

PATRIOT NATIONAL BANCORP INC
Form 10-Q
November 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from _____ to _____

Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	06-1559137
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)

900 Bedford Street, Stamford, Connecticut 06901

(Address of principal executive offices) (Zip Code)
(203) 324-7500

(Registrant's telephone number, including area code)

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

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

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

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

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a

court. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of November 9, 2018, there were 3,904,578 shares of the registrant's common stock outstanding.

1

Table of Contents

Table of Contents	
PART I- FINANCIAL INFORMATION	
Item 1: Consolidated Financial Statements	
Consolidated Balance Sheets (Unaudited)	3
Consolidated Statements of Income (Unaudited)	4
Consolidated Statements of Comprehensive (Loss) Income (Unaudited)	5
Consolidated Statements of Shareholder's Equity (Unaudited)	6
Consolidated Statements of Cash FLOws (Unaudited)	7
Note to Consolidated Financial Statements (Unaudited)	8
Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations	43
Item 3: Quantitative and Qualitative Disclosures about Market Risk	57
Item 4: Disclosure Controls and Procedures	59
PART II - OTHER INFORMATION	60
Item 1: Legal Proceedings	60
Item 5: Other Information	60
Item 6: Exhibits	61
SIGNATURES	63

PART I- FINANCIAL INFORMATION**Item 1: Consolidated Financial Statements****PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS (Unaudited)**

<i>(In thousands, except share data)</i>	September 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks:		
Noninterest bearing deposits and cash	\$ 5,596	3,582
Interest bearing deposits	43,636	45,659
Total cash and cash equivalents	49,232	49,241
Investment securities:		
Available-for-sale securities, at fair value	40,264	25,576
Other investments, at cost	4,450	4,450
Total investment securities	44,714	30,026
Federal Reserve Bank stock, at cost	2,833	2,502
Federal Home Loan Bank stock, at cost	4,928	5,889
Loans receivable (net of allowance for loan losses: 2018: \$6,605, 2017: \$6,297)	756,649	713,350
Accrued interest and dividends receivable	3,612	3,496
Premises and equipment, net	35,487	35,358
Other real estate owned	991	-
Deferred tax asset	10,907	10,397
Goodwill	1,944	-
Core deposit intangible, net	717	-
Other assets	3,272	1,821
Total assets	\$ 915,286	852,080
Liabilities		
Deposits:		
Noninterest bearing deposits	\$ 81,687	81,197
Interest bearing deposits	637,845	556,242
Total deposits	719,532	637,439
Federal Home Loan Bank and correspondent bank borrowings	90,000	120,000
Senior notes, net	11,759	11,703
Subordinated debt, net	9,720	-
Junior subordinated debt owed to unconsolidated trust	8,092	8,086
Note payable	1,436	1,580

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Advances from borrowers for taxes and insurance	1,659	2,829
Accrued expenses and other liabilities	4,167	3,694
Total liabilities	846,365	785,331

Commitments and Contingencies

Shareholders' equity

Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, \$.01 par value, 100,000,000 shares authorized; 2018: 3,980,707 shares issued; 3,906,966 shares outstanding. 2017: 3,973,416 shares issued; 3,899,675 shares outstanding	40	40
Additional paid-in capital	107,038	106,875
Accumulated deficit	(36,078)	(38,832)
Less: Treasury stock, at cost: 2018 and 2017, 73,741 and 73,741 shares, respectively	(1,179)	(1,179)
Accumulated other comprehensive loss	(900)	(155)
Total shareholders' equity	68,921	66,749
Total liabilities and shareholders' equity	\$ 915,286	852,080

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
<i>(In thousands, except per share amounts)</i>				
Interest and Dividend Income				
Interest and fees on loans	\$9,413	8,522	27,388	22,720
Interest on investment securities	364	275	921	688
Dividends on investment securities	125	105	374	280
Other interest income	342	65	763	148
Total interest and dividend income	10,244	8,967	29,446	23,836
Interest Expense				
Interest on deposits	2,457	1,339	6,111	3,457
Interest on Federal Home Loan Bank borrowings	486	248	1,245	509
Interest on senior debt	229	229	686	686
Interest on subordinated debt	278	92	489	266
Interest on note payable	6	7	23	24
Total interest expense	3,456	1,915	8,554	4,942
Net interest income	6,788	7,052	20,892	18,894
Provision (Credit) for Loan Losses	50	545	285	(944)
Net interest income after provision (credit) for loan losses	6,738	6,507	20,607	19,838
Non-interest Income				
Loan application, inspection and processing fees	16	25	36	61
Deposit fees and service charges	126	149	392	444
Gains on sale of loans	3	-	69	-
Rental Income	115	117	282	302
Loss on sale of investment securities	-	-	-	(78)
Other income	94	95	283	283
Total non-interest income	354	386	1,062	1,012
Non-interest Expense				
Salaries and benefits	2,794	2,741	8,417	7,668
Occupancy and equipment expense	829	796	2,346	2,378
Data processing expense	333	340	972	786
Professional and other outside services	565	410	1,594	1,612
Merger and tax initiative project expenses	653	39	1,768	39

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Advertising and promotional expense	57	81	194	266
Loan administration and processing expense	25	22	68	45
Regulatory assessments	275	230	825	572
Insurance (income) expense	(56)	66	52	181
Communications, stationary and supplies	146	97	369	287
Other operating expense	426	400	1,194	1,096
Total non-interest expense	6,047	5,222	17,799	14,930
Income before income taxes	1,045	1,671	3,870	5,920
Provision for Income Taxes	276	658	1,000	2,373
Net income	\$769	1,013	2,870	3,547
Basic earnings per share	\$0.20	0.26	0.74	0.91
Diluted earnings per share	\$0.20	0.26	0.73	0.91

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (Unaudited)

<i>(In thousands)</i>	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
Net income	\$769	1,013	2,870	3,547
Other comprehensive income				
Unrealized holding (loss) gain on securities	(299)	2	(1,009)	289
Income tax effect	73	(1)	264	(112)
Reclassification for realized losses on sale of investment securities	-	-	-	(78)
Income tax effect	-	-	-	30
Total other comprehensive (loss) income	(226)	1	(745)	129
Comprehensive income	\$543	1,014	2,125	3,676

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)

<i>(In thousands, except shares)</i>	Number of Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive (Loss) Income	Total
Balance at December 31, 2017	3,899,675	\$ 40	106,875	(38,832)	(1,179)	(155)	66,749
Comprehensive income:							
Net income	-	-	-	2,870	-	-	2,870
Unrealized holding loss on available-for-sale securities, net of tax	-	-	-	-	-	(745)	(745)
Total comprehensive income	-	-	-	2,870	-	(745)	2,125
Common stock dividends				(116)			(116)
Share-based compensation expense	-	-	163	-	-	-	163
Vesting of restricted stock	7,291	-	-	-	-	-	-
Balance at September 30, 2018	3,906,966	\$ 40	107,038	(36,078)	(1,179)	(900)	68,921
Balance at December 31, 2016	3,891,897	\$ 40	106,729	(42,902)	(1,177)	(120)	62,570
Comprehensive income:							
Net income	-	-	-	3,547	-	-	3,547
Unrealized holding gain on available-for-sale securities, net of tax	-	-	-	-	-	129	129
Total comprehensive income	-	-	-	3,547	-	129	3,676
Purchase of treasury stock	(100)				(2)		(2)
Common stock dividends				(39)			(39)
Share-based compensation expense	-	-	105	-	-	-	105
Vesting of restricted stock	3,923	-	-	-	-	-	-
Balance at September 30, 2017	3,895,720	\$ 40	106,834	(39,394)	(1,179)	9	66,310

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

<i>(In thousands)</i>	Nine Months Ended September 30,	
	2018	2017
Cash Flows from Operating Activities:		
Net income	\$2,870	3,547
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premiums, net	34	66
Amortization and accretion of purchase loan premiums and discounts	509	476
Amortization of debt issuance costs	69	62
Provision (credit) for loan losses	285	(944)
Depreciation and amortization	1,106	926
Amortization of core deposit intangible	31	-
Loss on sales of available-for-sale securities	-	78
Share-based compensation	163	105
(Increase) decrease in deferred income taxes	(246)	1,864
Changes in assets and liabilities:		
Increase in accrued interest and dividends receivable	(116)	(775)
Decrease (increase) in other assets	855	(4)
Change in contingent consideration	(1,284)	-
Increase (Decrease) in accrued expenses and other liabilities	1,141	(796)
Net cash provided by operating activities	5,417	4,605
Cash Flows from Investing Activities:		
Proceeds from sales on available-for-sale securities	35,532	13,846
Principal repayments on available-for-sale securities	1,362	1,639
Purchases of available-for-sale securities	(17,093)	(20,576)
Purchases of Federal Reserve Bank stock	(331)	(351)
Redemptions (purchases) of Federal Home Loan Bank stock	961	(744)
Decrease (increase) in originated loans receivable, net	15,330	(53,424)
Purchases of loans receivable	(37,830)	(73,022)
Purchase of premises and equipment	(1,229)	(2,880)
Escrow deposit for pending acquisition	(500)	-
Net cash used in business combination	(4,736)	-
Net cash used in investing activities	(8,534)	(135,512)
Cash Flows from Financing Activities:		
Increase in deposits, net	35,909	76,090
Repayments of FHLB and correspondent bank borrowings	(39,800)	(8,000)
Proceeds from issuance of subordinated debt, net	9,713	-

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Principal repayments of note payable	(144)	(142)
Decrease in advances from borrowers for taxes and insurance	(1,170)	(877)
Purchases of treasury stock	-	(2)
Dividends paid on common stock	(116)	(39)
Payments of contingent consideration	(1,284)	-
Net cash provided by financing activities	3,108	67,030
Net decrease in cash and cash equivalents	(9)	(63,877)
Cash and cash equivalents at beginning of period	49,241	92,289
Cash and cash equivalents at end of period	\$49,232	28,412
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$7,492	4,467
Cash paid for income taxes	\$1,243	475
Business Combination Non-Cash Disclosures		
Assets acquired in business combination (net of cash received)	\$60,492	-
Liabilities acquired in business combination	\$56,095	-
Contingent liability assumed in business combination	\$1,761	-

See Accompanying Notes to Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 1: Basis of Financial Statement Presentation

The accompanying unaudited condensed consolidated financial statements of Patriot National Bancorp, Inc. (the “Company”) and its wholly-owned subsidiary Patriot Bank, N.A. (the “Bank”) (collectively, “Patriot”), have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) have been omitted. The accompanying unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included on the Annual Report on Form 10-K for the year ended December 31, 2017.

The Consolidated Balance Sheet at December 31, 2017 presented herein has been derived from the audited consolidated financial statements of the Company at that date, but does not include all of the information and footnotes required by US GAAP for complete financial statements.

On May 10, 2018 the Bank completed its acquisition of Prime Bank, a Connecticut bank headquartered in Orange, CT (“Prime Bank”). The closing of the transaction added a new Patriot branch located in the Town of Orange, New Haven County, Connecticut. The results of Prime Bank’s operations were included in the Company’s Consolidated Financial Statements from the date of acquisition.

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

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

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three months ended September 30, 2018 are not necessarily indicative of the results of operations that may be expected for the remainder of 2018.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 2: Accounting Policies

New Accounting Policy

Please refer to the summary of Significant Accounting Policies included in the Company's 2017 Annual Report on Form 10-K for a list of all policies in effect as of December 31, 2017. The below summary is intended to provide updates or new policies required as a result of a new accounting standard or a change to the Company's operations or assets that require a new or amended policy.

Acquired Loans

Acquired loans are initially recorded at their acquisition date fair values. The carryover of allowance for loan losses is prohibited as any credit losses in the acquired loans are included in the determination of the fair value of the loans at the acquisition date. Fair values for acquired loans are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, prepayment risk, liquidity risk, default rates, loss severity, payment speeds, collateral values and discount rate.

Acquired Impaired Loans- Purchase Credit Impaired "PCI" Loans

Acquired loans that exhibit evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments are accounted for as PCI loans under Accounting Standards Codification ("ASC") 310-30. The excess of undiscounted cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is accreted into interest income over the remaining life of the loans using the interest method. The difference between contractually required payments at acquisition and the undiscounted cash flows expected to be collected at acquisition is referred to as the non-accretable discount. The non-accretable discount represents estimated future credit losses and other contractually required payments that the Company does not expect to collect. Subsequent decreases in expected cash flows are recognized as impairments through a charge to the provision for loan losses resulting in an increase in the allowance for loan losses. Subsequent improvements in expected cash flows result in a recovery of previously recorded

allowance for loan losses or a reversal of a corresponding amount of the nonaccretable discount, which the Company then reclassifies as an accretable discount that is accreted into interest income over the remaining life of the loans using the interest method.

PCI loans are initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, the associated allowance for credit losses related to these loans is not carried over at the acquisition date.

Acquired loans that met the criteria for non-accrual of interest prior to acquisition were not considered performing upon acquisition. When the customers resume payments, to make the nonaccrual loans current, the loans may return to accrual status, including the impact of any accretable discounts, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans.

Acquired Non-impaired Loans

Acquired loans that do not meet the requirements under ASC 310-30 are considered acquired non-impaired loans. The difference between the acquisition date fair value and the outstanding balance represents the fair value adjustment for a loan and includes both credit and interest rate considerations. Fair value adjustments may be discounts (or premiums) to a loan's cost basis and are accreted (or amortized) to net interest income (or expense) over the loan's remaining life in accordance with ASC 310-20. Fair value adjustments for revolving loans are accreted (or amortized) using a straight line method. Term loans are accreted (or amortized) using the constant effective yield method.

Subsequent to the purchase date, the methods used to estimate the allowance for loan losses for the acquired non-impaired loans are consistent with the policy for allowance for loan losses described in Note 5.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Allowance for loan losses (“ALLL”) methodology

As of September 30, 2018, the Company changed its methodology to estimate its allowance for loan losses.

The Bank further segmented its loan pools by Pass, Special Mention, Substandard, and Doubtful risk ratings and assigning additional risk premiums to each group. The qualitative and economic factors for all of the pools and subsegments were also evaluated, with Pass loans receiving adjustments to reflect their credit profile relative to the non-impaired criticized assets. These adjustments generally flow through the qualitative factors addressing severity of past due loans and other similar conditions and the nature and volume of the portfolio and terms of the loans.

The Bank’s leveraged lending portfolio was evaluated relative to the rest of the Commercial & Industrial (“C&I”) pool (federal call code 4a), and an additional risk premium was assigned to those loans in aggregate, and is reflected in the “other reserves” category in the ALLL calculation. These loans were isolated due their risk parameters and profile, including higher leverage than the rest of the Bank’s C&I portfolio.

The change in methodology resulted in better alignment of the credit characteristics of the various risk grades and loan types with the calculated allowance. The provision of \$50,000 in the third quarter incorporated these changes.

Intangible Assets

Intangible assets include core deposit intangibles and goodwill arising from acquisitions. The initial and ongoing carrying value of intangible assets is based upon modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires use of a discount rate that reflects the current return requirements of the market in relation to present risk-free interest rates, required equity market premiums, peer volatility indicators, and company-specific risk indicators.

