, 2006 (restated)	June 30, 2006 (as filed)	June 30, 2006 (restated)	Sept. 30, 2006 (as filed)	Sept. 30, 2006 (restated)
<b>CASH AND DUE FROM BANKS</b>	\$ 10,743,710	\$ 10,743,710	\$ 7,997,038	\$ 7,997,038	\$ 10,572,978	\$ 10,572,978
<b>FEDERAL FUNDS SOLD/SHORT TERM INVESTMENTS</b>	12,539	12,539	1,020,804	1,020,804	18,477	18,477
Total cash and cash equivalents	10,756,249	10,756,249	9,017,842	9,017,842	10,591,455	10,591,455
<b>SECURITIES</b>						
Available for sale, at fair value	64,184,157	64,184,157	64,660,336	64,660,336	71,726,638	71,726,638
Held to maturity	17,496,090	17,496,090	17,436,619	17,436,619	17,377,868	17,377,868
<b>Total Securities</b>	<b>81,680,247</b>	<b>81,680,247</b>	<b>82,096,955</b>	<b>82,096,955</b>	<b>89,104,506</b>	<b>89,104,506</b>
<b>LOANS HELD FOR SALE</b>	10,973,442	10,973,442	12,950,636	12,950,636	13,133,085	13,133,085
<b>LOANS</b>	252,810,235	252,810,235	264,520,397	264,520,397	265,347,774	265,347,774
Less- Allowance for loan losses	(2,533,891)	(2,533,891)	(2,692,737)	(2,692,737)	(2,792,889)	(2,792,889)
<b>Net loans</b>	<b>250,276,344</b>	<b>250,276,344</b>	<b>261,827,660</b>	<b>261,827,660</b>	<b>262,554,885</b>	<b>262,554,885</b>
<b>PREMISES AND EQUIPMENT, net</b>	2,732,548	2,732,548	2,687,439	2,687,439	2,892,925	2,892,925
<b>ACCRUED INTEREST</b>	1,940,971	1,940,971	1,992,167	1,992,167	2,290,812	2,290,812

## RECEIVABLE

BANK-OWNED  
LIFE

INSURANCE	8,909,532	8,914,875	8,992,466	8,997,809	9,100,604	9,105,947
-----------	-----------	-----------	-----------	-----------	-----------	-----------

## OTHER

ASSETS (1)	1,798,597	1,865,124	2,060,566	2,188,014	1,481,338	1,669,707
------------	-----------	-----------	-----------	-----------	-----------	-----------

Total Assets	\$ 369,067,930	\$ 369,139,800	\$ 381,625,731	\$ 381,758,522	\$ 391,149,610	\$ 391,343,322
--------------	----------------	----------------	----------------	----------------	----------------	----------------

LIABILITIES  
AND  
SHAREHOLDERS'  
EQUITY

## LIABILITIES:

## Deposits

bearing	Non-interest	\$ 56,762,450	\$ 56,762,450	\$ 64,384,645	\$ 64,384,645	\$ 63,463,233	\$ 63,463,233
---------	--------------	---------------	---------------	---------------	---------------	---------------	---------------

bearing	Interest	227,680,077	227,680,077	229,540,724	229,540,724	238,668,737	238,668,737
---------	----------	-------------	-------------	-------------	-------------	-------------	-------------

Total Deposits	284,442,527	284,442,527	293,925,369	293,925,369	302,131,970	302,131,970
----------------	-------------	-------------	-------------	-------------	-------------	-------------

## OTHER

BORROWINGS	44,200,000	44,200,000	28,400,000	28,400,000	27,300,000	27,300,000
------------	------------	------------	------------	------------	------------	------------

REDEEMABLE  
SUBORDINATED

DEBENTURES	5,155,000	5,155,000	23,712,000	23,712,000	23,712,000	23,712,000
------------	-----------	-----------	------------	------------	------------	------------

ACCRUED  
INTEREST

PAYABLE	1,321,327	1,321,327	1,628,711	1,628,711	1,786,003	1,786,003
---------	-----------	-----------	-----------	-----------	-----------	-----------

ACCRUED  
EXPENSES AND  
OTHER

LIABILITIES (2)	3,122,662	2,929,452	2,251,791	2,227,592	2,052,025	2,196,837
-----------------	-----------	-----------	-----------	-----------	-----------	-----------

