PATRIOT NATIONAL BANCORP INC
Form 10-Q
August 15, 2016
**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarter Ended June 30, 2016

Commission file number 000-29599

**PATRIOT NATIONAL BANCORP, INC.**

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| Connecticut | 06-1559137 |
| (State of incorporation) | (I.R.S. Employer Identification Number) |

**900 Bedford Street, Stamford, Connecticut 06901**

**(Address of principal executive offices)**

**(203) 324-7500**

**(Registrant’s telephone number)**

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 __X__ No_____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes __X__ No_____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer ____ Accelerated Filer ____ Non-Accelerated Filer ____ Smaller Reporting Company __X__

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes _____ No __X__

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date.

Common stock, $0.01 par value per share, 3,958,486 shares outstanding as of the close of business August 12, 2016.

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**PART I- FINANCIAL INFORMATION**

***Item 1: Consolidated Financial Statements***

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**CONSOLIDATED BALANCE SHEETS (Unaudited)**

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| **ASSETS** | *(in thousands, except shares and per share amounts)* | |
| Cash and due from banks: | | |
| Noninterest bearing deposits and cash | $2,893 | $2,588 |
| Interest bearing deposits | 43,594 | 82,812 |
| Total cash and cash equivalents | 46,487 | 85,400 |
| | | |
| Securities: | | |
| Available for sale securities, at fair value (Note 2) | 23,037 | 29,377 |
| Other Investments | 4,450 | 4,450 |
| Restricted stock, at cost | 7,982 | 8,645 |
| Total securities | 35,469 | 42,472 |
| | | |
| Loans receivable (net of allowance for loan losses: 2016: $5,250; 2015: $5,242) (Note 3) | 523,404 | 479,127 |
| Premises and equipment, net | 29,972 | 29,421 |
| Other real estate owned | 851 | - |
| Accrued interest and dividends receivable | 2,120 | 2,010 |
| Deferred tax asset (Note 7) | 13,073 | 13,763 |
| Other assets | 1,679 | 1,338 |
| **Total assets** | $653,055 | $653,531 |
| | | |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Liabilities** | | |
| Deposits (Note 5): | | |
| Noninterest bearing deposits | $75,244 | $85,065 |
| Interest bearing deposits | 371,092 | 359,615 |
| Total deposits | 446,336 | 444,680 |
| | | |
| Federal Home Loan Bank borrowings (Note 9) | 128,000 | 132,000 |
| Junior subordinated debt owed to unconsolidated trust (Note 9) | 8,248 | 8,248 |
| Note Payable (Note 9) | 1,846 | 1,939 |
| Advances from borrowers for taxes and insurance | 2,451 | 2,367 |
| Accrued expenses and other liabilities | 3,064 | 2,833 |

| | | |
|---|---|---|
| **Total liabilities** | 589,945 | 592,067 |
| | | |
| **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; 3,959,903 and 3,957,377 shares issued; 3,958,733 and 3,956,207 shares outstanding; at June 30, 2016 and December 31, 2015, respectively | 40 | 40 |
| Additional paid-in capital | 106,876 | 106,568 |
| Accumulated deficit | (43,565 ) | (44,832 ) |
| Less: Treasury stock, at cost: 2016 and 2015, 1,170 shares | (160 ) | (160 ) |
| Accumulated other comprehensive loss | (81 ) | (152 ) |
| **Total shareholders' equity** | 63,110 | 61,464 |
| **Total liabilities and shareholders' equity** | $653,055 | $653,531 |