Core deposit intangibles are amortized on straight-line basis over a 10-year period because that is managements’ conservative estimate of the period Patriot will benefit from Prime Bank’s stable deposit base comprised of funds

associated with long term customer relationships.

The Company will evaluate goodwill for impairment on an annual basis, or more often if events or circumstances indicate there may be impairment. The annual impairment test will be conducted as of November annually. The implied fair value of a reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value. The fair value of each reporting unit is compared to the carrying amount of such reporting unit in order to determine if impairment is indicated.

Contingent Consideration

Contingent consideration represents an estimate of the additional amount of purchase price consideration and is measured based on the probability that certain loans are restructured in accordance with the related acquisition agreement. Resolution of the contingent consideration will result in a cash payment and will be reflected in the financial statements as a measurement period adjustment as they are finalized. Changes will be recognized as an increase or decrease to goodwill, the valuation of the related loans and the contingent consideration/purchase price.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

New Accounting Standards

Accounting Standards Adopted During 2018

Effective January 1, 2018, the following new Accounting Standards Updates (ASUs) were adopted by the Company:

ASU 2014-09

ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) including subsequent ASUs issued to clarify this Topic. The ASU, and subsequent related updates, establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most previous revenue recognition guidance, including industry-specific guidance. The ASUs are intended to increase comparability across industries. The core principle of the revenue model is that a company will recognize revenue when it transfers control of goods or services to customers, at an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services.

The Company adopted the ASU on January 1, 2018 on a modified retrospective transition approach. The adoption of this guidance did not have a material impact on the Company's Consolidated Financial Statements, and there was no cumulative effect adjustment to opening retained earnings as no material changes were identified in the timing of revenue recognition.

ASU 2016-01 and ASU 2018-03

ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities, and ASU No. 2018-03, Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10). The ASUs included targeted amendments in connection with the recognition, measurement, presentation, and disclosure of financial instruments. The main provisions require investments in equity securities to be measured at fair value through net income, unless they qualify for a practical expedient, and require fair value changes arising from changes in instrument-specific credit risk for financial liabilities that are measured under the fair value option to be recognized in other comprehensive income. The provisions also emphasized the existing requirement to use exit prices to measure fair value for disclosure purposes. The Company adopted the ASUs on January 1, 2018 on a modified retrospective basis. In connection with the adoption of ASU 2016-01 on January 1,

2018, we refined our methodology to estimate the fair value of our loan portfolio using an exit price notion resulting in prior-periods no longer being comparable.

ASU 2016-15

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 addresses the classification of certain specific transactions presented on the Statement of Cash Flows, in order to improve consistency across entities. Debt prepayment or extinguishment, debt-instrument settlement, contingent consideration payments post-business combination, and beneficial interests in securitization transactions are specific items addressed by this ASU that may affect the Bank. Additionally, the ASU codifies the predominance principle for classifying separately identifiable cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. As of September 30, 2018, Patriot did not have any debt prepayment or extinguishment, debt-instrument settlement, or beneficial interests in securitization transactions. Contingent consideration payments post-business combination were classified as a specific item under cash flows from financing activities.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

ASU 2016-18

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows: Restricted Cash*. The purpose of the standard is to improve consistency and comparability among companies with respect to the reporting of changes in restricted cash and cash equivalents on the Statement of Cash Flows. The ASU requires the Statement of Cash Flows to include all changes in total cash and cash equivalents, including restricted amounts, and to the extent restricted cash and cash equivalents are presented in separate line items on the Balance Sheet, disclosure reconciling the change in total cash and cash equivalents to the amounts shown on the Balance Sheet are required. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. As of September 30, 2018 and December 31, 2017, Patriot did not have restricted cash and cash equivalents separately disclosed on its Balance Sheet. In the future, if Patriot's activities warrant presenting separate line items on its Balance Sheet for restricted cash and cash equivalents, management does not envision any difficulties implementing the requirements of ASU 2016-18, as applicable.

ASU 2017-09

In May 2017, the FASB issued ASU 2017-09, *Scope of Modification Accounting*, which provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718 Stock compensation. The ASU is effective to all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period. This ASU did not have a material impact on its Consolidated Financial Statements.

ASU 2018-04

ASU 2018-04 - Investments - Debt Securities (Topic 320) and Regulated Operations (Topic 980): The amendment in this ASU adds, amends and supersedes various paragraphs that contain SEC guidance in ASC 320, Investments-Debt Securities and ASC 980, Regulated Operations. The amendments in this ASU are effective when a registrant adopts ASU 2016-01, which for Patriot, was January 1, 2018. This amendment did not have an impact on the Company's Consolidated Financial Statements.

Accounting Standards Issued But Not Yet Adopted

ASU 2016-02

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. This ASU was issued to improve the financial reporting of leasing activities and provide a faithful representation of leasing transactions and improve understanding and comparability of a lessee's financial statements. Under the new accounting guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. This ASU will require both finance and operating leases to be recognized on the balance sheet. This ASU will affect all companies and organizations that lease real estate. The FASB issued an update in January 2018 (ASU 2018-01) providing an optional transition practical expedient to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842. This ASU will become effective for interim and annual reporting periods beginning after December 15, 2018. The Company will adopt this new accounting guidance as required. Management is currently evaluating the impact of the new standard on its Consolidated Financial Statements.

ASU 2016-13

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments*. The ASU changes the methodology for measuring credit losses on financial instruments measured at amortized cost to a current expected loss ("CECL") model. Under the CECL model, entities will estimate credit losses over the entire contractual term of a financial instrument from the date of initial recognition of the instrument. The ASU also changes the existing impairment model for available-for-sale debt securities. In cases where there is neither the intent nor a more-likely-than-not requirement to sell the debt security, an entity will record credit losses as an allowance rather than a direct write-down of the amortized cost basis. Additionally, ASU 2016-13 notes that credit losses related to available-for-sale debt securities and purchased credit impaired loans should be recorded through an allowance for credit losses. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted for fiscal years beginning after December 15, 2018. Management is currently evaluating the impact that the standard will have on its Consolidated Financial Statements.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

ASU 2017-04

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The objective of this guidance is to simplify an entity's required test for impairment of goodwill by eliminating Step 2 from the goodwill impairment test. In Step 2 an entity measured a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. In computing the implied fair value of goodwill, an entity had to determine the fair value at the impairment date of its assets and liabilities, including any unrecognized assets and liabilities, following a procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Under this Update, an entity should perform its annual or quarterly goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount and record an impairment charge for the excess of the carrying amount over the reporting unit's fair value. The loss recognized should not exceed the total amount of goodwill allocated to the reporting unit and the entity must consider the income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. This guidance is effective for a public business entity that is an SEC filer for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of this standard is not expected to have a material impact on the Company's Consolidated Financial Statements.

ASU 2017-08

In March 2017, the FASB issued ASU 2017-08, *Premium Amortization on Purchased Callable Debt Securities*, which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Earlier application is permitted for all entities, including adoption in an interim period. If an entity early adopts the ASU in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. Management is currently evaluating the impact the adoption of ASU 2017-08 will have on its Consolidated Financial Statements.

ASU 2018-02

In February 2018, the FASB issued ASU 2018-02, *Income Statement-Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminated the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. The amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying

guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not effected. The amendments in this ASU also require certain disclosures about stranded tax effects. The guidance in this ASU will become effective for reporting periods beginning after December 15, 2018, with early adoption permitted, and will be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. Management is currently evaluating the impact that the standard will have on its Consolidated Financial Statements.

ASU 2018-05

ASU 2018-05 - *Income Taxes (Topic 740)*: Amendment to clarify situations where a registrant does not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting under ASC 740 for certain income tax effects of the Tax Cuts and Jobs Act for the reporting period. As of December 31, 2017, the Company partially completed the accounting for the tax effects of enactment of the Tax Cuts and Jobs Act, and management made reasonable estimates of the effects of a reduced federal corporate income tax rate on its existing deferred tax balances. The Company will continue to make and refine its calculations during the one-year re-measurement period as additional analysis is completed. In addition, these estimates may be affected as management gains a more thorough understanding of the new tax reform legislation.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

ASU 2018-13

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820) - Changes to the Disclosure Requirements for Fair Value Measurement*, to modify the disclosure requirements on fair value measurements. This ASU removes requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements. ASU 2018-13 clarifies that disclosure regarding measurement uncertainty is intended to communicate information about the uncertainty in measurement as of the reporting date. ASU 2018-13 adds certain disclosure requirements, including disclosure of changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The amendments in this update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty should be applied prospectively, while all other amendments should be applied retrospectively for all periods presented upon their effective date. Management is currently evaluating the impact of adopting the new guidance on the Consolidated Financial Statements, but it is not expected to have a material impact.

Note 3: Business Combinations

The Company's acquisitions are accounted for under the acquisition method of accounting in accordance with ASC 805, Business Combinations. Both the purchased assets and liabilities assumed are recorded at their respective acquisition date fair values. Determining the fair value of assets and liabilities, especially the loan portfolio, is a complicated process involving significant judgment regarding methods and assumptions used to calculate estimated fair values. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding fair values becomes available.

Acquisition of Prime Bank

On May 10, 2018 the Company completed its acquisition of Prime Bank, a Connecticut bank headquartered in Orange, CT. The closing of the transaction added a new Patriot branch located in the Town of Orange, New Haven County, Connecticut. On the acquisition date, Prime Bank had assets with a carrying value of approximately \$65

million, including investment securities with a carrying value of \$36 million, loans outstanding with a carrying value of approximately \$23 million, as well as deposits with a carrying value of approximately \$46 million. The results of Prime Bank's operations were included in the Company's Consolidated Statement of Income from the date of acquisition.

The acquisition will enable Patriot to expand its consumer and small business relationships, lending operations, and community presence, all of which will improve key operating metrics. The goodwill recognized results from the expected synergies and potential earnings from this combination, including some future cost savings related to the operations of Prime Bank. Patriot incurred \$632,000 acquisition costs, charged to operations during the nine months ended September 30, 2018.

The assets acquired and liabilities assumed from Prime Bank were recorded at their fair value as of the closing date of the merger. Goodwill of \$2.1 million was recorded at the time of the acquisition, and was adjusted to \$1.9 million as of September 30, 2018, primarily due to updating of fair value of the core deposit intangibles. The goodwill is all deductible for income taxes over 15 years.

Patriot engaged independent consultants recognized as experts in the field of valuations and fair value measurements for acquisition and merger transactions. Fair value is defined 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."

Loans were evaluated on an individual basis, considering the loan's underlying characteristics, types, remaining terms, annual interest rates, current market rates, loan to value ratios (LTV), loss exposure and remaining balances. The independent consultants utilized a discounted cash flow model to estimate the fair value of the loans using assumptions for probability of defaults, loss given defaults / recovery rates and foreclosure / recovery lags. ASC 310-30 Purchase Credit Impaired Loans were separately addressed with specific discount rates adjusted for an illiquidity premium.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)**

To estimate the core deposit customer relationships intangible the consultants first identified the core deposits and utilized assumptions regarding the account retention rate, growth rate and float and reserve percentages. Retention rates were based on historical attrition rates based on previous transactions, the growth rate assumed no new accounts, and 3% increase in existing account balances, while the floats and reserve percentage assumed the market participant would most likely be subject to a reserve requirement given the current level of core deposits.

The fair value of time deposits included segmenting into certificate of deposits (“CDs”) and IRA CDs and CDs less than \$100,000 and those \$100,000 and above. The methodology entailed discounting the contractual cash flows of the instruments over their remaining contractual lives at prevailing market rates.

The following table summarizes the consideration paid by the Company in the merger with Prime Bank and the estimated fair values of the assets acquired and liabilities assumed recognized at the acquisition date and subsequent measurement period adjustments:

<i>(In thousands)</i>	Initially Recorded at Acquisition Date	Measurement Period Adjustments	Adjusted Values
Consideration Paid			
Cash consideration	\$ 5,596	\$ 1,284	\$ 6,880
Contingent consideration	1,761	(1,284)	477
Recognized amounts of identifiable assets acquired and liabilities assumed			
Cash and cash equivalents	\$ 1,152	\$ -	\$ 1,152
Securities	35,532	-	35,532
Loans	21,605	(12)	21,593
Premises and equipment	6	-	6
Other real estate owned	991	-	991
Core deposit intangibles	552	196	748
Other assets	1,514	-	1,514
Total assets acquired	\$ 61,352	\$ 184	\$ 61,536
Deposits	46,184	-	46,184
Borrowings	9,800	-	9,800
Other liabilities	111	28	139
Total liabilities assumed	\$ 56,095	\$ 28	\$ 56,123

Identifiable net assets acquired	\$ 5,257	\$ 156	\$ 5,413
Goodwill resulting from acquisition	\$ 2,100	\$ (156	) \$ 1,944

All securities acquired in the transaction with Prime Bank were sold at the fair value at acquisition date with no recorded gain or loss. Fair value adjustments to assets acquired and liabilities assumed will be amortized on a straight-line basis over periods consistent with the average useful life or contractual term of related assets and liabilities. The core deposit intangible will be amortized over a 10-year period using the straight-line method.

Under the terms of the agreement, the transaction is accounted for as an asset sale. As a result, tax basis to Prime Bank is not carried over to Patriot and deferred tax assets on Prime Bank's books have been written off as part of the purchase accounting adjustments.

The cash consideration is based on the initial calculation of Prime Bank tangible book value in accordance with the agreement. The initial cash payment made totaled \$5.89 million and \$1.0 million of this amount remains with the escrow agent pending resolution of the final closing tangible book value calculation.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Pursuant to a letter agreement, Patriot will make payments for up to one year after the acquisition date. These additional payments (contingent consideration) are to be determined based on the curing of certain loan deficiencies. On August 29, 2018 Patriot paid \$1.28 million to the shareholders of Prime Bank pursuant to the agreement. The maximum remaining amount payable under the letter agreement is \$1.57 million and the liability under the agreement is currently estimated to be \$477,000. This estimate has been measured based on Patriots assessment of the probability that certain loans are cured in accordance with the agreement.

The accounting for the business combination includes certain provisional amounts associated with the resolution of the purchase price consideration noted above. In addition, certain other provisional amounts have been included in the determination of the fair value of the acquired assets and liabilities and changes to those underlying estimates will be reflected as measurement period adjustments within the one-year measurement period. Those provisional amounts relate to the valuation of loans, other real estate owned, deposits, tax and other accrued liabilities of the acquired company.

The nature of the measurement period adjustments noted in the table above were a result of a series of payments in August 2018 and pursuant to ongoing negotiations between the parties, and information obtained subsequent to our initial reporting of provisional fair values but prior to finalizing our fair values as of September 30, 2018. Such information was determined to be a condition in existence as of acquisition date. The income effects resulting from the recorded measurement period adjustments during the period ending September 30, 2018 are immaterial for separate disclosure.

Pending Acquisition

Definitive Purchase Agreement

On February 6, 2018, the Company, Hana Small Business Lending, Inc. (“Hana SBL”), a wholly-owned subsidiary of Hana Financial, Inc. (“Hana Financial”), and three wholly-owned subsidiaries of Hana SBL entered into a definitive purchase agreement (“Purchase Agreement”) pursuant to which Patriot will acquire Hana SBL’s small business administration (“SBA”) lending business.