Total Liabilities	338,241,516	338,048,306	349,917,871	349,893,672	356,981,998	357,126,810
-------------------	-------------	-------------	-------------	-------------	-------------	-------------

COMMITMENTS  
AND  
CONTINGENCIESSHAREHOLDERS'  
EQUITY

## Common

Stock	25,503,370	25,503,370	25,526,412	25,526,412	24,847,392	24,847,392
-------	------------	------------	------------	------------	------------	------------

Retained earnings	7,236,561	7,495,383	8,593,824	8,738,298	9,972,943	10,003,069
-------------------	-----------	-----------	-----------	-----------	-----------	------------

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Treasury Stock, at cost	(885,834)	(885,834)	(890,522)	(890,522)	(6,698)	(6,698)
Accumulated other comprehensive (loss)	(1,027,683)	(1,021,425)	(1,521,854)	(1,509,338)	(646,025)	(627,251)
Total shareholders' equity	30,826,414	31,091,494	31,707,860	31,864,850	34,167,612	34,216,512
Total liabilities and shareholders' equity	\$ 369,067,930	\$ 369,139,800	\$ 381,625,731	\$ 381,758,522	\$ 391,149,610	\$ 391,343,322

The quarterly consolidated balance sheets for 2006 presented above reflect balances in the lines (1) Other Assets, (2) Accrued Expenses and Other Liabilities; (3) Retained Earnings and (4) Accumulated Other Comprehensive (Loss). These restated balances represent the impact of the 2006 restatement adjustments as discussed above.

The following table presents the effects of adjustments made to the Company's previously reported consolidated statements of income for interim periods in 2007:

1st Constitution Bancorp Consolidated Statements Of Income (unaudited)						
	Three Months Ended March 31, 2007 (as filed)		Three Months Ended June 30, 2007 (restated)		Three Months Ended Sept. 30, 2007 (as filed)	
INTEREST INCOME:						
Interest and fees on loans	\$ 6,167,725	\$ 6,167,725	\$ 6,092,841	\$ 6,092,841	\$ 6,493,304	\$ 6,493,304
Interest on securities:						
Taxable	992,327	992,327	1,083,967	1,083,967	1,098,844	1,098,844
Tax Exempt	206,568	206,568	225,791	225,791	225,503	225,503
Interest on Federal funds sold and short-term investments	22,544	22,544	42,879	42,879	8,087	8,087
Total interest income	7,389,164	7,389,164	7,445,478	7,445,478	7,825,738	7,825,738
INTEREST EXPENSE:						
Interest on deposits	2,216,085	2,216,085	2,435,381	2,435,381	2,486,055	2,486,055
Interest on securities sold under agreements to repurchase						
And other borrowed funds	286,339	286,339	346,073	346,073	498,681	498,681
Interest on redeemable subordinated debentures	429,067	429,067	349,507	349,507	322,460	322,460
Total interest expense	2,931,491	2,931,491	3,130,961	3,130,961	3,307,196	3,307,196
Net interest income	4,457,673	4,457,673	4,314,517	4,314,517	4,518,542	4,518,542
PROVISION FOR LOAN LOSSES						
Net interest income after provision	40,000	40,000	30,000	30,000	30,000	30,000
For loan losses	4,417,673	4,417,673	4,284,517	4,284,517	4,488,542	4,488,542
NON-INTEREST INCOME:						
Service charges on deposit accounts	149,855	149,855	175,181	175,181	168,578	168,578
Gain on sale of loans held for sale	231,777	231,777	188,741	188,741	183,750	183,750
Income on Bank-owned life insurance	90,348	90,348	88,233	88,233	95,446	95,446
Other income	171,761	171,761	196,268	196,268	197,932	197,932
Total other income	643,741	643,741	648,423	648,423	645,706	645,706
NON-INTEREST EXPENSES:						
Salaries and employee benefits (1)	1,812,799	1,863,252	1,637,213	1,687,666	1,760,120	1,810,120
Occupancy expense (2)	525,195	527,753	535,655	538,213	429,330	431,113