See Accompanying Notes to Consolidated Financial Statements.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| | *(in thousands, except per share amounts)* | | | |
| **Interest and Dividend Income** | | | | |
| Interest and fees on loans | $5,783 | $5,924 | $11,623 | $11,470 |
| Interest on investment securities | 132 | 119 | 274 | 235 |
| Dividends on investment securities | 90 | 60 | 176 | 117 |
| Other interest income | 28 | 17 | 69 | 46 |
| **Total interest and dividend income** | **6,033** | **6,120** | **12,142** | **11,868** |
| **Interest Expense** | | | | |
| Interest on deposits | 496 | 513 | 969 | 1,042 |
| Interest on Federal Home Loan Bank borrowings | 64 | 85 | 185 | 156 |
| Interest on subordinated debt | 83 | 73 | 165 | 144 |
| Interest on other borrowings | 8 | - | 16 | - |
| **Total interest expense** | **651** | **671** | **1,335** | **1,342** |
| **Net interest income** | **5,382** | **5,449** | **10,807** | **10,526** |
| **Provision for Loan Losses** | - | - | - | 250 |
| **Net interest income after provision for loan losses** | **5,382** | **5,449** | **10,807** | **10,276** |
| **Non-Interest Income** | | | | |
| Loan application, inspection & processing fees | 21 | 105 | 88 | 155 |
| Fees and service charges | 150 | 147 | 301 | 321 |
| Rental Income | 104 | 177 | 207 | 110 |
| Other income | 90 | 22 | 179 | 259 |
| **Total non-interest income** | **365** | **451** | **775** | **845** |
| **Non-Interest Expense** | | | | |
| Salaries and benefits | 2,615 | 2,395 | 5,165 | 4,739 |
| Occupancy and equipment expense | 750 | 909 | 1,530 | 1,864 |
| Data processing expense | 241 | 255 | 526 | 505 |
| Advertising and promotional expenses | 96 | 137 | 213 | 187 |
| Professional and other outside services | 364 | 391 | 773 | 960 |
| Loan administration and processing expenses | 8 | 7 | 16 | 29 |
| Regulatory assessments | 147 | 157 | 294 | 311 |
| Insurance expense | 56 | 83 | 111 | 164 |
| Material and communications | 115 | 106 | 208 | 187 |
| Other operating expenses | 344 | 319 | 664 | 544 |
| **Total non-interest expense** | **4,736** | **4,759** | **9,500** | **9,490** |
| **Income before income taxes** | **1,011** | **1,141** | **2,082** | **1,631** |
| **Expense for income taxes** | 397 | 452 | 815 | 653 |
| **Net income** | **$614** | **$689** | **$1,267** | **$978** |

| | | | | |
|---|---|---|---|---|
| **Basic and diluted income per share (1)** | $0.16 | $0.18 | $0.32 | $0.25 |

(1) All common stock data has been restated for a 1-for-10 reverse stock split which took effect on March 4, 2015.

See Accompanying Notes to Consolidated Financial Statements.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

| | Three Months Ended | | Six Months Ended | | Three Months Ended | |
|---|---|---|---|---|---|---|
| | June 30, | | June 30, | | March 31, | |
| *in thousands* | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| | *(in thousands)* | | | | | |
| Net income | $614 | $689 | $1,267 | $978 | 653 | 289 |
| Other comprehensive income (loss) : | | | | | | |
| Unrealized holding gains (losses) on securities | 59 | (45 ) | 115 | 227 | 56 | 267 |
| Income tax effect | (23 ) | 18 | (44 ) | (91 ) | (21 ) | (104) |
| Total other comprehensive income (loss) | 36 | (27 ) | 71 | 136 | 35 | 163 |
| **Total comprehensive income** | **$650** | **$662** | **$1,338** | **$1,114** | **$688** | **$452** |

See Accompanying Notes to Consolidated Financial Statements.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)**

| *(in thousands, except shares)* | Number of Shares | Common Stock | Additional Paid-In Capital | Accumulated Deficit | Treasury Stock | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2014 | 3,924,192 | $ 39 | $ 106,108 | $ (46,975) | $ (160) | $ (277) | $ 58,735 |
| Net Income | - | - | - | 978 | - | - | 978 |
| Unrealized holding gain on available for sale securities, net of taxes | - | - | - | - | - | 136 | 136 |
| Total comprehensive income | | - | - | - | - | | 1,114 |
| Share-based compensation expense | - | - | 227 | - | - | - | 227 |
| Issuance of restricted stock | 450 | - | - | - | - | - | - |
| Balance, June 30, 2015 | 3,924,642 | $ 39 | $ 106,335 | $ (45,997) | $ (160) | $ (141) | $ 60,076 |
| Balance December 31, 2015 | 3,956,207 | 40 | 106,568 | (44,832) | (160) | (152) | 61,464 |
| Net income | - | - | - | 1,267 | - | - | 1,267 |
| Unrealized holding gain on available for sale securities, net of taxes | - | - | - | - | - | 71 | 71 |
| Total comprehensive income | | - | - | - | - | - | 1,338 |
| Share-based compensation expense | - | - | 308 | - | - | - | 308 |
| Issuance of restricted stock | 2,526 | - | - | - | - | - | - |
| **Balance, June 30, 2016** | 3,958,733 | $ 40 | $ 106,876 | $ (43,565) | $ (160) | $ (81) | $ 63,110 |