Hana SBL is a fully integrated national SBA origination and servicing platform. It has originated nearly \$1 billion of SBA 7(a) loans since its inception in 2006.

On August 2, 2018, the Company, Hana SBL and three wholly-owned subsidiaries of Hana SBL, entered into an amendment (the "Amendment") to the Purchase Agreement. Pursuant to the Amendment, the closing date of the above referenced transaction has been extended from August 2, 2018 to August 1, 2019.

On October 29, 2018 the Company withdrew its initial application to the OCC requesting approval of the acquisition. At that time, the Company entered into renewed negotiations with Hana SBL designed to restructure the terms of the pending acquisition. Those negotiations continue through the date of the filing of this report. The Company continues to pursue a transaction with Hana SBL to achieve its SBA product goals. Before the Company can complete a transaction with Hana SBL, the Company will need to obtain necessary regulatory approvals or non-objection. There is no assurance of the outcome or conditions of obtaining such approvals or non-objection, and an approval or non-objection could require material modifications of current terms of the agreement with Hana SBL. There can be no guarantee that Hana SBL will agree to any modifications of the agreement.

The Company incurred \$993,000 of merger and acquisition expenses related to the Hana SBL acquisition for the nine months ended September 30, 2018.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Note 4: Available-for Sale Securities**

The amortized cost, gross unrealized gains, gross unrealized losses and fair values of available-for-sale securities at September 30, 2018 and December 31, 2017 are as follows:

<i>(In thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
<u>September 30, 2018:</u>				
U. S. Government agency mortgage-backed securities	\$ 21,530	1	(296)	21,235
Corporate bonds	14,000	-	(993)	13,007
Subordinated notes	4,500	25	-	4,525
U.S. Treasury notes	1,497	-	-	1,497
	\$ 41,527	26	(1,289)	40,264
<u>December 31, 2017:</u>				
U. S. Government agency mortgage-backed securities	\$ 7,330	-	(106)	7,224
Corporate bonds	14,000	-	(196)	13,804
Subordinated notes	4,500	48	-	4,548
	\$ 25,830	48	(302)	25,576

The following table presents the available-for-sale securities' gross unrealized losses and fair value, aggregated by the length of time the individual securities have been in a continuous loss position as of September 30, 2018 and December 31, 2017:

<i>(In thousands)</i>	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
<u>September 30, 2018:</u>						
U. S. Government agency mortgage-backed securities	\$ 16,955	(83)	4,040	(213)	20,995	(296)

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Corporate bonds	-	-	13,007	(993)	13,007	(993)	
	\$16,955	(83)	17,047	(1,206)	34,002	(1,289)

December 31, 2017:

U. S. Government agency mortgage-backed securities	\$4,118	(13	)	3,106	(93	)	7,224	(106)
Corporate bonds	13,804	(196	)	-	-		13,804	(196)
	\$17,922	(209	)	3,106	(93	)	21,028	(302)

At September 30, 2018 and December 31, 2017, thirteen of seventeen and nine of eleven available-for-sale securities had unrealized losses with an aggregate decline of 3.7% and 1.4%, respectively from the amortized cost of those securities.

Based on its quarterly reviews, management believes that none of the losses on available-for-sale securities noted above constitute an other-than-temporary impairment (“OTTI”). The noted losses are considered temporary due to market fluctuations in available interest rates on U.S. Government agency debt, mortgage-backed securities issued by U.S. Government agencies, and corporate debt. Management considers the issuers of the securities to be financially sound, the corporate bonds are investment grade, and the collectability of all contractual principal and interest payments is reasonably expected. Since Patriot is not more-likely-than-not to be required to sell the investments before recovery of the amortized cost basis and does not intend to sell the securities at a loss, none of the available-for-sale securities noted are considered to be OTTI as of September 30, 2018.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)**

At September 30, 2018 and December 31, 2017, available-for-sale securities of \$7.3 million and \$6.7 million, respectively, were pledged to the Federal Reserve Bank of New York ("FRB"), primarily to secure municipal deposits.

The following summarizes, by class and contractual maturity, the amortized cost and estimated fair value of available-for-sale debt securities held at September 30, 2018 and December 31, 2017. The mortgages underlying the mortgage-backed securities are not due at a single maturity date. Additionally, these mortgages often are and generally may be pre-paid without penalty, creating a degree of uncertainty that such investments can be held until maturity. For convenience, mortgage-backed securities have been included in the summary as a separate line item.

<i>(In thousands)</i>	Amortized Cost				Fair Value			
	Due Within 5 years	Due After 5 years through 10 years	Due After 10 years	Total	Due Within 5 years	Due After 5 years through 10 years	Due After 10 years	Total
<u>September 30, 2018:</u>								
Corporate bonds	\$-	9,000	5,000	14,000	-	8,397	4,610	13,007
Subordinated notes	-	4,500	-	4,500	-	4,525	-	4,525
U.S. Treasury notes	1,497	-	-	1,497	1,497	-	-	1,497
Available-for-sale securities with single maturity dates	1,497	13,500	5,000	19,997	1,497	12,922	4,610	19,029
U. S. Government agency mortgage-backed securities	6,828	6,297	8,405	21,530	6,817	6,129	8,289	21,235
	\$8,325	19,797	13,405	41,527	8,314	19,051	12,899	40,264
<u>December 31, 2017:</u>								
Corporate bonds	\$-	9,000	5,000	14,000	-	8,928	4,876	13,804
Subordinated notes	-	4,500	-	4,500	-	4,548	-	4,548
Available-for-sale securities with single maturity dates	-	13,500	5,000	18,500	-	13,476	4,876	18,352
U. S. Government agency mortgage-backed securities	-	3,200	4,130	7,330	-	3,107	4,117	7,224
	\$-	16,700	9,130	25,830	-	16,583	8,993	25,576

During the year to date period ended September 30, 2018, the Company sold \$35.5 million securities acquired in the transaction with Prime Bank, which were sold at the fair value at acquisition date with no recorded gain or loss. The Bank purchased \$15.6 million U.S. Government agency mortgage-backed securities and \$1.5 million U.S. Treasury

notes in the third quarter of 2018. There were no sales of the Bank's available-for-sale securities in the nine-month period ended September 30, 2018. During the year to date period ended September 30, 2017, there were \$13.8 million sales and \$20.6 million purchases of available-for-sale securities. A loss on the sale of available-for-sale securities of \$78,000 was recorded during the nine months ended September 30, 2017.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Note 5: Loans Receivable and Allowance for Loan Losses**

As of September 30, 2018 and December 31, 2017, loans receivable, net, consists of the following:

<i>(In thousands)</i>	September 30, 2018	December 31, 2017
<u>Loan portfolio segment:</u>		
Commercial Real Estate	\$ 276,100	299,925
Residential Real Estate	155,077	146,377
Commercial and Industrial	174,480	131,161
Consumer and Other	97,463	87,707
Construction	45,476	47,619
Construction to Permanent - CRE	14,658	6,858
Loans receivable, gross	763,254	719,647
Allowance for loan losses	(6,605)	(6,297)
Loans receivable, net	\$ 756,649	713,350

Patriot's lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County in New York, and the five Boroughs of New York City. Patriot originates commercial real estate loans, commercial business loans, a variety of consumer loans, and construction loans, and has purchased residential loans since 2016. All commercial and residential real estate loans are collateralized primarily by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent to some degree on the status of the regional economy as well as upon the regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

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

when warranted. Real estate is the primary form of collateral, although other forms of collateral do exist and may include such assets as accounts receivable, inventory, marketable securities, time deposits, and other business assets.

In connection with the Prime Bank merger in May 2018 loans were acquired, a subset of these loans was determined to have evidence of credit deterioration at the acquisition date, which was accounted for in accordance with ASC 310-30. The purchased credit impaired ("PCI") loans presently maintain a carrying value of \$901,000 as of September 30, 2018. The loans were evaluated for impairment through the periodic reforecasting of expected cash flows.

Income is recognized on PCI loans pursuant to ASC Topic 310-30. A portion of the fair value discount has been ascribed as an accretable yield that is accreted into interest income over the estimated remaining life of the loans. The remaining non-accretable difference represents cash flows not expected to be collected.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)**

The table below summarizes the total contractually required principal and interest cash payments, management's estimate of expected total cash payments and fair value of the loans at acquisition date. Contractually required principal and interest payments have been adjusted for estimated prepayments.

<i>(In thousands)</i>	Acquisition Date
Contractually required principal and interest at acquisition	\$ 5,816
Contractual cash flows not expected to be collected (nonaccretable discount)	(2,064)
Expected cash flows at acquisition	3,752
Interest component of expected cash flows (accretable discount)	(1,316)
Fair value of acquired loans	\$ 2,436

The accretion of the accretable discount for PCI loans for the year-to-date of September 30, 2018 was \$57,000. The table above includes \$887,000 additional expected cash flows at acquisition, and \$887,000 additional accretable discount, both resulting from a revised acquisition date estimate of PCI loans performance.

Risk characteristics of the Company's portfolio classes include the following:**Commercial Real Estate Loans**

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

Residential Real Estate Loans

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

In 2017, Patriot purchased \$73 million of residential real estate loans, including a premium of \$985,000 over the book value of the loans. During the year to date period of September 30, 2018, \$16.4 million residential real estate loans were purchased.

Commercial and Industrial Loans

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

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Consumer and Other Loans

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

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

During the year to date period of September 30, 2018, \$21.4 million education loans were purchased.

Construction Loans

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

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

Construction to Permanent - Commercial Real Estate ("CRE")

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

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

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Allowance for Loan Losses

The following tables summarize the activity in the allowance for loan losses, allocated to segments of the loan portfolio, for the three months ended September 30, 2018 and 2017:

(In thousands)

	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer and Other	Construction	Construction to Permanent - CRE	Unallocated	Total
Three months ended September 30, 2018								
Allowance for loan losses:								
June 30, 2018	\$ 2,305	1,096	1,996	523	499	80	26	6,525
Charge-offs	-	(2)	-	(3)	-	-	-	(5)
Recoveries	24	11	-	-	-	-	-	35
Provisions (credits)	(566)	(240)	245	150	181	20	260	50
September 30, 2018	\$ 1,763	865	2,241	670	680	100	286	6,605

**Three months ended
September 30, 2017****Allowance for loan losses:**

June 30, 2017	\$ 2,218	1,041	1,453	593	490	73	76	5,944
Charge-offs	-	-	(265)	(10)	-	-	-	(275)
Recoveries	6	-	-	2	-	-	-	8
Provisions (credits)	(52)	4	685	(327)	293	(27)	(31)	545
September 30, 2017	\$ 2,172	1,045	1,873	258	783	46	45	6,222

The following tables summarize the activity in the allowance for loan losses, allocated to segments of the loan portfolio, for the nine months ended September 30, 2018 and 2017:

(In thousands)

Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer and Other	Construction	Construction to Permanent - CRE	Unallocated	Total
------------------------------	-------------------------------	---------------------------------	--------------------------	--------------	--	-------------	-------

**Nine months ended
September 30, 2018**

Allowance for loan losses:

December 31, 2017	\$ 2,212	959	2,023	568	481	54	-	6,297
Charge-offs	-	(2)	-	(17)	-	-	-	(19)
Recoveries	30	12	-	-	-	-	-	42
Provisions (credits)	(479)	(104)	218	119	199	46	286	285
September 30, 2018	\$ 1,763	865	2,241	670	680	100	286	6,605

**Nine months ended
September 30, 2017**

Allowance for loan losses:

December 31, 2016	\$ 1,853	534	740	641	712	69	126	4,675
Charge-offs	-	-	(265)	(23)	-	-	-	(288)
Recoveries	8	-	2,769	2	-	-	-	2,779
Provisions (credits)	311	511	(1,371)	(362)	71	(23)	(81)	(944)
September 30, 2017	\$ 2,172	1,045	1,873	258	783	46	45	6,222

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize, by loan portfolio segment, the amount of loans receivable evaluated individually and collectively for impairment as of September 30, 2018 and December 31, 2017:

(In thousands)

	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer and Other	Construction	Construction to Permanent - CRE	Unallocated	Total
September 30, 2018								
Allowance for loan losses:								
Individually evaluated for impairment	\$ -	-	48	7	-	-	-	55
Collectively evaluated for impairment	1,763	865	2,193	663	680	100	286	6,550
Total allowance for loan losses	\$ 1,763	865	2,241	670	680	100	286	6,605
Loans receivable, gross:								
Individually evaluated for impairment	\$ 3,989	3,521	1,028	789	-	-	-	9,327
PCI loans individually evaluated for impairment	-	-	901	-	-	-	-	901
Collectively evaluated for impairment	272,111	151,556	172,551	96,674	45,476	14,658	-	753,026
Total loans receivable, gross	\$ 276,100	155,077	174,480	97,463	45,476	14,658	-	763,254

(In thousands)

	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer and Other	Construction	Construction to Permanent - CRE	Unallocated	Total
December 31, 2017								
Allowance for loan losses:								

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Individually evaluated for impairment	\$ -	-	251	2	-	-	-	253
Collectively evaluated for impairment	2,212	959	1,772	566	481	54	-	6,044
Total allowance for loan losses	\$ 2,212	959	2,023	568	481	54	-	6,297
Loans receivable, gross:								
Individually evaluated for impairment	\$ 1,977	3,336	748	692	-	-	-	6,753
Collectively evaluated for impairment	297,948	143,041	130,413	87,015	47,619	6,858	-	712,894
Total loans receivable, gross	\$ 299,925	146,377	131,161	87,707	47,619	6,858	-	719,647

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

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

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

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

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

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

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

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

In accordance with Federal Financial Institutions Examination Council published policies establishing uniform criteria for the classification of retail credit based on delinquency status, “Open-end” and “Closed-end” credits are charged off when 180 days and 120 days delinquent, respectively.

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

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Loan Portfolio Aging Analysis

The following tables summarize performing and non-performing (i.e., non-accruing) loans receivable by portfolio segment, by aging category, by delinquency status as of September 30, 2018.