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Other operating expenses	683,219	683,219	649,458	649,458	768,910	768,910
Total other expenses	3,021,213	3,074,224	2,822,326	2,875,337	2,958,360	3,011,377
Income before income taxes	2,040,201	1,987,190	2,110,614	2,057,603	2,175,888	2,122,811
INCOME TAXES (3)	634,701	661,296	612,909	639,504	660,552	687,368
Net Income	\$ 1,405,500	\$ 1,325,894	\$ 1,497,705	\$ 1,418,099	\$ 1,515,336	\$ 1,435,443
NET INCOME PER SHARE						
Basic	\$ 0.36	\$ 0.33	\$ 0.38	\$ 0.36	\$ 0.38	\$ 0.38
Diluted	\$ 0.35	\$ 0.33	\$ 0.37	\$ 0.35	\$ 0.38	\$ 0.38

The adjusted balances are primarily the result of the Company restatement of (1) salaries and employee benefits expense of \$50,453 in the quarters ended March 31, June 30 and September 30 to correct the liability related to future benefits to plan participants in the Company's Supplemental Executive Retirement Plan; (2) Occupancy expense of \$2,558 in the quarter ended March 31, June 30 and September 30, 2007 to record additional rent expense under the straight-line method in accordance with Statement of Financial Accounting Standards number 13, "Accounting for Leases" and (3) Income Tax expense was restated by a net amount of \$26,595 in the quarters ended March 31, June 30 and September 30 which consisted of \$47,799 additional expense to correct the current and deferred tax liabilities related to the Company's trust preferred securities partially offset by a reduction of \$21,204 for the tax benefits attributable to the increased expense level resulting from the restatement adjustment.

The following table presents the effects of adjustments made to the Company's previously reported interim balance sheets for 2007:

1st CONSTITUTION BANCORP  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

ASSETS	March 31, 2007 (as filed)	March 31, 2007 (restated)	June 30, 2007 (as filed)	June 30, 2007 (restated)	Sept. 30, 2007 (as filed)	Sept. 30, 2007 (restated)
<b>CASH AND DUE FROM BANKS</b>	\$ 9,212,906	\$ 9,212,906	\$ 9,559,584	\$ 9,559,584	\$ 8,743,801	\$ 8,743,801
<b>FEDERAL FUNDS SOLD/SHORT TERM INVESTMENTS</b>	10,928,022	10,928,022	20,901	20,901	818,988	818,988
Total cash and cash equivalents	20,140,928	20,140,928	9,580,485	9,580,485	9,562,789	9,562,789
<b>SECURITIES</b>						
Available for sale, at fair value	79,765,545	79,765,545	82,047,134	82,047,134	79,815,933	79,815,933
Held to maturity	26,577,983	26,577,983	26,528,257	26,528,257	26,111,786	26,111,786
<b>Total Securities</b>	106,343,528	106,343,528	108,575,391	108,575,391	105,927,719	105,927,719
<b>LOANS HELD FOR SALE</b>	10,664,170	10,664,170	8,937,522	8,937,522	12,701,546	12,701,546
<b>LOANS</b>	270,021,017	270,021,017	285,576,595	285,576,595	287,132,871	287,132,871
Less- Allowance for loan losses	(3,348,063)	(3,348,063)	(3,310,080)	(3,310,080)	(3,318,080)	(3,318,080)
<b>Net loans</b>	266,672,954	266,672,954	282,266,515	282,266,515	283,814,791	283,814,791
<b>PREMISES AND EQUIPMENT, net</b>	3,039,206	3,039,206	2,916,754	2,916,754	2,912,316	2,912,316
<b>ACCRUED INTEREST</b>	2,396,829	2,396,829	2,582,561	2,582,561	2,649,942	2,649,942



## RECEIVABLE

BANK-OWNED  
LIFE

INSURANCE	9,269,756	9,269,756	9,357,989	9,357,989	9,453,435	9,453,435
-----------	-----------	-----------	-----------	-----------	-----------	-----------

## OTHER ASSETS

(1)	2,992,749	3,333,272	3,982,204	4,152,932	3,119,576	3,120,509
-----	-----------	-----------	-----------	-----------	-----------	-----------

Total Assets	\$ 421,520,120	\$ 421,860,643	\$ 428,199,422	\$ 428,370,150	\$ 430,142,114	\$ 430,143,047
--------------	----------------	----------------	----------------	----------------	----------------	----------------