See Accompanying Notes to Consolidated Financial Statements.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

| | Six Months Ended June 30, 2016 *(in thousands)* | | | 2015 | | |
|---|---|---|---|---|---|---|
| Cash Flows from Operating Activities: | | | | | | |
| Net income | $ | 1,267 | | $ | 978 | |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | | |
| Amortization (accretion) of investment premiums and discounts, net | | 35 | | | 107 | |
| Amortization and accretion of purchase loan premiums and discounts, net | | 8 | | | 158 | |
| Provision for loan losses | | - | | | 250 | |
| Depreciation and amortization | | 616 | | | 499 | |
| Share-based compensation | | 308 | | | 227 | |
| Deferred income taxes | | 646 | | | 619 | |
| Gain on acquisition of OREO | | (11 | ) | | - | |
| Changes in assets and liabilities: | | | | | | |
| (Increase) decrease in net deferred loan costs | | (8 | ) | | 232 | |
| Increase in accrued interest and dividends receivable | | (110 | ) | | (116 | ) |
| | | (341 | ) | | (44 | ) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Increase in other assets | | | | | | |
| Increase in accrued expenses and other liabilities | | 231 | | | 514 | |
| **Net cash provided by operating activities** | | **2,641** | | | **3,424** | |
| | | | | | | |
| Cash Flows from Investing Activities: | | | | | | |
| Principal repayments on available for sale securities | | 1,389 | | | 2,157 | |
| Proceeds from call of available for sale securities | | 5,031 | | | - | |
| (Purchases) redemptions of Federal Reserve Bank stock | | (48 | ) | | 38 | |
| Redemptions of Federal Home Loan Bank stock | | 711 | | | - | |
| Increase in loans | | (45,117 | ) | | (17,361 | ) |
| Purchase of bank premises and equipment, net | | (1,167 | ) | | (2,845 | ) |
| **Net cash used in investing activities** | | **(39,201** | ) | | **(18,011** | ) |
| | | | | | | |
| Cash Flows from Financing Activities: | | | | | | |
| Net increase in deposits | | 1,656 | | | 14,340 | |
| Decrease in FHLB borrowings | | (4,000 | ) | | (20,000 | ) |
| Repayment of Note Payable | | (93 | ) | | - | |
| Increase in advances from borrowers for taxes and insurance | | 84 | | | 82 | |
| **Net cash used in financing activities** | | **(2,353** | ) | | **(5,578** | ) |
| **Net decrease in cash and cash equivalents** | | **(38,913** | ) | | **(20,165** | ) |
| | | | | | | |
| Cash and Cash Equivalents: | | | | | | |
| Beginning | | 85,400 | | | 73,258 | |
| Ending | $ | 46,487 | | $ | 53,093 | |

| | | | | |
|---|---|---|---|---|
| Interest paid | $ | 1,173 | $ | 1,144 |
| Income taxes paid | $ | - | $ | 3 |
| Transfer of loans to other real estate owned | $ | 840 | $ | - |

See Accompanying Notes to Consolidated Financial Statements.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Note 1: Basis of Financial Statement Presentation**

The accompanying unaudited condensed consolidated financial statements of Patriot National Bancorp, Inc. (the "Company") and its wholly-owned subsidiaries including Patriot National Bank (the "Bank"), have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. 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 have been omitted. The accompanying unaudited condensed consolidated financial statements presented herein should be read in conjunction with the previously filed audited financial statements of the Company and notes thereto for the year ended December 31, 2015.

The Consolidated Balance Sheet at December 31, 2015 presented herein has been derived from the audited financial statements of Patriot National Bancorp, Inc. (the "Company") at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

Effective June 30, 2016, the Company has reclassified loans secured by 1-4 Family Non-owner occupied real estate to "Residential" from the "Commercial Real Estate" classification. Amounts presented for prior periods have been reclassified for consistency with the current period. See Note 3: Loans Receivable and Allowance for Loan Losses for additional information. Certain additional other prior period amounts have been reclassified to conform to current year presentation.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results of operations that may be expected for the remainder of 2016.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Note 2: Investment Securities**