<i>(In thousands)</i>	Performing (Accruing) Loans				Total	Current	Total Performing Loans	Non-accruing Loans	Loans Receivable Gross
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due	Total					
<u>As of September 30, 2018:</u>									
Loan portfolio segment:									
Commercial Real Estate:									
Pass	\$1,919	516	670	3,105	264,496	267,601	-	267,601	
Special mention	-	-	-	-	2,311	2,311	-	2,311	
Substandard	-	-	-	-	4,115	4,115	2,073	6,188	
	1,919	516	670	3,105	270,922	274,027	2,073	276,100	
Residential Real Estate:									
Pass	1,055	-	-	1,055	149,295	150,350	-	150,350	
Substandard	-	-	1,504	1,504	-	1,504	3,223	4,727	
	1,055	-	1,504	2,559	149,295	151,854	3,223	155,077	
Commercial and Industrial:									
Pass	888	480	2,100	3,468	162,762	166,230	-	166,230	
Special mention	250	-	2,374	2,624	3,048	5,672	-	5,672	
Substandard	-	-	-	-	1,494	1,494	1,084	2,578	
	1,138	480	4,474	6,092	167,304	173,396	1,084	174,480	
Consumer and Other:									
Pass	24	30	6	60	97,304	97,364	-	97,364	
Substandard	-	-	-	-	-	-	99	99	
	24	30	6	60	97,304	97,364	99	97,463	
Construction:									
Pass	1,152	-	2,922	4,074	32,602	36,676	-	36,676	
Substandard	-	-	8,800	8,800	-	8,800	-	8,800	
	1,152	-	11,722	12,874	32,602	45,476	-	45,476	
Construction to Permanent - CRE:									

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Pass	-	-	-	-	14,658	14,658	-	14,658
Total	\$5,288	1,026	18,376	24,690	732,085	756,775	6,479	763,254
Loans receivable, gross:								
Pass	\$5,038	1,026	5,698	11,762	721,117	732,879	-	732,879
Special mention	250	-	2,374	2,624	5,359	7,983	-	7,983
Substandard	-	-	10,304	10,304	5,609	15,913	6,479	22,392
Loans receivable, gross	\$5,288	1,026	18,376	24,690	732,085	756,775	6,479	763,254

As of September 30 2018 the loans 90 days and over past due and still accruing were primarily due to one construction loan of \$8.8 million, on which interest payments are current-to-date. Management has determined the loan is well secured and in process of collection. The other loan in the Substandard category was a \$1.5 million dollar multifamily residential loan in New Haven, being actively managed by the Bank's Special Assets team. The borrower is expected to bring the loan current following the resolution of real estate tax disputes with the City of New Haven.

The \$5.7 million of Pass loans 90 days and over past due and still accruing consists of five loans, all of which are actively managed by the Bank and are expected to be brought current based on recent discussions with each borrower. The \$2.4 million of Special mention loans 90 days or more past due and still accruing reflects one loan which is expected to be brought current following the sale of a property.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize performing and non-performing (i.e., non-accruing) loans receivable by portfolio segment, by aging category, by delinquency status as of December 31, 2017.

<i>(In thousands)</i>	Performing (Accruing) Loans			Total	Current	Total Performing Loans	Non-accruing Loans	Loans Receivable Gross
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due					
As of December 31, 2017:								
Loan portfolio segment:								
Commercial Real Estate:								
Pass	\$-	-	-	-	286,428	286,428	-	286,428
Special mention	-	1,121	-	1,121	9,317	10,438	-	10,438
Substandard	-	1,688	-	1,688	1,371	3,059	-	3,059
	-	2,809	-	2,809	297,116	299,925	-	299,925
Residential Real Estate:								
Pass	1,068	255	-	1,323	140,497	141,820	-	141,820
Special mention	-	1,529	-	1,529	-	1,529	-	1,529
Substandard	-	-	-	-	-	-	3,028	3,028
	1,068	1,784	-	2,852	140,497	143,349	3,028	146,377
Commercial and Industrial:								
Pass	-	2,000	375	2,375	127,057	129,432	-	129,432
Substandard	-	-	981	981	-	981	748	1,729
	-	2,000	1,356	3,356	127,057	130,413	748	131,161
Consumer and Other:								
Pass	498	-	-	498	87,207	87,705	-	87,705
Substandard	-	-	-	-	-	-	2	2
	498	-	-	498	87,207	87,705	2	87,707
Construction:								
Pass	-	-	-	-	47,619	47,619	-	47,619
Construction to Permanent - CRE:								
Pass	-	-	-	-	6,858	6,858	-	6,858
Total	\$1,566	6,593	1,356	9,515	706,354	715,869	3,778	719,647
Loans receivable, gross:								
Pass	\$1,566	2,255	375	4,196	695,666	699,862	-	699,862

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Special mention	-	2,650	-	2,650	9,317	11,967	-	11,967
Substandard	-	1,688	981	2,669	1,371	4,040	3,778	7,818
Loans receivable, gross	\$1,566	6,593	1,356	9,515	706,354	715,869	3,778	719,647

26

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize non-performing (i.e., non-accruing) loans by aging category and status, within the applicable loan portfolio segment as of September 30, 2018 and December 31, 2017:

(In thousands)

	Non-accruing Loans			Total Past Due	Current	Total Non-accruing Loans
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due			
<u>As of September 30, 2018:</u>						
Loan portfolio segment:						
Commercial Real Estate Substandard	\$-	-	2,073	2,073	-	2,073
Residential Real Estate: Substandard	-	-	3,223	3,223	-	3,223
Commercial and Industrial: Substandard	-	-	1,084	1,084	-	1,084
Consumer and Other Substandard	-	-	99	99	-	99
Total non-accruing loans	\$-	-	6,479	6,479	-	6,479

(In thousands)

	Non-accruing Loans			Total Past Due	Current	Total Non-accruing Loans
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due			
<u>As of December 31, 2017:</u>						
Loan portfolio segment:						
Residential Real Estate: Substandard	\$-	-	3,028	3,028	-	3,028
Commercial and Industrial: Substandard	-	-	748	748	-	748
Consumer and Other Substandard	-	-	2	2	-	2

Total non-accruing loans \$- - 3,778 3,778 - 3,778

If non-accrual loans had been performing in accordance with the original contractual terms, additional interest income of approximately \$85,000 and \$266,000 would have been recognized in income during the three and nine months ended September 30, 2018, respectively. During the three and nine months ended September 30, 2017, additional interest income of approximately \$27,000 and \$70,000 would have been recognized in income, respectively.

Additionally, certain loans for which the borrower cannot demonstrate sufficient cash flow to continue loan payments in the future and certain troubled debt restructurings (“TDRs”) are placed on non-accrual status. During the three and nine months ended September 30, 2018 and 2017, no interest income was collected and recognized on non-accruing loans.

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

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Troubled Debt Restructurings (“TDR”)**

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

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

The recorded investment in TDRs was \$2.9 million at September 30, 2018 and \$3.0 million at December 31, 2017, respectively. All TDRs at September 30, 2018 and December 31, 2017 were performing in accordance with their modified terms and therefore, were on accrual status.

(In thousands)

	September 30, 2018	December 31, 2017
<u>Loan portfolio segment:</u>		
Commercial Real Estate	\$ 1,916	1,977
Residential Real Estate	989	999
Total TDR Loans	2,905	2,976
Less: TDRs included in non-accrual loans	-	-
Total accrual TDR Loans	\$ 2,905	2,976

There were no loans modified as TDRs and no defaults of TDRs during the three and nine months ended September 30, 2018 and 2017. At September 30, 2018 and December 31, 2017, there were no commitments to advance additional funds under TDRs.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Impaired Loans**

Impaired loans may consist of non-accrual loans and/or performing and non-performing TDRs. As of September 30, 2018 and December 31, 2017, based on the on-going monitoring and analysis of the loan portfolio, impaired loans of \$9.3 million and \$6.8 million, respectively, were identified, for which \$55,000 and \$253,000 specific reserves were established, respectively. Loans not requiring specific reserves had sufficient collateral values, less costs to sell, supporting the net investment in the loan which includes principal balance, unamortized fees and costs and accrued interest, if any. Once a borrower is in default, Patriot is under no obligation to advance additional funds on unused commitments.

At September 30, 2018 and December 31, 2017, exposure to the impaired loans was related to 16 and 12 borrowers, respectively. In all cases, appraisal reports of the underlying collateral, if any, have been obtained from independent licensed appraisal firms. For non-performing loans, the independently determined appraised values were reduced by an estimate of the costs to sell the assets, in order to estimate the potential loss, if any, that may eventually be realized. Performing loans are monitored to determine when, if at all, additional loan loss reserves may be required for a loss of underlying collateral value.

In addition the remaining \$901,000 PCI loans acquired from Prime Bank acquisition; all remaining PCI loans were commercial and industrial loans. The PCI loans were originally recorded at fair value by the Bank on the date of acquisition. At September 30, 2018, those loans were considered individually evaluated for impairment, with no allowance recorded.

The following table reflects information about the impaired loans, excluding PCI loans, by class as of September 30, 2018 and December 31, 2017:

(In thousands)

	September 30, 2018			December 31, 2017		
	Recorded Investment	Principal Outstanding	Related Allowance	Recorded Investment	Principal Outstanding	Related Allowance
<u>With no related allowance recorded:</u>						
Commercial Real Estate	\$3,989	4,481	-	1,977	2,425	-
Residential Real Estate	3,521	3,554	-	3,336	3,369	-
Commercial and Industrial	980	1,751	-	497	683	-

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Consumer and Other	768	842	-	690	818	-
	9,258	10,628	-	6,500	7,295	-
<u>With a related allowance recorded:</u>						
Commercial Real Estate	-	-	-	-	-	-
Residential Real Estate	-	-	-	-	-	-
Commercial and Industrial	48	98	48	251	251	251
Consumer and Other	21	21	7	2	2	2
	69	119	55	253	253	253
<u>Impaired Loans, Total:</u>						
Commercial Real Estate	3,989	4,481	-	1,977	2,425	-
Residential Real Estate	3,521	3,554	-	3,336	3,369	-
Commercial and Industrial	1,028	1,849	48	748	934	251
Consumer and Other	789	863	7	692	820	2
Impaired Loans, Total	\$9,327	10,747	55	6,753	7,548	253

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following tables summarize additional information regarding impaired loans, excluding PCI loans, by class for the three and nine months ended September 30, 2018 and 2017.

(In thousands)

	Three Months Ended September 30,			
	2018		2017	
	Average	Interest	Average	Interest
	Recorded	Income	Recorded	Income
	Investment	Recognized	Investment	Recognized
<u>With no related allowance recorded:</u>				
Commercial Real Estate	\$4,062	21	6,111	10
Residential Real Estate	3,523	3	1,903	-
Commercial and Industrial	1,018	-	37	-
Consumer and Other	771	8	584	-
	9,374	32	8,635	10
<u>With a related allowance recorded:</u>				
Commercial Real Estate	-	-	-	-
Residential Real Estate	-	-	-	-
Commercial and Industrial	45	-	245	-
Consumer and Other	5	-	-	-
	50	-	245	-
<u>Impaired Loans, Total:</u>				
Commercial Real Estate	4,062	21	6,111	10
Residential Real Estate	3,523	3	1,903	-
Commercial and Industrial	1,063	-	282	-
Consumer and Other	776	8	584	-
Impaired Loans, Total	\$9,424	32	8,880	10

(In thousands)

	Nine Months Ended September 30,			
	2018		2017	
	Average	Interest	Average	Interest
	Recorded	Income	Recorded	Income
	Investment	Recognized	Investment	Recognized
<u>With no related allowance recorded:</u>				
Commercial Real Estate	\$3,157	70	6,173	159
Residential Real Estate	3,451	8	1,907	5
Commercial and Industrial	948	-	46	-
Consumer and Other	739	23	558	10
	8,295	101	8,684	174
<u>With a related allowance recorded:</u>				

Commercial Real Estate	-	-	-	-
Residential Real Estate	-	-	-	-
Commercial and Industrial	185	-	237	-
Consumer and Other	4	-	-	-
	189	-	237	-
<u>Impaired Loans, Total:</u>				
Commercial Real Estate	3,157	70	6,173	159
Residential Real Estate	3,451	8	1,907	5
Commercial and Industrial	1,133	-	283	-
Consumer and Other	743	23	558	10
Impaired Loans, Total	\$8,484	101	8,921	174

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Note 6: Deposits**

The following table presents the balance of deposits held, by category as of September 30, 2018 and December 31, 2017.

<i>(In thousands)</i>	September 30, 2018	December 31, 2017
Non-interest bearing	\$ 81,687	\$ 81,197
<u>Interest bearing:</u>		
NOW	24,827	25,476
Savings	100,294	135,975
Money market	62,314	16,575
Certificates of deposit, less than \$250,000	203,044	173,221
Certificates of deposit, \$250,000 or greater	81,346	66,866
Brokered deposits	166,020	138,129
Interest bearing, Total	637,845	556,242
Total Deposits	\$ 719,532	\$ 637,439

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Note 7: Share-Based Compensation and Employee Benefit Plan**

The Company maintains the Patriot National Bancorp, Inc. 2012 Stock Plan (the “Plan”) to provide an incentive to directors and employees of the Company by the grant of restricted stock awards (“RSA”), options, or phantom stock units. Since 2013, the Company’s practice is to grant RSAs. As of September 30, 2018 and December 31, 2017, there were no options or phantom stock units outstanding, or that have been exercised during the period then ended.

The Plan provides for the issuance of up to 3,000,000 shares of the Company’s common stock subject to certain limitations. As of September 30, 2018, 2,870,113 shares of stock are available for issuance under the Plan. In accordance with the terms of the Plan, the vesting of RSAs and options may be accelerated at the discretion of the Compensation Committee of the Board of Directors. The Compensation Committee sets the terms and conditions applicable to the vesting of RSAs and stock option grants. RSAs granted to directors and employees generally vest in quarterly or annual installments over a three, four or five year period from the date of grant.

The following is a summary of the status of the Company’s restricted shares as of September 30, 2018 and 2017 and changes therein during the periods indicated:

	Number of Shares Awarded	Weighted Average Grant Date Fair Value
<u>Three months ended September 30, 2018:</u>		
Unvested at June 30, 2018	38,086	\$ 14.57
Vested	(2,388)	\$ 16.24
Forfeited	(200)	\$ 15.50
Unvested at September 30, 2018	35,498	\$ 14.46
<u>Nine months ended September 30, 2018:</u>		
Unvested at December 31, 2017	25,870	\$ 12.15
Granted	18,323	\$ 18.07
Vested	(7,291)	\$ 15.36
Forfeited	(1,404)	\$ 14.44

Unvested at September 30, 2018 35,498 \$ 14.46

	Number of Shares Awarded	Weighted Average Grant Date Fair Value
<u>Three months ended September 30, 2017:</u>		
Unvested at June 30, 2017	32,117	\$ 12.39
Vested	(1,692)	\$ 16.80
Forfeited	(600)	\$ 15.50
Unvested at September 30, 2017	29,825	\$ 12.08

Nine months ended September 30, 2017:

Unvested at December 31, 2016	35,264	\$ 12.84
Granted	5,084	\$ 15.05
Vested	(3,923)	\$ 14.66
Forfeited	(6,600)	\$ 15.50
Unvested at September 30, 2017	29,825	\$ 12.08

The Company recognizes compensation expense for all director and employee share-based compensation awards on a straight-line basis over the requisite service period, which is equal to the vesting schedule of each award, for each vesting portion of an award equal to its grant date fair value.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

For the three and nine months ended September 30, 2018, the Company recognized total share-based compensation expense of \$56,000 and \$163,000, respectively. The share-based compensation attributable to employees of Patriot amounted to \$33,000 and \$100,000, respectively, for the three and nine months ended September 30, 2018. Included in share-based compensation expense for the three and nine months ended September 30, 2018 were \$23,000 and \$63,000 attributable to Patriot's external Directors, who received total compensation of \$77,000 and \$241,000 for each of those periods, respectively, which amounts are included in Other Operating Expenses in the Consolidated Statements of Income.

For the three and nine months ended September 30, 2017, the Company recognized total share-based compensation expense of \$37,000 and \$105,000, respectively. The share-based compensation attributable to employees of Patriot amounted to \$16,000 and \$48,000, respectively. Included in share-based compensation expense for the three and nine months ended September 30, 2017 were \$21,000 and \$57,000 attributable to Patriot's external Directors, who received total compensation of \$80,000 and \$226,000 for each of those periods, respectively, which amounts are included in Other Operating Expenses in the Consolidated Statements of Income.