LIABILITIES  
AND  
SHAREHOLDERS'  
EQUITY

## LIABILITIES:

## Deposits

	Non-interest					
bearing	\$ 60,435,356	\$ 60,435,356	\$ 59,254,332	\$ 59,254,332	\$ 57,674,845	\$ 57,674,845
	Interest					
bearing	280,346,289	280,346,289	266,696,151	266,696,151	275,270,212	275,270,212

Total Deposits	340,781,645	340,781,645	325,950,483	325,950,483	332,945,057	332,945,057
----------------	-------------	-------------	-------------	-------------	-------------	-------------

## OTHER

BORROWINGS	15,500,000	15,500,000	43,000,000	43,000,000	33,300,000	33,300,000
------------	------------	------------	------------	------------	------------	------------

REDEEMABLE  
SUBORDINATED

DEBENTURES	23,712,000	23,712,000	18,557,000	18,557,000	18,557,000	18,557,000
------------	------------	------------	------------	------------	------------	------------

## ACCRUED

INTEREST						
----------	--	--	--	--	--	--

PAYABLE	2,005,887	2,005,887	1,869,468	1,869,468	2,135,717	2,135,717
---------	-----------	-----------	-----------	-----------	-----------	-----------

## ACCRUED

## EXPENSES AND

## OTHER

LIABILITIES (2)	2,687,296	3,188,867	1,430,128	1,930,587	3,483,730	3,983,077
-----------------	-----------	-----------	-----------	-----------	-----------	-----------

Total Liabilities	384,686,828	385,188,399	390,807,079	391,307,538	390,421,504	390,920,851
-------------------	-------------	-------------	-------------	-------------	-------------	-------------

COMMITMENTS  
AND  
CONTINGENCIESSHAREHOLDERS'  
EQUITY

## Common

Stock	28,918,957	28,918,957	28,935,469	28,935,469	28,968,434	28,968,434
-------	------------	------------	------------	------------	------------	------------

## Retained

earnings (3)	8,696,416	8,336,105	10,194,120	9,754,203	11,709,456	11,189,933
--------------	-----------	-----------	------------	-----------	------------	------------

Treasury Stock, at cost	(3,545)	(3,545)	(186,969)	(186,969)	(12,108)	(12,108)
Accumulated other comprehensive (loss) (4)	(778,536)	(579,273)	(1,550,277)	(1,440,091)	(945,172)	(924,063)
Total shareholders' equity	36,833,292	36,672,244	37,392,343	37,062,612	39,720,610	39,222,196

Total liabilities and shareholders' equity	\$ 421,520,120	\$ 421,860,643	\$ 428,199,422	\$ 428,370,150	\$ 430,142,114	\$ 430,143,047
--	----------------	----------------	----------------	----------------	----------------	----------------

The quarterly consolidated balance sheets for 2007 presented above reflect restated balances in the lines (1) Other Assets, (2) Accrued Expenses and Other Liabilities, (3) Retained Earnings and (4) Accumulated Other Comprehensive (Loss). These restated balances represent the combined impact of 2006 and 2007 restatement adjustments as discussed above.

## 25. Derivative Financial Instruments

The use of derivative financial instruments creates exposure to credit risk. This credit risk relates to losses that would be recognized if the counterparts fail to perform their obligations under the contracts. As part of the Company's interest rate risk management process, the Company entered into an interest rate derivative contract. Interest rate derivative contracts are typically used to limit the variability of the Company's net interest income that could result due to shifts in interest rates. This derivative interest rate contract was an interest rate swap used to modify the repricing characteristics of a specific liability. At December 31, 2007 the Company's position in derivative contracts consisted entirely of this interest rate swap. The Company had no derivative contracts outstanding at December 31, 2006.