The amortized cost, gross unrealized gains and losses and approximate fair values of available-for-sale securities at June 30, 2016 and December 31, 2015 are as follows:

| *(in thousands)* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **June 30, 2016:** | | | | |
| U. S. Government agency mortgage-backed securities | $ 12,170 | $ 21 | $ (52 ) | $ 12,139 |
| Corporate bonds | 9,000 | - | (102 ) | 8,898 |
| Subordinated Notes | 2,000 | - | - | 2,000 |
| | $ 23,170 | $ 21 | $ (154 ) | $ 23,037 |
| December 31, 2015: | | | | |
| U. S. Government agency bonds | $ 5,000 | $ - | $ (46 ) | $ 4,954 |
| U. S. Government agency mortgage-backed securities | 13,625 | - | (212 ) | 13,413 |
| Corporate bonds | 9,000 | 71 | (61 ) | 9,010 |
| Subordinated Notes | 2,000 | - | - | 2,000 |
| | $ 29,625 | $ 71 | $ (319 ) | $ 29,377 |

The following table presents the gross unrealized loss and fair value of the Company's available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at June 30, 2016 and December 31, 2015:

| | **Less Than 12 Months** | | **12 Months or More** | | **Total** | |
|---|---|---|---|---|---|---|
| *(in thousands)* | **Fair** | **Unrealized** | **Fair** | **Unrealized** | **Fair** | **Unrealized** |

| | Value | Loss | Value | Loss | Value | Loss |
|---|---|---|---|---|---|---|
| **June 30, 2016:** | | | | | | |
| U. S. Government agency mortgage - backed securities | $- | $ - | $7,136 | $ (52 ) | $7,136 | $ (52 ) |
| Corporate bonds | 2,985 | (15 ) | 5,913 | (87 ) | 8,898 | (102 ) |
| Totals | $2,985 | $ (15 ) | $13,049 | $ (139 ) | $16,034 | $ (154 ) |
| **December 31, 2015:** | | | | | | |
| U. S. Government agency bonds | $4,954 | $ (46 ) | $- | $ - | $4,954 | $ (46 ) |
| U. S. Government agency mortgage - backed securities | 2,863 | (42 ) | 10,550 | (170 ) | 13,413 | (212 ) |
| Corporate bonds | - | - | 5,939 | (61 ) | 5,939 | (61 ) |
| Totals | $7,817 | $ (88 ) | $16,489 | $ (231 ) | $24,306 | $ (319 ) |

At June 30, 2016, six of ten available-for-sale securities had unrealized losses with an average depreciation of 0.7% from the total amortized cost. At December 31, 2015, nine out of eleven available-for-sale securities had unrealized losses with an aggregate depreciation of 1.3% from the total amortized cost.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The Company performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, management's plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management believes that none of the unrealized losses on available-for-sale securities noted above are other than temporary due to the fact that they relate to market interest rate changes on U.S. Government agency debt, corporate debt and mortgage-backed securities issued by U.S. Government agencies. Management considers the issuers of the securities to be financially sound, the corporate bonds are investment grade and the Company expects to receive all contractual principal and interest related to these investments. Because the Company does not intend to sell the investments, and it will not be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2016.

The amortized cost and fair value of available-for-sale debt securities at June 30, 2016 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be prepaid without any penalties. The actual maturities will also differ from contractual maturities because issuers of certain securities retain early call or prepayment rights.

*(in thousands)*

| | Amortized Cost | Fair Value |
|---|---|---|
| Maturity: | | |
| Due after five years through ten years | $ 11,000 | $ 10,898 |
| U.S. Government agency mortgage-backed securities | 12,170 | 12,139 |
| Total | $ 23,170 | $ 23,037 |

At June 30, 2016 and December 31, 2015, securities of $4.9 and $5.5 million, respectively, were pledged with the Federal Reserve Bank of New York primarily to secure municipal deposits.

There were no sales of available-for-sale securities in during the six-month periods ended June 30, 2016 or June 30, 2015.

**Note 3: Loans Receivable and Allowance for Loan Losses**

Loans that the Company has the intent and ability to hold for the foreseeable future or until maturity generally are reported at their outstanding unpaid principal balances adjusted for unearned income, the allowance for loan losses, and any unamortized deferred fees or costs.

Interest income is accrued based on the unpaid principal balance. Loan application fees are non interest income while, other certain direct origination costs, are deferred and amortized as a level yield adjustment over the respective term of the loan and reported in interest income.