Unrecognized compensation expense attributable to the unvested restricted shares outstanding as of September 30, 2018 amounts to \$428,000, which amount is expected to be recognized over the weighted average remaining life of the awards of 2.61 years.

RSA Grant - Non-executive Employees

During the three and nine months ended September 30, 2018, 200 and 300 granted shares were forfeited, respectively. During the three and nine months ended September 30, 2017, 600 and 600 granted shares were forfeited, respectively. The remaining 6,000 shares continue to vest and \$8,000 of compensation expense is expected to be recognized through the January 2019 vesting date.

Dividends

On July 17, 2017, the Company announced its intention to make quarterly cash dividend payments. For the three and nine months ended September 30, 2018, the Company paid cash dividends of \$.01 per share of common stock, or an

aggregated of \$39,000 and \$116,000, respectively. For the three and nine months ended September 30, 2017, the Company paid cash dividends of \$39,000.

Retirement Plan

The Company offers a 401K retirement plan (the “401K”), which provides for tax-deferred salary deductions for eligible employees. Employees may choose to make voluntary contributions to the 401K, limited to an annual maximum amount as set forth periodically by the Internal Revenue Service. The Company matches 50% of such contributions, up to a maximum of six percent of an employee's annual compensation. During the three and nine months ended September 30, 2018 compensation expense under the 401K aggregated \$38,000 and \$154,000, respectively. During the three and nine months ended September 30, 2017, compensation expense under the 401K aggregated \$37,000 and \$132,000, respectively.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Note 8: Earnings per share**

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

The following table summarizes the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2018 and 2017:

<i>(Net income in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,	2017	September 30,	2017
	2018	2017	2018	2017
<u>Basic earnings per share:</u>				
Net income attributable to Common shareholders	\$769	1,013	2,870	3,547
<u>Divided by:</u>				
Weighted average shares outstanding	3,904,751	3,894,237	3,903,056	3,893,702
Basic earnings per common share	\$0.20	0.26	0.74	0.91
<u>Diluted earnings per share:</u>				
Net income attributable to Common shareholders	\$769	1,013	2,870	3,547
Weighted average shares outstanding	3,904,751	3,894,237	3,903,056	3,893,702
Effect of potentially dilutive restricted common shares	14,067	9,193	17,974	4,854
<u>Divided by:</u>				
Weighted average diluted shares outstanding	3,918,818	3,903,430	3,921,030	3,898,556

Diluted earnings per common share	\$0.20	0.26	0.73	0.91
--	--------	------	------	------

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)****Note 9: Financial Instruments with Off-Balance Sheet Risk**

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

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

Financial instruments with credit risk at September 30, 2018 are as follows:

(In thousands)

	As of September 30, 2018
<u>Commitments to extend credit:</u>	
Unused lines of credit	\$ 93,277
Undisbursed construction loans	13,994
Home equity lines of credit	19,430
Future loan commitments	35,089
Financial standby letters of credit	1,161
	\$ 162,951

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates or other termination clauses, and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary upon extending credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include commercial property, residential property, deposits and securities. Patriot has established a \$8,000 reserve for credit loss as of September 30, 2018, which is included in accrued expenses and other liabilities.

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

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Note 10: Regulatory and Operational Matters

In November 2018 the Bank entered into a formal written agreement (the "Agreement") with the Office of the Comptroller of the Currency (the "OCC"). Under the terms of the Agreement, the Bank has appointed a Compliance Committee of three independent outside directors and one member of management responsible for monitoring adherence to the Agreement and has appointed a Lead Independent Director. The Agreement also states that by December 31, 2018 the Board and Bank will develop, implement and revise written documents and policies related to executive compensation, conflict of interest, internal audit, liquidity and asset/liability management, commercial loan administration, leveraged lending, practices relating to the Allowance for Loan Losses, and assumptions used in the Bank's interest rate risk model. Under the Agreement the Bank has also agreed to provide a revised written 3-year strategic and capital plan for the Bank by December 31, 2018. The Bank has taken or put into process many of the steps identified in the Agreement. Further details pertaining to the Agreement are provided in Part II Item 5: Other information.

Federal and state regulatory authorities have adopted standards requiring financial institutions to maintain increased levels of capital. Effective January 1, 2015, federal banking agencies imposed four minimum capital requirements on a community bank's risk-based capital ratios consisting of Total Capital, Tier 1 Capital, Common Equity Tier 1 ("CET1") Capital, and a Tier 1 Leverage Capital ratio. The risk-based capital ratios measure the adequacy of a bank's capital against the riskiness of its on- and off-balance sheet assets and activities. Failure to maintain adequate capital is a basis for "prompt corrective action" or other regulatory enforcement action. In assessing a bank's capital adequacy, regulators also consider other factors such as interest rate risk exposure, liquidity, funding and market risks, quality and level of earnings, concentrations of credit, quality of loans and investments, nontraditional activity risk, policy effectiveness, and management's overall ability to monitor and control risk.

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

Management continuously assesses the adequacy of the Bank's capital in order to maintain its "well capitalized" status.

The Company's and the Bank's regulatory capital amounts and ratios at September 30, 2018 and December 31, 2017 are summarized as follows:

<i>(In thousands)</i>	Patriot National Bancorp, Inc.				Patriot Bank, N.A.			
	September 30, 2018		December 31, 2017		September 30, 2018		December 31, 2017	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Total Capital (to risk weighted assets):								
Actual	88,781	10.328	74,264	10.092	97,403	11.385	83,711	11.406
To be Well Capitalized ⁽¹⁾	-	-	-	-	85,554	10.000	73,393	10.000
For capital adequacy with Capital Buffer ⁽²⁾	-	-	-	-	84,485	9.875	67,889	9.250
For capital adequacy	68,767	8.000	58,868	8.000	68,443	8.000	58,715	8.000
Tier 1 Capital (to risk weighted assets):								
Actual	72,165	8.395	67,959	9.235	90,787	10.612	77,407	10.547
To be Well Capitalized ⁽¹⁾	-	-	-	-	68,443	8.000	58,715	8.000
For capital adequacy with Capital Buffer ⁽²⁾	-	-	-	-	67,374	7.875	53,210	7.250
For capital adequacy	51,575	6.000	44,151	6.000	51,333	6.000	44,036	6.000
Common Equity Tier 1 Capital (to risk weighted assets):								
Actual	64,165	7.465	59,959	8.148	90,787	10.612	77,407	10.547
To be Well Capitalized ⁽¹⁾	-	-	-	-	55,610	6.500	47,706	6.500
For capital adequacy with Capital Buffer ⁽²⁾	-	-	-	-	54,541	6.375	42,201	5.750
For capital adequacy	38,681	4.500	33,113	4.500	38,499	4.500	33,027	4.500
Tier 1 Leverage Capital (to average assets):								
Actual	72,165	7.847	67,959	8.219	90,787	9.917	77,407	9.360
To be Well Capitalized ⁽¹⁾	-	-	-	-	45,775	5.000	41,351	5.000
For capital adequacy	36,785	4.000	33,072	4.000	36,620	4.000	33,081	4.000

⁽¹⁾ Designation as "Well Capitalized" does not apply to bank holding companies - the Company. Such categorization of capital adequacy only applies to insured depository institutions - the Bank.

⁽²⁾

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

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Under the final capital rules that became effective on January 1, 2015, there was a requirement for a CET1 capital conservation buffer of 2.5% of risk-weighted assets, which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain this required capital buffer become subject to progressively more stringent limitations on the percentage of earnings that may be distributed to shareholders or used for stock repurchases and on the payment of discretionary bonuses to senior executive management.

The capital buffer requirement is being phased in over three years beginning in 2016. The 1.25% capital conservation buffer for 2017 has been included in the minimum capital adequacy ratios in the 2017 column in the table above. The capital conservation buffer increased to 1.875% for 2018, which has been included in the minimum capital adequacy ratios in the 2018 column above.

The capital buffer requirement effectively raises the minimum required Total Capital ratio to 10.5%, the Tier 1 capital ratio to 8.5% and the CET1 capital ratio to 7.0% on a fully phased-in basis, which will be effective beginning on January 1, 2019. Management believes that, as of September 30, 2018, Patriot satisfies all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis, as if all such requirements were currently in effect.

Note 11: Fair Value and Interest Rate Risk

Patriot measures the carrying value of certain financial assets and liabilities at fair value, as required by its policies as a financial institution and by US GAAP. The carrying values of certain assets and liabilities are measured at fair value on a recurring basis, such as available-for-sale securities; while other assets and liabilities are measured at fair value on a non-recurring basis due to external factors requiring management's judgment to estimate potential losses of value resulting in asset impairments or the establishment of valuation reserves. Measuring assets and liabilities at fair value may result in fluctuations to carrying value that have a significant impact on the results of operations or other comprehensive income for the period and period over period.

Following is a detailed summary of the guidance provided by US GAAP regarding the application of fair value measurements and Patriot's application thereof. Additionally, the following information includes detailed summaries of the effects fair value measurements have on the carrying amounts of asset and liabilities presented in the Consolidated Financial Statements.

The objective of fair value measurement is to value an asset that may be sold or a liability that may be transferred at the estimated value which might be obtained in a transaction between unrelated parties under current market conditions. US GAAP establishes a framework for measuring assets and liabilities at fair value, as well as certain financial instruments classified in equity. The framework provides a fair value hierarchy, which prioritizes quoted prices in active markets for identical assets and liabilities and minimizes unobservable inputs, which are inputs for which market data are not available and that are developed by management using the best information available to develop assumptions about the value market participants might place on the asset to be sold or liability to be transferred.

The three levels of the fair value hierarchy consist of:

Level 1 Unadjusted quoted market prices for identical assets or liabilities in active markets that the entity has the ability to access at the measurement date (such as active exchange-traded equity securities and certain U.S. and government agency debt securities).

Level 2 Observable inputs other than quoted prices included in Level 1, such as:

- Quoted prices for similar assets or liabilities in active markets (such as U.S. agency and government sponsored mortgage-backed securities)
- Quoted prices for identical or similar assets or liabilities in less active markets (such as certain U.S. and government agency debt securities, and corporate and municipal debt securities that trade infrequently)
- Other inputs that are observable for substantially the full term of the asset or liability (i.e. interest rates, yield curves, prepayment speeds, default rates, etc.).

Level 3 Valuation techniques that require unobservable inputs that are supported by little or no market activity and are significant to the fair value measurement of the asset or liability (such as pricing and discounted cash flow models that typically reflect management's estimates of the assumptions a market participant would use in pricing the asset or liability).

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

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

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

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

Available-for-sale securities

The fair value of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted prices, or using unobservable inputs employing various techniques and assumptions (Level 3).

Other Investments

The Bank's investment portfolio includes the Solomon Hess SBA Loan Fund totaling \$4.5 million. This investment is utilized by the Bank to satisfy its Community Reinvestment Act ("CRA") lending requirements. As this fund operates as a private fund, shares in the fund are not publicly traded but may be redeemed with 60 days notice at cost. For that reason, the carrying amount was considered comparable to fair value.

Federal Reserve Bank Stock and Federal Home Loan Bank Stock

Shares in the Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") are purchased and redeemed based upon their \$100 par value. The stocks are non-marketable equity securities, and as such, are considered restricted securities that are carried at cost.

Loans

The fair value of loans are estimated by discounting the future cash flows using the rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. In connection with the adoption of ASU 2016-01 on January 1, 2018, we refined our methodology to estimate the fair value of our loan portfolio using an exit price notion resulting in prior periods no longer being comparable. The exit price notion requires determination of the price at which willing market participants would transact at the measurement date under current market conditions depending on facts and circumstances, such as origination rates, credit risk, transaction costs, liquidity, national and regional market trends and other adjustments, utilizing publicly available rates and indices. The application of an exit price notion requires the use of significant judgment.

Deposits

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

The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. Patriot does not record deposits at fair value on a recurring basis.

Senior Notes, Subordinated Notes, and Junior Subordinated Debt

Patriot does not record senior notes at fair value on a recurring basis. The fair value of the senior notes was estimated by discounting future cash flows at rates at which similar notes would be made. The carrying value is considered comparable to fair value.

Patriot does not record subordinated notes issued in June 2018 at fair value on a recurring basis. The fair value of the subordinated notes was estimated by discounting future cash flows at rates at which similar notes would be made. The carrying value is considered comparable to fair value.

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

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

Federal Home Loan Bank Borrowings

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

Contingent Consideration Liability

The Company estimates the fair value of the contingent consideration liability by using a discounted cash flow model of future contingent payments based on interest income related to the acquired PCI loans. The estimated fair value of the contingent consideration liability is reviewed on a quarterly basis and any valuation adjustments resulting from a change of estimated future contingent payments based on interest income of the acquired PCI loans affecting the contingent consideration liability will be recorded through noninterest expense. Due to the significant unobservable input related to the interest income, the contingent consideration liability is classified within Level 3 of the valuation hierarchy. An increase in the interest income may result in a higher fair value of the contingent consideration liability. Alternatively, a decrease in the interest income may result in a lower estimated fair value of the contingent consideration liability.

Off-balance sheet financial instruments

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

The following tables detail the financial assets measured at fair value on a recurring basis and the valuation techniques utilized relative to the fair value hierarchy, as of September 30, 2018 and December 31, 2017:

(In thousands)

Quoted Prices in Active Markets for Identical	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
--	--	--	--------------

	Assets (Level 1)				
September 30, 2018:					
U. S. Government agency mortgage-backed securities	\$	-	21,235	-	21,235
Corporate bonds		-	13,007	-	13,007
Subordinated notes		-	4,525	-	4,525
U.S. Treasury notes		-	1,497	-	1,497
Available-for-sale securities	\$	-	40,264	-	40,264
Contingent consideration liability	\$	-	-	477	477
December 31, 2017:					
U. S. Government agency mortgage-backed securities	\$	-	7,224	-	7,224
Corporate bonds		-	13,804	-	13,804
Subordinated notes		-	4,548	-	4,548
Available-for-sale securities	\$	-	25,576	-	25,576

Patriot measures certain financial assets and financial liabilities at fair value on a non-recurring basis. When circumstances dictate (e.g., impairment of long-lived assets, other than temporary impairment of collateral value), the carrying values of such financial assets and financial liabilities are adjusted to fair value or fair value less costs to sell, as may be appropriate.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**Notes to consolidated financial statements (Unaudited)**

The table below presents the valuation methodology and unobservable inputs for level 3 assets measures at fair value on a non-recurring basis as of September 30, 2018 and December 31, 2017:

<i>(In thousands)</i>	Fair Value	Valuation Methodology	Unobservable Inputs	Range of Inputs
September 30, 2018:				
Impaired loans, net including PCI loans	\$ 10,173	Real Estate Appraisals	Discount for appraisal type	0% - 8%
Other Real Estate Owned	991	Real Estate Appraisals	Discount for appraisal type	14%
December 31, 2017:				
Impaired loans	\$6,500	Real Estate Appraisals	Discount for appraisal type	0% - 8%

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

The estimated fair value amounts have been measured as of September 30, 2018 and December 31, 2017, and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of the financial instruments measured may be different than if they had been subsequently valued.