Maturity	Hedged Liability	Notional Amounts	Swap Fixed Interest Rates	Swap Variable Interest Rates
Pay fixed Swap 2007	Trust Preferred Securities	\$18,000,000	5.87%	3 month LIBOR plus 165 basis points

During 2006, the Company issues trust preferred securities to fund loan growth and generate liquidity. In conjunction with the trust preferred securities issuance, the Company entered into a \$18.0 million in pay fixed swap designated as fair value hedges that was used to convert floating rate quarterly interest payments indexed to three month LIBOR, based on common notional amounts and maturity dates. The pay fixed swap changed the repricing characteristics of the quarterly interest payments from floating rate to fixed rate. The result was a better match between the repricing characteristics of the quarterly interest payments with floating rate commercial loans the Company made in 2007. The fair value of the pay fixed swap outstanding at December 31, 2007 was (\$99,754) and was recorded in other assets in the consolidated statements of condition. The Company had no derivative contracts outstanding at December 31, 2006.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

1st CONSTITUTION BANCORP

Date: April 15, 2008

By: /s/ ROBERT F. MANGANO  
Robert F. Mangano  
President and Chief Executive Officer  
(Principal Executive Officer)

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

Signature	Capacity	Date
/s/ ROBERT F. MANGANO Robert F. Mangano	President, Chief Executive Officer and Director (Principal Executive Officer)	April 15, 2008
/s/ CHARLES S. CROW, III Charles S. Crow, III	Chairman of the Board	April 15, 2008
/s/ DAVID C. REED David C. Reed	Director	April 15, 2008
/s/ WILLIAM M. RUE William M. Rue	Director	April 15, 2008
/s/ FRANK E. WALSH, III Frank E. Walsh, III	Director	April 15, 2008
/s/ JOSEPH M. REARDON Joseph M. Reardon	Senior Vice President and Treasurer (Principal Accounting and Financial Officer)	April 15, 2008

1st CONSTITUTION BANCORP  
INDEX TO EXHIBITS

Exhibit No.	Description
3 (i)	Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3(i) to the Company's Form 10-K filed with the SEC on March 24, 2005).
3 (ii)(A)	Bylaws of the Company (conformed copy) (incorporated by reference to Exhibit 3(ii)(A) to the Company's Form 8-K filed with the SEC on October 22, 2007)
3 (ii)(B)	Amendment No. 2 to By-laws of the Company (incorporated by reference to Exhibit 3(ii)(B) to the Company's Form 8-K filed with the SEC on October 22, 2007)
4.1	Specimen Share of Common Stock (incorporated by reference to the Company's Form 10-KSB filed with the SEC on March 22, 2002)
4.2	Amended and Restated Declaration of Trust of 1st Constitution Capital Trust I dated as of April 10, 2002 among the Registrant, as sponsor, Wilmington Trust Company, as Delaware and institutional trustee, and the Administrators named therein (incorporated by reference to the Company's Form 10-QSB filed with the SEC on May 8, 2002)
4.3	Indenture dated as of April 10, 2002 between the Registrant, as issuer, and Wilmington Trust Company, as trustee, relating to the Floating Rate Junior Subordinated Debt Securities due 2032 (incorporated by reference to the Company's Form 10-QSB filed with the SEC on May 8, 2002)
4.4	Guarantee Agreement dated as of April 10, 2002 between the Registrant and the Wilmington Trust Company, as guarantee trustee (incorporated by reference to the Company's Form 10-QSB filed with the SEC on May 8, 2002)
4.5	Rights Agreement, dated as of March 18, 2004, between 1st Constitution Bancorp and Registrar and Transfer Company, as Rights Agent, including the form of Certificate of Amendment to the Company's Certificate of Incorporation as Exhibit A thereto, the form of Rights Certificates as Exhibit B thereto, and the Summary of Rights as Exhibit C thereto. Pursuant to the Rights Agreement, printed Rights Certificates will not be mailed until after the Distribution Date (as such term is defined in the Rights Agreement) (incorporated by reference to the Company's Form 8-A12G filed with the SEC on March 18, 2004)
10.1 #	1st Constitution Bancorp Supplemental Executive Retirement Plan, dated as of October 1, 2002 (Incorporated by reference to the Company's Form 10-QSB filed with the SEC on November 13, 2002)
10.2 #	Amended and Restated 1st Constitution Bancorp Directors' Insurance Plan, effective as of June 16, 2005 (incorporated by reference to Exhibit No. 10 to the Company's Form 8-K filed with the SEC on March 24, 2006)
10.3 #	1st Constitution Bancorp Form of Executive Life Insurance Agreement (Incorporated by reference to the Company's Form 10-QSB filed with the SEC on November 13, 2002)
10.4 #	