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 nonaccrual status or charged off at an earlier date if collection of principal or interest is considered doubtful.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

All interest accrued but not collected for loans that are placed on nonaccrual status or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying for return to accrual status. Upon receipt of cash, the cash received is first applied to satisfy principal and then applied to interest unless the loan is in a cure period and Management believes there will be a loss. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A summary of the Company's loan portfolio at June 30, 2016 and December 31, 2015 is as follows:

| *(in thousands)* | June 30, | December 31, | | |
|---|---|---|---|---|
| | 2016 | 2015 | Inc (Dec) | Inc/(Dec) % |
| Commercial and Industrial | $71,658 | $59,752 | $11,906 | 19.9 % |
| Commercial Real Estate | 270,003 | 245,828 | 24,175 | 9.8 % |
| Construction | 26,094 | 15,551 | 10,543 | 67.8 % |
| Construction to permanent- CRE | 4,229 | 4,880 | (651) | (13.3) |
| Residential | 104,746 | 110,837 | (6,091) | (5.5) |
| Consumer/Other | 51,924 | 47,521 | 4,403 | 9.3 |
| Total Loans | 528,654 | 484,369 | 44,285 | 9.1 |
| Allowance for loan losses | (5,250) | (5,242) | (8) | 0.2 |
| Loans receivable, net | $523,404 | $479,127 | $44,277 | 9.2 % |

Amounts presented at December 31, 2015 include $28.2 million of loans secured by 1-4 Family Non-owner Occupied real estate in the Residential category, reclassified from Commercial Real Estate for consistency with the June 30, 2016 presentation. Net unamortized purchase loan premiums aggregated $0.8 million and $0.9 million as of June 30, 2016 and December 31, 2015, respectively. Net deferred loan costs aggregated $0.3 million as of June 30, 2016 and December 31, 2015.

The Company'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. The Company originates commercial real estate loans, commercial business loans, and a variety of consumer loans. In addition, the Company previously had originated loans on residential real estate. All residential and commercial mortgage 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.

The Company has established credit policies applicable to each type of lending activity in which it engages, by which it evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral for commercial real estate at the date of the credit extension depending on the Company's evaluation of the borrowers' creditworthiness and type of collateral and up to 80% for multi–family real estate. In the case of construction loans, the maximum loan-to-value is 75% of the “as completed” appraised value. The appraised value of collateral is monitored on an ongoing basis and additional collateral is requested when warranted. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

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

*Commercial and Industrial Loans* – The Company's commercial and industrial loan portfolio consists primarily of commercial business loans and lines of credit to businesses and professionals. These loans are usually made to finance accounts receivable, the purchase of inventory or new or used equipment and 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 this type of loan, the Company primarily looks to the borrower's cash flow as the source of repayment with collateral and personal guarantees, where obtained, as a secondary source. Payments on such loans are often dependent upon the successful operation of the underlying business involved. Repayment of such loans may therefore be negatively impacted by adverse changes in economic conditions, management's inability to effectively manage the business, claims of others against the borrower's assets which may take priority over the Company's claims against assets, death or disability of the borrower or loss of markets for the borrower's products or services.

*Commercial Real Estate Loans* – In underwriting commercial real estate loans, the Company 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 or should there be a substantial decline in the value of the property securing the loan or decline in general economic conditions. Where the owner occupies the property, the Company also evaluates the business ability to repay the loan on a timely basis. In addition, the Company may require personal guarantees, lease assignments and/or the guarantee of the operating company when the property is owner occupied.

*Construction Loans* – Construction loans are short-term loans (generally up to eighteen months) secured by land for both residential and commercial development. The loans are generally made for acquisition and improvements. Funds are disbursed as phases of construction are completed. Included in this category are loans to construct single family homes where no contract of sale exists. These loans are based upon the experience and the financial strength of the builder, the type and location of the property and other factors. Construction loans are generally personally guaranteed by the principal(s). Repayment of such loans may be negatively impacted by the builders' inability to complete construction, by a downturn in the new construction market, by a significant increase in interest rates or by decline in general economic conditions.

*Construction to Perm-CRE* – One time close of a construction facility converting to an amortizing mortgage loan typically upon an event which would include a certificate of occupancy as well as stabilization, defined as cash flow sufficient to support a pre-defined minimum debt coverage ratio, as well as other conditions and covenants particular to the loan type. The construction facility would typically carry a floating rate, then upon conversion to amortization would reset at a predetermined spread over FHLB with a minimum interest rate.

*Residential Real Estate Loans* – Home equity loans secured by real estate properties are offered by the Company. The Company no longer offers residential mortgages, having exited this business in 2013. 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 decline in general economic conditions.

*Consumer/ Other Loans* – The Company also offers installment loans, credit cards, and consumer overdraft and reserve lines of credit to individuals. Repayments of such loans are often 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.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

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

The following table sets forth activity in our allowance for loan losses, by loan type, for the three and six months ended June 30, 2016. The following table also details the amount of loans receivable that are evaluated individually and collectively for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment, as of June 30, 2016.