The information presented should not be interpreted as an estimate of the total fair value of Patriot's assets and liabilities, since only a portion of Patriot's assets and liabilities are required to be measured at fair value for financial reporting purposes. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between Patriot's fair value disclosures and those of other bank holding companies may not be meaningful.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

The following table provides a comparison of the carrying amounts and estimated fair values of Patriot's financial assets and liabilities as of September 30, 2018 and December 31, 2017:

<i>(In thousands)</i>		September 30, 2018		December 31, 2017	
	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:					
Cash and noninterest bearing balances due from banks	Level 1	\$5,596	5,596	3,582	3,582
Interest-bearing deposits due from banks	Level 1	43,636	43,636	45,659	45,659
U. S. Government agency mortgage-backed securities	Level 2	21,235	21,235	7,224	7,224
Corporate bonds	Level 2	13,007	13,007	13,804	13,804
Subordinated notes	Level 2	4,525	4,525	4,548	4,548
U.S. Treasury notes	Level 2	1,497	1,497	-	-
Other investments	Level 2	4,450	4,450	4,450	4,450
Federal Reserve Bank stock	Level 2	2,833	2,833	2,502	2,502
Federal Home Loan Bank stock	Level 2	4,928	4,928	5,889	5,889
Loans receivable, net	Level 3	756,649	748,988	713,350	702,816
Accrued interest receivable	Level 2	3,612	3,612	3,496	3,496
Financial assets, total		\$861,968	854,307	804,504	793,970
Financial Liabilities:					
Demand deposits	Level 2	\$81,687	81,687	81,197	81,197
Savings deposits	Level 2	100,294	100,294	135,975	135,975
Money market deposits	Level 2	62,314	62,314	16,575	16,575
NOW accounts	Level 2	24,827	24,827	25,476	25,476
Time deposits	Level 2	284,390	282,671	240,087	239,219
Brokered deposits	Level 1	166,020	165,437	138,129	137,870
FHLB and correspondent bank borrowings	Level 2	90,000	89,266	120,000	120,218
Senior notes	Level 2	11,759	11,108	11,703	11,249
Subordinated debt	Level 2	9,720	9,158	-	-
Junior subordinated debt owed to unconsolidated trust	Level 2	8,092	8,092	8,086	8,086
Note payable	Level 3	1,436	1,245	1,580	1,416
Accrued interest payable	Level 2	1,563	1,563	569	569
Contingent consideration liability	Level 3	477	477	-	-
Financial liabilities, total		\$842,579	838,139	779,377	777,850

The carrying amount of cash and noninterest bearing balances due from banks, interest-bearing deposits due from banks, and demand deposits approximates fair value, due to the short-term nature and high turnover of these balances. These amounts are included in the table above for informational purposes.

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

Notes to consolidated financial statements (Unaudited)

In the normal course of its operations, Patriot assumes interest rate risk (i.e., the risk that general interest rate levels will fluctuate). As a result, the fair value of the Patriot's financial assets and liabilities are affected when interest market rates change, which change may be either favorable or unfavorable. Management attempts to mitigate interest rate risk by matching the maturities of its financial assets and liabilities. However, borrowers with fixed rate obligations are less likely to prepay their obligations in a rising interest rate environment and more likely to prepay their obligations in a falling interest rate environment. Conversely, depositors receiving fixed rates are more likely to withdraw funds before maturity in a rising interest rate environment and less likely to do so in a falling interest rate environment. Management monitors market rates of interest and the maturities of its financial assets and financial liabilities, adjusting the terms of new loans and deposits in an attempt to minimize interest rate risk. Additionally, management mitigates its overall interest rate risk through its available funds investment strategy.

Off-balance-sheet instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at September 30, 2018 and December 31, 2017. The estimated fair value of fee income on letters of credit at September 30, 2018 and December 31, 2017 was insignificant.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

"SAFE HARBOR" STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in the Company's public statements, including this one, and in particular in "Management's Discussion and Analysis of Financial Condition and Results of Operations," may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to: (1) changes in prevailing interest rates which would affect the interest earned on the Company's interest earning assets and the interest paid on its interest bearing liabilities; (2) the timing of repricing of the Company's interest earning assets and interest bearing liabilities; (3) the effect of changes in governmental monetary policy; (4) the effect of changes in regulations applicable to the Company and the Bank and the conduct of its business; (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks; (6) the ability of competitors that are larger than the Company to provide products and services which it is impracticable for the Company to provide; (7) the state of the economy and real estate values in the Company's market areas, and the consequent effect on the quality of the Company's loans; (8) recent governmental initiatives that are expected to have a profound effect on the financial services industry and could dramatically change the competitive environment of the Company; (9) other legislative or regulatory changes, including those related to residential mortgages, changes in accounting standards, and Federal Deposit Insurance Corporation ("FDIC") premiums that may adversely affect the Company; (10) the application of generally accepted accounting principles, consistently applied; (11) the fact that one period of reported results may not be indicative of future periods; (12) the state of the economy in the greater New York metropolitan area and its particular effect on the Company's customers, vendors and communities and (13) other such factors, including risk factors, as may be described in the Company's other filings with the SEC. The following discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 30, 2017 filed with the SEC on March 30, 2018 (the "2017 Form 10-K") and the consolidated financial statements and notes thereto included in Part I, Item 1 of this Form 10-Q.

Although the Company believes that it offers the loan and deposit products and has the resources needed for continued success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause the Company to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

CRITICAL ACCOUNTING POLICIES

The preparation of consolidated financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified the accounting for the allowance for loan losses, the analysis and valuation of

its investment securities, the valuation of deferred tax assets and the valuation of the assets acquired and liabilities assumed in connection with its business combination, as the Company's most critical accounting policies and estimates in that they are important to the portrayal of the Company's financial condition and results of operations. They require management's most subjective and complex judgment as a result of the need to make estimates about the effect of matters that are inherently uncertain. Refer to the 2017 Form 10-K for additional information.

Summary

The Company reported net income for the third quarter of 2018 of \$769,000 (\$0.20 basic and diluted earnings per share) compared to a net income of \$1.0 million (\$0.26 basic and diluted earnings per share) for the quarter ended September 30, 2017. On a pre-tax basis, the Company earned \$1.0 million for the three month period ended September 30, 2018, a decrease of \$626,000 compared to the third quarter of 2017.

For the nine months ended September 30, 2018, the Company reported net income of \$2.9 million (\$0.74 basic and \$0.73 diluted earnings per share) compared to net income of \$3.5 million (\$0.91 basic and diluted earnings per share) for the nine months ended September 30, 2017, a decrease of \$677,000.

The net income for the nine months ended September 30, 2018 was not comparable to the same period last year due to a material credit recovery that was recognized in the first quarter of 2017 and material non-recurring acquisition-related and tax initiatives expenses recognized in the current year. Pre-tax earnings reported for the three and nine months ended September 30, 2018 included non-recurring transaction expenses of \$653,000 and \$1.8 million, respectively, which were primarily associated with the acquisition of Prime Bank which closed in May 2018 and the pending acquisition of Hana SBL. These non-recurring expenses will cease once the acquisitions are consummated and the acquired companies are fully integrated.

The quarter's results reflect continued, measured progress. Building scale and franchise value remains on track, and the Company continues to build its management team to add specialization and depth to its lending platform and retail banking presence.

Management is encouraged with the positive developments at Patriot over the first three quarters of 2018. The Company has followed 2017, the best earnings year in its history, with a strong first three quarters of 2018. While costs that were incurred to execute the completed and pending acquisitions are temporarily reducing the reported earnings, management is confident these investments will result in enhanced performance into 2019 and beyond.

The successful completion of the Prime Bank transaction represented an important step in the process of building Patriot into a leading community bank. Management looks forward to the next steps, which will include the Company's expansion into a national SBA lending platform, and the continued building of the Company's retail banking presence.

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

As of September 30, 2018, total assets increased to \$915.3 million, as compared to \$852.1 million at December 31, 2017. Net Loan portfolio increased \$43.2 million or 6.1% from \$713.4 million at December 31, 2017 to \$756.6 million at September 30, 2018. Deposits continued to grow to \$719.5 million at September 30, 2018, as compared to \$637.4 million at December 31, 2017. All of these balance sheet categories were positively impacted by the completed merger with Prime Bank.

Equity increased \$2.2 million or 3.3%, from \$66.7 million at December 31, 2017 to \$68.9 million at September 30, 2018, primarily due to \$2.9 million of net income and \$163,000 of equity compensation, which were offset by \$745,000 of investment portfolio unrealized losses and \$116,000 common stock dividend payments in the nine months period ended September 30, 2018.

Financial Condition

Cash and Cash Equivalents

Cash and cash equivalents of \$49.2 million at September 30, 2018 were consistent with December 31, 2017. This was primarily attributable to the offsetting effect of the followings:

\$35.9 million increase in deposits,
 \$35.5 million of proceeds from sales on securities acquired in the Prime Bank acquisition, and
 \$5.4 million in net cash provided by operating activities in the year-to-date September 30, 2018.
 The effect of these cash inflows was partially offset by:

\$39.8 million of repayments of FHLB and correspondent bank borrowings,
 \$37.8 million in cash outflows for purchases of loans receivable,
 \$17.1 million in cash used for purchases of available-for-sale securities, and
 \$4.7 million in net cash used in business combination.

Investments

The following table is a summary of the Company's available-for-sale securities portfolio, at fair value, at the dates shown:

	September 30, 2018	December 31, 2017	Inc/(Dec) (\$)	Inc/(Dec) (%)	
<i>(In thousands)</i>					
U. S. Government agency mortgage-backed securities	\$ 21,235	7,224	14,011	193.95	%
Corporate bonds	13,007	13,804	(797)	(5.77)%
Subordinated notes	4,525	4,548	(23)	(0.51)%
U.S. Treasury notes	1,497	-	1,497	100.00	%
Total Available-for-Sale Securities	\$ 40,264	25,576	14,688	57.43	%

Available-for-sale securities increased \$14.7 million or 57.4%, from \$25.6 million at December 31, 2017 to \$40.3 million at September 30, 2018. This increase was primarily attributable to purchases of \$15.6 million U.S. Government agency mortgage-backed securities and \$1.5 million U.S. Treasury notes, which was offset by \$1.4 million repayments of principal on Government agency mortgage-backed securities and \$1.0 million change in unrealized losses of the available for sale securities. In the nine month period ended September 30, 2018, the Company sold \$35.5 million securities acquired in the Prime Bank transaction, which were sold at the fair value at acquisition date with no recorded gain or loss.

Loans

The following table provides the composition of the Company's loan portfolio as of September 30, 2018 and December 31, 2017:

<i>(In thousands)</i>	September 30, 2018		December 31, 2017	
	Total	%	Amount	%
<u>Loan portfolio segment:</u>				
Commercial Real Estate	\$276,100	36.17 %	299,925	41.68 %
Residential Real Estate	155,077	20.32 %	146,377	20.34 %
Commercial and Industrial	174,480	22.86 %	131,161	18.23 %
Consumer and Other	97,463	12.77 %	87,707	12.19 %
Construction	45,476	5.96 %	47,619	6.62 %
Construction to permanent - CRE	14,658	1.92 %	6,858	0.94 %
Loans receivable, gross	763,254	100.00%	719,647	100.00%
Allowance for loan losses	(6,605)		(6,297)	
Loans receivable, net	\$756,649		713,350	

The Company's gross loan portfolio increased \$43.7 million, or 6.1%, from \$719.6 million at December 31, 2017 to \$763.3 million at September 30, 2018. The increase in loans was primarily attributable to \$21.6 million acquired loans from Prime Bank, and \$37.8 million purchases of loans receivable in the third quarter of 2018, which was partially offset by net paydown of \$15.3 million during 2018. As of September 30, 2018, the loan pipeline is strong. The Company will continue to add to the product lines and enhance service offerings to the customers.

At September 30, 2018, the net loan to deposit ratio was 105% and the net loan to total assets ratio was 83%. At December 31, 2017, these ratios were 112% and 84%, respectively.

Allowance for Loan Losses

The allowance for loan losses increased \$308,000 or 4.9% from \$6.3 million at December 31, 2017 to \$6.6 million at September 30, 2018. The increase was primarily attributable to \$285,000 provision for all loan categories.

The overall credit quality of the loan portfolio continues to be strong and stable. Based upon the overall assessment and evaluation of the loan portfolio at September 30, 2018, management believes the allowance for loan losses of \$6.6 million, which represents 0.9% of gross loans outstanding, was adequate under prevailing economic conditions to absorb existing losses in the loan portfolio.

The following table provides detail of activity in the allowance for loan losses for business activities loans:

<i>(In thousands)</i>	Three months ended September 30, 2018		Nine months ended September 30, 2017	
	2018	2017	2018	2017
Balance at beginning of the period	\$6,525	5,944	6,297	4,675
Charge-offs:				
Residential Real Estate	(2)	-	(2)	-
Commercial and Industrial	-	(265)	-	(265)
Consumer and Other	(3)	(10)	(17)	(23)
Total charge-offs	(5)	(275)	(19)	(288)
Recoveries:				
Commercial Real Estate	24	6	30	8
Residential Real Estate	11	-	12	-
Commercial and Industrial	-	-	-	2,769

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Consumer and Other	-	2	-	2
Total recoveries	35	8	42	2,779
Net (recoveries) charge-offs	(30)	267	(23)	(2,491)
Provision (credit) charged to earnings	50	545	285	(944)
Balance at end of the period	\$6,605	6,222	6,605	6,222

Ratios:

Net (recoveries) charge-offs to average loans	(0.004)%	0.038%	(0.003)%	(0.388)%
Allowance for loan losses to total loans	0.87 %	0.88 %	0.87 %	0.88 %

The following table provides an allocation of allowance for loan losses by portfolio segment and the percentage of the loans to total loans:

<i>(In thousands)</i>	September 30, 2018		December 31, 2017	
	Allowance for loan losses	% of loans	Allowance for loan losses	% of loans
Commercial Real Estate	\$1,763	36.17 %	2,212	41.68 %
Residential Real Estate	865	20.32 %	959	20.34 %
Commercial and Industrial	2,241	22.86 %	2,023	18.23 %
Consumer and Other	670	12.77 %	568	12.19 %
Construction	680	5.96 %	481	6.62 %
Construction to permanent - CRE	100	1.92 %	54	0.94 %
Unallocated	286	N/A	-	N/A
Total	\$6,605	100.00%	6,297	100.00%

Non-performing Assets

The following table presents non-performing assets as of September 30, 2018 and December 31, 2017:

<i>(In thousands)</i>	September 30, 2018	December 31, 2017
Non-accruing loans:		
Commercial Real Estate	\$ 2,073	-
Residential Real Estate	3,223	3,028
Commercial and Industrial	1,084	748
Consumer and Other	99	2
Total non-accruing loans	6,479	3,778
Loans past due over 90 days and still accruing	18,376	1,356
Other real estate owned	991	-
Total nonperforming assets	\$ 25,846	5,134
Nonperforming assets to total assets	2.82 %	0.60 %

Nonperforming loans to total loans	3.26	%	0.71	%
------------------------------------	------	---	------	---

The \$7.1 million of non-accrual loans at September 30, 2018 was comprised of eleven relationships, for which a specific reserve of \$55,000 has been established.