Amended and Restated 1990 Stock Option Plan for Key Employees, as amended (incorporated by reference to Exhibit No. 10.1 to the Company's Form 10-QSB filed with the SEC on August 9, 2002)

---

Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Exhibit No.	Description
10.5	# 1996 Employee Stock Option Plan, as amended (incorporated by reference to Exhibit No. 10.2 to the Company's Form 10-QSB filed with the SEC on August 9, 2002)
10.6	# 2000 Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit No. 6.3 to the Company's Form 10-SB filed with the SEC on June 15, 2001)
10.7	# Directors Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit No. 6.4 to the Company's Form 10-SB filed with the SEC on June 15, 2001)
10.8	# Employment Agreement between the Company and Robert F. Mangano dated April 22, 1999 (incorporated by reference to Exhibit No. 6.5 to the Company's Form 10-SB filed with the SEC on June 15, 2001)
10.9	# Amendment No. 1 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective January 1, 2004 (incorporated by reference to Exhibit 10.12 to the Company's Form 10-Q filed with the SEC on August 11, 2004)
10.10	# Change of Control Agreement, effective as of April 1, 2004, by and between the Company and Joseph M. Reardon (incorporated by reference to Exhibit 10.13 to the Company's Form 10-Q filed with the SEC on August 11, 2004)
10.11	# Form of Stock Option Agreement under the 1st Constitution Bancorp Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit 10.14 to the Company's Form 8-K filed with the SEC on December 22, 2004)
10.12	# Form of Restricted Stock Agreement under the 1st Constitution Bancorp Employee Stock Option and Restricted Stock Plan (incorporated by reference to Exhibit 10.15 to the Company's Form 8-K filed with the SEC on December 22, 2004)
10.13	# Employment Agreement between the Company and Robert F. Mangano dated February 22, 2005 (incorporated by reference to Exhibit No. 10.16 to the Company's Form 8-K filed with the SEC on February 24, 2005)
10.14	# The 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Appendix A of the Company's proxy statement filed on April 15, 2005)
10.15	# Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.18 to the Company's Form 10-Q filed with the SEC on August 8, 2005)
10.16	# Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.19 to the Company's Form 10-Q filed with the SEC on August 8, 2005)
10.17	# Form of Incentive Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.20 to the Company's Form 10-Q filed with the SEC on August 8, 2005)

10.18	#	1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on May 19, 2006)
-------	---	---

---



Edgar Filing: 1ST CONSTITUTION BANCORP - Form 10-K

Exhibit No.		Description
10.19	#	Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed with the SEC on May 19, 2006)
10.20	#	Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed with the SEC on May 19, 2006)
10.21		Amended and Restated Declaration of Trust of 1st Constitution Capital Trust II, dated as of June 15, 2006, among 1st Constitution Bancorp, as sponsor, the Delaware and institutional trustee named therein, and the administrators named therein (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on June 16, 2006)
10.22		Indenture, dated as of June 15, 2006, between 1st Constitution Bancorp, as issuer, and the trustee named therein, relating to the Floating Rate Junior Subordinated Debt Securities due 2036 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed with the SEC on June 16, 2006)
10.23		Guarantee Agreement, dated as of June 15, 2006, between 1st Constitution Bancorp and the guarantee trustee named therein (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed with the SEC on June 16, 2006)
10.24	*#	Amendment No. 2 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective as of December 31, 2004
10.25	#	1st Constitution Bancorp 2005 Supplemental Executive Retirement Plan, effective as of January 1, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on December 28, 2006)
10.26		Branch Purchase and Assumption Agreement, dated as of November 6, 2006, by and between 1st Constitution Bank and Sun National Bank (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on November 13, 2006)
14		Code of Business Conduct and Ethics (incorporated by reference to Exhibit 14 to the Company's Form 10-K filed with the SEC on March 25, 2004)
21	*	Subsidiaries of the Company
23.1	*	Consent of Independent Registered Public Accounting Firm – Grant Thornton LLP
31.1	*	Certification of the principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
31.2	*	Certification of the principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
32	*	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by the principal executive officer and the principal financial

officer of the Company

\* Filed herewith.

# Management contract or compensatory plan or arrangement.

---