*(in thousands)*

| **Three months ended June 30, 2016** | **Commercial and Industrial** | **Commercial Real Estate** | **Construction** | **Construction to Permanent** | **Residential** | **Consumer/ Other** | **Unallocated** | **Total** |
|---|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | $ 1,083 | $ 1,943 | $ 650 | $ 121 | $ 624 | $ 609 | $ 217 | $ 5,247 |
| Charge-offs | - | - | - | - | - | (1 ) | - | (1 ) |
| Recoveries | 3 | - | - | - | 1 | - | - | 4 |
| Provision | 355 | 352 | (481 ) | 24 | 22 | (77 ) | (195 ) | - |
| Ending Balance | $ 1,441 | $ 2,295 | $ 169 | $ 145 | $ 647 | $ 531 | $ 22 | $ 5,250 |
| | | | | | | | | |
| **Six months ended June 30, 2016** | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | $ 1,027 | $ 1,970 | $ 486 | $ 123 | $ 740 | $ 677 | $ 219 | $ 5,242 |
| Charge-offs | - | - | - | - | (4 ) | (2 ) | - | (6 ) |
| Recoveries | 12 | - | - | - | 1 | 1 | - | 14 |
| Provision | 402 | 325 | (317 ) | 22 | (90 ) | (145 ) | (197 ) | - |
| Ending Balance | $ 1,441 | $ 2,295 | $ 169 | $ 145 | $ 647 | $ 531 | $ 22 | $ 5,250 |
| | | | | | | | | |
| Ending balance: individually evaluated for impairment | 1,018 | - | - | - | - | 2 | - | $ 1,020 |
| | 423 | 2,295 | 169 | 145 | 647 | 529 | 22 | $ 4,230 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Ending balance: collectively evaluated for impairment | | | | | | | | |
| Total allowance for loan losses | $ 1,441 | $ 2,295 | $ 169 | $ 145 | $ 647 | $ 531 | $ 22 | $ 5,250 |
| **As of June 30, 2016** | | | | | | | | |
| Total loans ending balance | $ 71,658 | $ 270,003 | $ 26,094 | $ 4,229 | $ 104,746 | $ 51,924 | $ - | $ 528,654 |
| Ending balance: individually evaluated for impairment | $ 3,272 | $ 6,526 | $ - | $ - | $ 4,515 | $ 546 | $ - | $ 14,859 |
| Ending balance: collectively evaluated for impairment | $ 68,386 | $ 263,477 | $ 26,094 | $ 4,229 | $ 100,231 | $ 51,378 | $ - | $ 513,795 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following table sets forth activity in our allowance for loan losses, by loan type, for the three and six months ended June 30, 2015. The following table also details the amount of loans receivable that are evaluated individually and collectively for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment, as of December 31, 2015.

*(in thousands)*

| **Three months ended June 30, 2015** | **Commercial and Industrial** | **Commercial Real Estate** | **Construction** | **Construction to Permanent** | **Residential** | **Consumer** | **Unallocated** | **Total** |
|---|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | $ 1,297 | $ 2,024 | $ 222 | $ 191 | $ 730 | $ 711 | $ 18 | $ 5,193 |
| Charge-offs | - | - | - | - | - | - | - | - |
| Recoveries | 14 | - | - | - | - | 1 | - | 15 |
| Provision | (329) | 121 | 53 | (41) | 102 | 14 | 80 | - |
| Ending Balance | $ 982 | $ 2,145 | $ 275 | $ 150 | $ 832 | $ 726 | $ 98 | $ 5,208 |
| **Six Months Ended June 30, 2015** | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Beginning Balance | $ 1,918 | $ 1,419 | $ 63 | $ 215 | $ 831 | $ 478 | $ - | $ 4,924 |
| Charge-offs | - | - | - | - | (3) | (7) | - | (10) |
| Recoveries | 30 | - | - | 5 | - | 9 | - | 44 |
| Provision | (966) | 726 | 212 | (70) | 4 | 246 | 98 | 250 |
| Ending Balance | $ 982 | $ 2,145 | $ 275 | $ 150 | $ 832 | $ 726 | $ 98 | $ 5,208 |
| **As of December 31, 2015** | | | | | | | | |
| Ending balance: individually evaluated for impairment | - | - | - | - | - | 3 | - | 3 |
| Ending balance: collectively evaluated for impairment | 1,027 | 1,970 | 486 | 123 | 740 | 674 | 219 | 5,239 |
| Total allowance for loan losses | $ 1,027 | $ 1,970 | $ 486 | $ 123 | $ 740 | $ 677 | $ 219 | $ 5,242 |
| | $ 59,752 | $ 245,828 | $ 15,551 | $ 4,880 | $ 110,837 | $ 47,521 | $ - | $ 484,369 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total loans ending balance | | | | | | | | |
| Ending balance: individually evaluated for impairment | - | 7,745 | - | - | 4,556 | 550 | - | 12,851 |
| Ending balance: collectively evaluated for impairment | $ 59,752 | $ 238,083 | $ 15,551 | $ 4,880 | $ 106,281 | $ 46,971 | $ - | $ 471,518 |