The Company has obtained appraisal reports from independent licensed appraisal firms and discounted those values for estimated selling costs to determine estimated impairment.

The \$3.8 million of non-accrual loans at December 31, 2017 was comprised of eight borrowers, for which a specific reserve of \$253,000 had been established.

Loans greater than 90 days past due or more, and still accruing interest, were \$18.4 million at September 30, 2018, as compared to \$1.4 million at December 31, 2017. The \$18.4 million at September 30, 2018 was primarily due to one construction loan of \$8.8 million, on which interest payments are current-to-date. Management has determined the loan is well secured and in process of collection. The other loan in the Substandard category was a \$1.5 million dollar multifamily residential loan in New Haven, being actively managed by the Bank's Special Assets team. The borrower is expected to bring the loan current following the resolution of real estate tax disputes with the City of New Haven.

The \$5.7 million of Pass loans 90 days and over past due and still accruing consists of five loans, all of which are actively managed by the Bank and are expected to be brought current based on recent discussions with each borrower. The \$2.4 million of Special mention loans 90 days or more past due and still accruing reflected one loan which is expected to be brought current following the sale of a property.

Deferred Taxes

Deferred tax assets increased \$510,000, from \$10.4 million at December 31, 2017 to \$10.9 million at September 30, 2018. The increase in deferred tax assets resulted from capitalization of certain allowable expenses for tax purposes in the 2017 income tax returns which were expensed for financial reporting purposes and changes in the tax effects on unrealized gains and losses.

Patriot anticipates utilizing the net operating loss carry forwards to reduce income taxes otherwise payable on current year taxable income and net unrealized gains on the investment portfolio to the net operating loss carry forward.

The Company will continue to evaluate its ability to realize its net deferred tax asset. If future evidence suggests that it is more likely than not that a portion of the deferred tax asset will not be realized, a valuation allowance will be established.

Deposits

The following table is a summary of the Company's deposits at the dates shown:

<i>(In thousands)</i>	September 30,	December 31,	Inc/(Dec)	Inc/(Dec)
-----------------------	--------------------------	-------------------------	------------------	------------------

	2018	2017	(\$)	(%)	
Non-interest bearing	\$ 81,687	81,197	490	0.60	%
<u>Interest bearing:</u>					
NOW	24,827	25,476	(649)	(2.55)	%
Savings	100,294	135,975	(35,681)	(26.24)	%
Money market	62,314	16,575	45,739	275.95	%
Certificates of deposit, less than \$250,000	203,044	173,221	29,823	17.22	%
Certificates of deposit, \$250,000 or greater	81,346	66,866	14,480	21.66	%
Brokered deposits	166,020	138,129	27,891	20.19	%
Total Interest bearing	637,845	556,242	81,603	14.67	%
Total Deposits	\$ 719,532	637,439	82,093	12.88	%

Deposits increased \$82.1 million or 12.9%, from \$637.4 million at December 31, 2017 to \$719.5 million at September 30, 2018, resulting from an increase of \$46.2 million acquired deposits from the Prime Bank merger, \$27.9 million in broker deposits partially offset by a decline savings deposit of \$35.7 million. During 2018, several commercial and consumer clients saw cyclical draw downs in their liquid accounts, for reasons ranging from bonus allocations, business expenses, tax expenses, to loan paydowns.

Borrowings

Total borrowings were \$121.0 million and \$141.4 million as of September 30, 2018 and December 31, 2017, respectively. Borrowings consist primarily of FHLB advances, senior notes, subordinated notes, junior subordinated debentures and a note payable.

Federal Home Loan Bank borrowings

The Company is a member of the Federal Home Loan Bank of Boston ("FHLB-B"). Borrowings from the FHLB-B are limited to a percentage of the value of qualified collateral, as defined on the FHLB-B Statement of Products Policy. Qualified collateral, as defined, primarily consists of mortgage-backed securities and loans receivable that are required to be free and clear of liens and encumbrances, and may not be pledged for any other purposes. As of September 30, 2018, the Bank had \$60.0 million of available borrowing capacity from the FHLB-B.

In addition, Patriot has a \$2.0 million revolving line of credit with the FHLB-B. At September 30, 2018 and December 31, 2017, no funds had been borrowed under the line of credit.

Correspondent Bank - Line of Credit

Effective July 2016, Patriot entered into a federal funds sweep and federal funds line of credit facility agreement (the "Correspondent Bank Agreement") with ZB, N.A. ("Zions Bank"). The purpose of the agreement is to provide a credit facility intended to satisfy overnight federal account balance requirements and to provide for daily settlement of FRB, ACH, and other clearinghouse transactions.

The Correspondent Bank Agreement provides for up to \$16 million in borrowings of which no borrowings were outstanding as of September 30, 2018. The Correspondent Bank Agreement is unsecured, currently requires a compensating balance of \$250,000 to remain on account with Zions Bank at all times, pays interest on funds on account (e.g., federal funds sweep, compensating balance) at variable rates depending on the total deposit, and charges interest on advances at Zions Bank's daily federal funds rate, which is variable.

In June 2018, Patriot negotiated a similar line of credit facility for \$10 million with First Tennessee Bank.

Senior notes

On December 22, 2016, the Company issued \$12 million of senior notes bearing interest at 7% per annum and maturing on December 22, 2021 (the "Senior Notes"). Interest on the Senior Notes is payable semi-annually on June 22 and December 22 of each year beginning on June 22, 2017.

In connection with the issuance of the Senior Notes, the Company incurred \$374,000 of costs, which are being amortized over the term of the Senior Notes to recognize a constant rate of interest expense. At September 30, 2018 and December 31, 2017, \$241,000 and \$297,000 of unamortized debt issuance costs have been deducted from the face amount of the Senior Notes included in the Consolidated Balance Sheet.

The Senior Notes contain affirmative covenants that require the Company to: maintain its and its subsidiaries' legal entity and tax status, pay its income tax obligations on a timely basis, and comply with SEC and FDIC reporting requirements. The Senior Notes are unsecured, rank equally with all other senior obligations of the Company, are not redeemable nor may they be put to the Company by the holders of the notes, and require no payment of principal until maturity.

Subordinated notes

On June 29, 2018, the Company entered into certain subordinated note purchase agreements with two institutional accredited investors and completed a private placement of \$10 million of fixed-to-floating rate subordinated notes with the maturity date of September 30, 2028 (the “Subordinated Notes”) pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, and Rule 506(b) of Regulation D promulgated thereunder.

The Subordinated Notes will initially bear interest at 6.25% per annum, from and including June 29, 2018, to but excluding, June 30, 2023, payable semi-annually in arrears. From and including June 30, 2023, until but excluding June 30, 2028 or an early redemption date, the interest rate shall reset quarterly to an interest rate per annum equal to the then current three-month LIBOR (but not less than zero) plus 332.5 basis points, payable quarterly in arrears. The Company may, at its option, beginning on June 30, 2023 and on any scheduled interest payment date thereafter, redeem the Subordinated Notes. Interest on the Subordinated Notes is payable beginning on December 30, 2018.

In connection with the issuance of the Subordinated Notes, the Company incurred \$424,000 of debt issuance costs, which are being amortized over the term of the Subordinated Notes to recognize a constant rate of interest expense. At September 30, 2018, \$280,000 of unamortized debt issuance costs have been deducted from the face amount of the Subordinated Notes included in the Consolidated Balance Sheet.

Junior subordinated debt owed to unconsolidated trust

In 2003, the Patriot National Statutory Trust I (“the Trust”), which has no independent assets and is wholly-owned by the Company, issued \$8.0 million of trust preferred securities. The proceeds, net of a \$240,000 placement fee, were invested in junior subordinated debentures issued by the Company, which invested the proceeds in the Bank. The Bank used the proceeds to fund its operations.

At its option, exercisable on a quarterly basis, the Company may redeem the junior subordinated debentures from the Trust, which would then redeem the trust preferred securities.

Note Payable

In September 2015, the Bank purchased the property in which its Fairfield, Connecticut branch is located for approximately \$2.0 million, a property it had been leasing until that date. The purchase price was primarily satisfied by issuing the seller a \$2.0 million, nine-year, promissory note bearing interest at a fixed rate of 1.75% per annum. As of September 30, 2018 and December 31, 2017, the note had a balance outstanding of \$1.4 million and \$1.6 million, respectively. The note matures in August 2024 and requires a balloon payment of approximately \$234,000 at that time. The note is secured by a first Mortgage Deed and Security Agreement on the purchased property.

Equity

Equity increased \$2.2 million from \$66.7 million at December 31, 2017 to \$68.9 million at September 30, 2018, primarily due to \$2.9 million of year-to-date net income and \$163,000 of equity compensation, which were offset by \$745,000 of investment portfolio unrealized loss and \$116,000 common stock dividend payments.

Off-Balance Sheet Commitments

The Company's off-balance sheet commitments, which primarily consist of commitments to lend, increased \$45.8 million from \$117.2 million at December 31, 2017 to \$163.0 million at September 30, 2018.

RESULTS OF OPERATIONS**Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential**

The following tables present daily average balance sheets, interest income, interest expense and the corresponding yields earned and rates paid for the three months ended September 30, 2018 and 2017:

<i>(In thousands)</i>	Three months ended September 30,					
	2018			2017		
	Daily	Interest	Yield	Daily	Interest	Yield
	Average	(\$)	(%)	Average	(\$)	(%)
	Balance			Balance		
	(\$)			(\$)		
ASSETS						
Interest Earning Assets:						
Loans	\$748,162	9,413	4.99	702,307	8,522	4.81
Cash equivalents	69,733	342	1.95	23,383	65	1.11
Investments	48,753	489	4.01	39,923	380	3.81
Total interest earning assets	866,648	10,244	4.69	765,613	8,967	4.65
Cash and due from banks	5,298			2,766		
Premised and equipment, net	35,673			34,618		
Allowance for loan losses	(6,541)			(6,120)		
OREO	991			851		
Other assets	19,770			16,076		
Total Assets	\$921,839			813,804		
Liabilities						
Interest bearing liabilities:						
Deposits	\$631,437	2,457	1.54	511,941	1,339	1.04
Borrowings	101,587	486	1.90	137,027	248	0.72
Senior notes	11,748	229	7.73	11,673	229	7.77
Subordinated debt	17,877	278	6.17	8,237	92	4.47
Note Payable and other	1,453	6	1.64	1,639	7	1.74
Total interest bearing liabilities	764,102	3,456	1.79	670,517	1,915	1.13
Demand deposits	83,758			75,081		
Other liabilities	4,650			1,811		

Total Liabilities	852,510	747,409	
Shareholders' equity	69,329	66,395	
Total Liabilities and Shareholders' Equity	\$921,839	813,804	
Net interest income	6,788	7,052	
Interest margin		3.11	3.65
Interest spread		2.90	3.52

51

The following tables present daily average balance sheets, interest income, interest expense and the corresponding yields earned and rates paid for the nine months ended September 30, 2018 and 2017:

<i>(In thousands)</i>	Nine months ended September 30,					
	2018			2017		
	Daily			Daily		
	Average	Interest	Yield	Average	Interest	Yield
	Balance	(\$)	(%)	Balance	(\$)	(%)
	(\$)			(\$)		
ASSETS						
Interest Earning Assets:						
Loans	\$737,808	27,388	4.96	642,742	22,720	4.73
Cash equivalents	59,438	763	1.72	23,365	148	0.85
Investments	42,439	1,295	4.07	36,871	968	3.50
Total interest earning assets	839,685	29,446	4.69	702,978	23,836	4.53
Cash and due from banks	4,571			4,092		
Premised and equipment, net	35,600			33,816		
Allowance for loan losses	(6,471)			(5,547)		
OREO	511			851		
Other assets	17,963			16,717		
Total Assets	\$891,859			752,907		
Liabilities						
Interest bearing liabilities:						
Deposits	\$603,105	6,111	1.35	487,248	3,457	0.95
Borrowings	114,159	1,245	1.46	102,900	509	0.66
Senior notes	11,730	686	7.80	11,655	686	7.87
Subordinated debt	11,459	489	5.71	8,244	266	4.32
Note Payable	1,737	23	1.77	1,689	24	1.76
Total interest bearing liabilities	742,190	8,554	1.54	611,736	4,942	1.08
Demand deposits	76,637			73,815		
Other liabilities	4,454			2,344		
Total Liabilities	823,281			687,895		
Shareholders' equity	68,578			65,012		
Total Liabilities and Shareholders' Equity	\$891,859			752,907		

Net interest income	20,892	18,894
Interest margin	3.33	3.59
Interest spread	3.15	3.45

52

The following table presents the dollar amount of changes in interest income and interest expense for the major categories of our interest-bearing assets and interest-bearing liabilities for the three and nine months ended September 30, 2018 and 2017:

<i>(In thousands)</i>	Three Months Ended September 30, 2018 compared to 2017 Increase/(Decrease)			Nine Months Ended September 30, 2018 compared to 2017 Increase/(Decrease)		
	Volume	Rate	Total	Volume	Rate	Total
Interest Earning Assets:						
Loans	\$600	291	891	\$3,432	1,236	4,668
Cash equivalents	129	148	277	228	387	615
Investments	82	27	109	147	180	327
Total interest earning assets	811	466	1,277	3,807	1,803	5,610
Interest bearing liabilities:						
Deposit	494	624	1,118	1,122	1,532	2,654
Borrowings	(64)	302	238	57	679	736
Senior notes	-	-	-	-	-	-
Subordinated debt	-	186	186	158	65	223
Note payable and other	(1)	-	(1)	(1)	-	(1)
Total interest bearing liabilities	429	1,112	1,541	1,336	2,276	3,612
Net interest income	\$382	(646)	(264)	\$2,471	(473)	1,998

For the quarter ended September 30, 2018, interest income increased \$1.3 million or 14% as compared to the quarter ended September 30, 2017, as focused growth and diversification in the loan portfolio yielded an increase in interest income. Average loan balances increased \$45.9 million or 7% as compared to the quarter ended September 30, 2017. Total interest expense increased \$1.5 million or 80% as compared to the quarter ended September 30, 2017, primarily driven by \$1.1 million increase in interest on deposits as the result of an increase in deposit rates, and \$238,000 increase in interest on borrowings.

For the nine-month period ended September 30, 2018, interest income increased \$5.6 million or 24% as compared to the nine-months ended September 30, 2017. Average loan balance increased \$95.1 million as compared to the nine-months ended September 30, 2017, primarily driven by \$21.6 million acquired loans from Prime Bank and \$37.8 million loans purchased in 2018.

Net interest income was \$6.8 million for the quarter ended September 30, 2018, decreased 4% from the corresponding 2017 period. Net interest income was \$20.9 million for the nine months ended September 30, 2018, up 11% from the corresponding 2017 period. Net interest margin for the quarter ended September 30, 2018 was 3.11% as compared to 3.65% for the quarter ended September 30, 2017. For the nine months ended September 30, 2018, net interest margin was 3.33% as compared to 3.59% for the year-ago period. The decline in net interest margin reflects the impact of the subordinated debt added June 29, 2018 and increasing deposit costs associated with higher rates paid on retail deposits and an increased reliance on more expansive wholesale funding sources.

Provision (Credit) for Loan Losses

The provision for loan losses for the three and nine months ended September 30, 2018 were \$50,000 and \$285,000, as compared to \$545,000 and a net credit of \$944,000 for the three and nine months ended September 30, 2017, respectively. The credit for loan losses in 2017 was primarily attributable to a \$2.8 million insurance recovery in its Commercial and Industrial portfolio segment, which was recorded as a credit to the allowance for loan losses in the first quarter of 2017.

Non-interest income

Non-interest income decreased \$32,000 from \$386,000 for the quarter ended September 30, 2017 to \$354,000 for the quarter ended September 30, 2018. The decrease was primarily attributable to a \$23,000 decrease in deposit fees.

For the nine months ended September 30, 2018, non-interest income increased \$50,000 to \$1.1 million as compared to \$1.0 million for the same period of 2017. The increase is primarily attributable to a \$78,000 loss recognized on sale of investment securities in the first quarter of 2017, and gain of \$69,000 on sale of loans in 2018, which were offset by \$52,000 declines in deposit and loan fees.

Non-interest expense

Non-interest expense increased \$825,000 from \$5.2 million for the quarter ended September 30, 2017 to \$6.0 million for the quarter ended September 30, 2018. The expenses were impacted by non-recurring project costs of \$653,000 primarily associated with the Prime Bank merger which was closed in May 2018 and the pending acquisition of Hana SBL. These non-recurring expenses will cease once the acquisitions are consummated and the acquired companies are fully integrated. The total increase in non-interest expense was partially offset by \$122,000 decrease in insurance expense and \$24,000 decrease in advertising and promotional expense.

For the nine month ended September 30, 2018, non-interest expense increased \$2.9 million to \$17.8 million as compared to \$14.9 million for the same period of 2017. The increase primarily driven by non-recurring project costs of \$1.7 million for merger and tax initiative projects, and \$749,000 increase in salaries and benefits as the Bank continues to grow its business activities.

Provision for income taxes

The provision for income taxes for the three and nine months ended September 30, 2018 were \$276,000 and \$1.0 million, as compared to \$658,000 and \$2.3 million for the three and nine months ended September 30, 2017, respectively. The decrease mainly reflected the lower pre-tax income (due to the prior year credit to the loan loss provision) and the positive impact of the change in the federal corporate tax rate from 35% to 21% enacted in December 2017.

Liquidity

The Company's balance sheet liquidity to total assets ratio was 9.3% at September 30, 2018 compared to 8.2% at December 31, 2017. Liquidity including readily available off balance sheet funding sources was 18.9% at September 30, 2018 compared to 15.6% at December 31, 2017. The Company's available total liquidity (readily available plus brokered deposit availability) to total assets ratio was 24.4% at September 30, 2018 compared to 18.3% at December 31, 2017.

The following categories of assets are considered balance sheet liquidity: cash and due from banks, federal funds sold (if any), short-term investments (if any) and unpledged available-for-sale securities. In addition, off balance sheet funding sources include collateral based borrowing available from the FHLB, correspondent bank borrowing lines, and brokered deposits subject to internal limitations.

Liquidity is a measure of the Company's ability to generate adequate cash to meet its financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts. Management believes the Company's liquid assets provide sufficient coverage to satisfy loan demand, cover potential fluctuations in deposit accounts, and to meet other anticipated operational cash requirements.

Capital

The following table illustrates the Company's and the Bank's regulatory capital ratios as of September 30, 2018 and December 31, 2017:

	Patriot National Bancorp, Inc.				Patriot Bank, N.A.			
	September 30, 2018		December 31, 2017		September 30, 2018		December 31, 2017	
<i>(In thousands)</i>	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Total Capital (to risk weighted assets)	88,781	10.328	74,264	10.092	97,403	11.385	83,711	11.406
Tier 1 Capital (to risk weighted assets)	72,165	8.395	67,959	9.235	90,787	10.612	77,407	10.547
Common Equity Tier 1 Capital (to risk weighted assets)	64,165	7.465	59,959	8.148	90,787	10.612	77,407	10.547
Tier 1 Leverage Capital (to average assets)	72,165	7.847	67,959	8.219	90,787	9.917	77,407	9.360

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. Under the regulatory framework for prompt correction action, to be considered “well capitalized,” an institution must generally have a leverage capital ratio of at least 5.0%, CET1 capital ratio at least 6.5%, a Tier 1 risk-based capital ratio of at least 8.0% and a total risk-based capital ratio of at least 10%. However, the OCC has the discretion to require increased capital ratios.

Under the final capital rules that became effective on January 1, 2015, there is a requirement for a CET1 Capital conservation buffer of 2.5% of risk-weighted assets, which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain this required capital buffer become subject to progressively more stringent limitations on the percentage of earnings that may be distributed to shareholders or used for stock repurchases and on the payment of discretionary bonuses to senior executive management.

The capital buffer requirement is being phased in over three years beginning in 2016. The 1.25% capital conservation buffer for 2017 has been included in the minimum capital adequacy ratios in the 2017 column in the table above. The capital conservation buffer increased to 1.875% for 2018, which has been included in the minimum capital adequacy ratios in the 2018 column above.

The capital buffer requirement effectively raises the minimum required Total Capital ratio to 10.5%, the Tier 1 Capital ratio to 8.5%, and the CET1 Capital ratio to 7.0% on a fully phased-in basis, which will be effective beginning on January 1, 2019. Management believes that, as of September 30, 2018, Patriot satisfies all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis, as if all such requirements were currently in effect.

The increases in the Bank’s capital ratios as of September 30, 2018 were primarily due to the \$10 million issuance of subordinated debt in June 2018. Management continuously assesses the adequacy of the Bank’s capital with the goal to maintain a “well capitalized” classification.

IMPACT OF INFLATION AND CHANGING PRICES

The Company's Consolidated Financial Statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effect of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Notwithstanding this, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, deflation or disinflation could significantly affect the Company's earnings in future periods.

Stock Repurchase Program

No shares of Patriot's common stock were repurchased during the three and nine months period ended September 30, 2018.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. The Company's market risk is primarily limited to interest rate risk.

The Company's goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price the Company's assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio and purchase short-term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest-bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies can be matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee ("ALCO"), which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions during the period and determines compliance with the Company's Investment, ALCO and Liquidity policies.

Management analyzes the Company's interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation and gap analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest sensitive." An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Management's goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Simulation analysis is only an estimate of the Company's interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate-sensitive assets and funding requirements of rate-sensitive liabilities.

The tables below set forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in the Company's portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results of these changes are added to or subtracted from the base case; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may therefore overstate the impact of short-term repricings. As a result of the historically low interest rate environment, the calculated effects of the 100 and 200 basis point downward shocks cannot absolutely reflect the risk to earnings and equity, since the interest rates on certain balance sheet items have approached their minimums. Therefore, it is not possible for the analyses to fully measure the true impact of these downward shocks.

(In thousands)

Net Portfolio Value - Performance Summary

Projected Interest Rate Scenario	As of September 30, 2018			As of December 31, 2017		
	Estimated Value	Change from	Change from	Estimated Value	Change from	Change from
		Base (\$)	Base (%)		Base (\$)	Base (%)
+200	116,478	(1,486)	(1.3)	89,258	(13,440)	(13.1)
+100	118,338	374	0.3	96,939	(5,758)	(5.6)
BASE	117,964	-	-	102,697	-	-
-100	114,251	(3,713)	(3.1)	105,874	3,177	3.1
-200	109,342	(8,622)	(7.3)	108,657	5,959	5.8

Net Interest Income - Performance Summary

Projected Interest Rate Scenario	September 30, 2018			Year ended December 31, 2017		
	Estimated Value	Change from	Change from	Estimated Value	Change from	Change from
		Base (\$)	Base (%)		Base (\$)	Base (%)
+200	30,747	1,005	3.4	27,936	(937)	(3.2)
+100	30,331	589	2.0	28,454	(420)	(1.5)
BASE	29,742	-	-	28,873	-	-
-100	29,223	(519)	(1.7)	28,830	(43)	(0.2)
-200	28,596	(1,146)	(3.9)	29,271	398	1.4

Item 4: Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to provide reasonable assurance that information, which is required to be disclosed timely, is accumulated and communicated to management in a timely fashion. In designing and evaluating such controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management is necessarily required to use judgment in evaluating controls and procedures.

An evaluation of the effectiveness of the Company's disclosure controls and procedures was performed by the Company's management, with the participation of the Company's Chief Executive Officer and its Chief Financial Officer, as of the end of the period covered by this report. As used herein, "disclosure controls and procedures" means controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation, the aforementioned officers concluded that, as of September 30, 2018, the Company's disclosure controls and procedures were effective.

Internal Control over Financial Reporting

There were no changes in the Company's internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II - OTHER INFORMATION

Item 1: Legal Proceedings

Neither the Company nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which the Company or the Bank is a party or any of its property is subject.

Item 5: Other Information

On November 7, 2018, the Bank entered into an agreement (the “OCC Agreement”) with The Comptroller of the Currency (“OCC”), pursuant to which the Bank agreed to take certain actions, including the following:

Within 30 days of the date of the OCC Agreement, the Board of the Bank shall appoint a Compliance Committee of at least three directors, a majority of whom shall not be employees or controlling shareholders of the Bank or any of its affiliates. The Compliance Committee shall be responsible for monitoring and coordinating the Bank’s adherence to the provisions of the OCC Agreement;

By December 31, 2018, the Board of the Bank shall develop and implement a written program to provide for effective Board and management supervision of the Bank. The program shall address the weaknesses in Board and management supervision;

By December 31, 2018, the Board of the Bank shall develop and implement formalized standards governing the performance and compensation of all senior executives and executive management, including that of the Chief Executive Officer;

By December 31, 2018, the Board of the Bank shall ensure that it receives and reviews sufficient information from management regarding the operation of the Bank and the Bank’s compliance with the OCC Agreement, to enable the Board to provide oversight and fulfill their fiduciary duties, other responsibilities under law, and in accordance with safe and sound standards. At least annually, the Board of the Bank shall perform an assessment of the adequacy of the information provided by management;

The Board of the Bank shall maintain a Lead Independent Director that has sufficient authority and expertise to ensure that the Bank is not subject to undue influence from any executive officer or director;

By December 31, 2018, the Board of the Bank shall develop and implement a written, comprehensive conflict of interest policy applicable to the Bank and the Company’s directors, principal shareholders, executive officers, affiliates, and employees;

By December 31, 2018, the Board of the Bank shall provide the OCC with a written 3-year strategic and capital plan for the Bank, establishing objectives for the Bank’s overall risk profile, earnings performance, growth, balance sheet

mix, off-balance sheet activities, liability structure, and capital adequacy, together with strategies to achieve those objectives;

By December 31, 2018, the Board of the Bank shall revise and implement an internal audit program that is consistent with safe and sound standards for internal audit;

Within 60 days of the date of the OCC Agreement, the Board of the Bank shall revise and implement a written liquidity and asset/liability management policy that is consistent with safe and sound standards for liquidity and asset/liability management;

By December 31, 2018, the Board of the Bank shall revise and submit to OCC for review a written program to improve the Bank's commercial loan administration;

Within 60 days of the date of the OCC Agreement, the Board of the Bank shall revise and submit to OCC for review a program designed to ensure the Bank's leveraged lending policies and procedures conform with safe and sound practices for leveraged lending;

By November 30, 2018, the Bank shall revise and submit to OCC for review written policies and procedures for the maintenance of an adequate allowance for loan and lease losses;

By December 31, 2018, the Bank shall revise the asset liability management policy to ensure that the Bank management documents, monitors and updates key assumptions used in the Bank's interest rate risk model that are consistent with safe and sound standards for such models;

As a result of the OCC Agreement, the Bank is designated by the OCC to be in "troubled condition" as set forth in 12 C.F.R. §5.51(c)(7)(ii) and not an "eligible bank" for purposes of 12 C.F.R. §5.3(g) and 12 C.F.R. §24.2(e).

The foregoing description of the terms of the OCC Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the form of the OCC Agreement filed herewith as Exhibit 99(1).

Item 6: Exhibits

The exhibits marked with the section symbol (#) are interactive data files.

No. Description

- 3(i) Certificate of Incorporation of Patriot National Bancorp, Inc. (incorporated by reference to Exhibit 3(i) to the Company's Current Report on Form 8-K filed on December 1, 1999).
- 3(i)(A) Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004 filed on March 25, 2005).
- 3(i)(B) Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006 (incorporated by reference to Exhibit 3(i)(B) to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 filed on November 14, 2006).
- 3(i) Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report Form 8-K filed on October 21, 2010)
- 3(ii) Amended and Restated By-laws of Patriot National Bancorp, Inc. (incorporated by reference to Exhibit 3(ii) to the Company's Current Report on Form 8-K filed on November 1, 2010)
- 4 Form of 6.25% Fixed to Floating Rate Subordinated Note (incorporated by reference to Exhibit 4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 filed on August 14, 2018)
- 10(1) 2012 Stock Plan of Patriot National Bancorp, Inc. (incorporated by reference from Annex A to the Proxy Statement on Schedule 14C filed on November 1, 2011)
- 10(2) Amended Financial Services Agreement (incorporated by reference to Exhibit 10(a) (20) to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (Commission File No. 000-29599) filed on August 8, 2014)
- 10(3) Agreement and Plan of Merger by and among Patriot National Bancorp, Inc., Patriot Bank, National Association, Prime Bank and Jasper J. Jaser, as stockholders' representative, dated as of August 1, 2017 (incorporated by reference to Exhibit 10(a) (21) to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2017 filed on August 11, 2017)

10(4) Asset Purchase Agreement by and among Hana Small Business Lending, Inc.; Hana ABS 2014-1, LLC; Hana Investment, LLC and Patriot Bank, N.A., dated as of February 2, 2018 (incorporated by reference to Exhibit 10(a) (26) to the Company's Annual Report on Form 10-K for the year ended December 31, 2017 filed on March 30, 2018).

10(5) Amendment to Asset Purchase Agreement by and among Hana Small Business Lending, Inc.; Hana ABS 2014-1, LLC; Hana Investment, LLC and Patriot Bank, N.A., dated as of August 2, 2018 (incorporated by reference to Exhibit 10(5) to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 filed on August 14, 2018)

10(6) Form of Subordinated Note Purchase Agreement (incorporated by reference to Exhibit 10(6) to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 filed on August 14, 2018)

31(1) Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

31(2) Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32* Section 1350 Certifications

99(1) Form of the Agreement with The Comptroller of the Currency, dated as of November 7, 2018.

61

101.INS#XBRL Instance Document

101.SCH#XBRL Schema Document

101.CAL#XBRL Calculation Linkbase Document

101.LAB#XBRL Labels Linkbase Document

101.PRE#XBRL Presentation Linkbase Document

101.DEF#XBRL Definition Linkbase Document

The exhibits marked with the section symbol (#) are interactive data files.

* The certification is being furnished and shall not be deemed filed.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 14, 2018

Patriot National Bancorp, Inc. (Registrant)

By: /s/ Joseph D. Perillo
Joseph D. Perillo
Executive Vice President and Chief
Financial Officer