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

The Company has a risk rating system as part of the risk assessment of its loan portfolio. The Company's lending officers are required to assign a risk rating to each loan in their portfolio at origination, which is ratified or modified by the Loan Committee to which the loan is submitted for approval. When the lender learns of important financial developments, the risk rating is reviewed accordingly, and adjusted if necessary. Similarly, the Loan Committee can adjust a risk rating. The Company employs a loan officer whose responsibility is to independently review the ratings annually for all commercial credits over $250,000.

The Company uses an independent third party loan reviewer who performs quarterly reviews of a sample of loans, validating the Company's risk ratings assigned to such loans. Any upgrades or downgrades to classified loans must be approved by the Management Loan Committee.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

When assigning a risk rating to a loan, management utilizes the Company'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:

An asset is considered "substandard" if it is not adequately protected by the current net worth and paying capacity of the obligor or the collateral pledged, if any. 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 the deficiencies are not corrected.

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

Charge–off generally commences after the loan is classified "doubtful" to reduce the loan to its recoverable balance. If the account is classified as "loss", the full balance is charged off regardless of the potential recovery from the sale of the collateral. That amount is recognized as a recovery after the collateral is sold.

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

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The unpaid principal balances of loans on nonaccrual status and considered impaired were $4.8 million at June 30, 2016 and $1.6 million at December 31, 2015.

The $4.8 million of non-accrual loans at June 30, 2016 is comprised of five relationships, for which a specific reserve of $0.3 million has been established. The non-accrual increase of $3.2 million from December 31, 2015 is related to a single commercial loan and is not indicative of a credit quality trend within the portfolio. As this relationship moved to non-accrual status, the loan loss allocation tied to other loans that were no longer considered criticized were then reallocated to this new non-accrual relationship.

If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded the following amounts of additional income:

| *(dollars in thousands)* | |
|---|---|
| Three months ended June 30, 2016 | $58 |
| Six months ended June 30, 2016 | $196 |
| Three months ended June 30, 2015 | $4 |
| Six months ended June 30, 2015 | $8 |

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following table sets forth the detail, and delinquency status, of non-accrual loans at June 30, 2016:

*(in thousands)*

| **2016** | **31-60 Days Past Due** | **61-90 Days Past Due** | **Greater Than 90 Days** | **Total Past Due** | **Current** | **Total Non-Accrual Loans** |
|---|---|---|---|---|---|---|
| Commercial & Industrial | | | | | | |
| Pass | $ - | $ - | $ - | $ - | $ - | $ - |
| Substandard | - | - | 3,208 | 3,208 | - | 3,208 |
| Total Commercial & Industrial | $ - | $ - | $ 3,208 | $ 3,208 | $ - | $ 3,208 |
| Commercial Real Estate | | | | | | |
| Substandard | $ - | $ - | | $ - | $ - | $ - |
| Total Commercial Real Estate | $ - | $ - | $ - | $ - | $ - | $ - |
| Residential Real Estate | | | | | | |
| Substandard | $ - | $ - | $ 1,590 | $ 1,590 | $ - | $ 1,590 |
| Total Residential Real Estate | $ - | $ - | $ 1,590 | $ 1,590 | $ - | $ 1,590 |
| Consumer | | | | | | |
| Substandard | $ - | $ - | $ 2 | $ 2 | $ - | $ 2 |
| Total Consumer | $ - | $ - | $ 2 | $ 2 | $ - | $ 2 |
| **Total** | $ - | $ - | $ 4,800 | $ 4,800 | $ - | $ 4,800 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following table sets forth the detail, and delinquency status, of non-accrual loans at December 31, 2015:

*(in thousands)*

| **2015** | **31-60 Days Past Due** | **61-90 Days Past Due** | **Greater Than 90 Days** | **Total Past Due** | **Current** | **Total Non-Accrual Loans** |
|---|---|---|---|---|---|---|
| Commercial & Industrial | | | | | | |
| Pass | $ - | $ - | $ - | $ - | $ - | $ - |
| Substandard | - | - | - | - | - | - |
| Total Commercial & Industrial | $ - | $ - | $ - | $ - | $ - | $ - |
| Commercial Real Estate | | | | | | |
| Substandard | $ - | $ - | $ - | $ - | $ - | $ - |
| Total Commercial Real Estate | $ - | $ - | $ - | $ - | $ - | $ - |
| Residential Real Estate | | | | | | |
| Substandard | $ - | $ - | $ 1,590 | $ 1,590 | $ - | $ 1,590 |
| Total Residential Real Estate | $ - | $ - | $ 1,590 | $ 1,590 | $ - | $ 1,590 |
| Consumer/ Other | | | | | | |
| Substandard | $ - | $ - | $ 3 | $ 3 | $ - | $ 3 |
| Total Consumer / Other | $ - | $ - | $ 3 | $ 3 | $ - | $ 3 |
| **Total** | $ - | $ - | $ 1,593 | $ 1,593 | $ - | $ 1,593 |

Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, and remain on non-accrual status until they are brought current, have at least six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accruing status.

At June 30, 2016, five loans were on non-accrual status totaling $4.8 million. For these five loans a specific reserve of $1.0 million has been established.

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following table sets forth the detail and delinquency status of loans receivable, by performing and non-performing loans at June 30, 2016.

| *(in thousands)* | **Performing (Accruing) Loans** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **2016** | **31-60 Days Past Due** | **61-90 Days Past Due** | **Greater Than 90 Days** | **Total Past Due** | **Current** | **Total Performing Loans** | **Total Non-Accrual Loans** | **Total Loans** |
| Commercial & Industrial | | | | | | | | |
| Pass | $39 | $ - | $ - | $39 | $68,406 | $ 68,445 | $ - | $68,445 |
| Special Mention | - | - | - | - | - | $ - | - | - |
| Substandard | - | - | - | - | 5 | $ 5 | 3,208 | 3,213 |
| Total Commercial & Industrial | $39 | $ - | $ - | $39 | $68,411 | $ 68,450 | $ 3,208 | $71,658 |
| Commercial Real Estate | | | | | | | | |
| Pass | $934 | $ - | $ - | $934 | $262,958 | $ 263,892 | $ - | $263,892 |
| Special Mention | - | - | - | - | 5,226 | $ 5,226 | - | 5,226 |
| Substandard | - | - | - | - | 885 | $ 885 | - | 885 |
| Total Commercial Real Estate | $934 | $ - | $ - | $934 | $269,069 | $ 270,003 | $ - | $270,003 |
| Construction | | | | | | | | |
| Pass | $- | $ - | $ - | $- | $26,094 | $ 26,094 | $ - | $26,094 |
| Total Construction | $- | $ - | $ - | $- | $26,094 | $ 26,094 | $ - | $26,094 |
| Construction to Permanent | | | | | | | | |
| Pass | $- | $ - | $ - | $- | $4,229 | $ 4,229 | $ - | $4,229 |
| Total Construction to Permanent | $- | $ - | $ - | $- | $4,229 | $ 4,229 | $ - | $4,229 |
| Residential Real Estate | | | | | | | | |
| Pass | $388 | $ 10 | $ 1,485 | $1,883 | $101,273 | $ 103,156 | $ - | $103,156 |
| Substandard | - | - | - | - | - | $ - | 1,590 | 1,590 |
| Total Residential Real Estate | $388 | $ 10 | $ 1,485 | $1,883 | $101,273 | $ 103,156 | $ 1,590 | $104,746 |
| Consumer/ Other | | | | | | | | |
| Pass | $402 | $ - | $ 6 | $408 | $51,514 | $ 51,922 | $ - | $51,922 |
| Substandard | - | - | - | - | - | $ - | 2 | $2 |
| Total Consumer/ Other | $402 | $ - | $ 6 | $408 | $51,514 | $ 51,922 | $ 2 | $51,924 |
| Total | | | | | | | | |
| Pass | $1,763 | $ 10 | $ 1,491 | $3,264 | $514,474 | $ 517,738 | $ - | $517,738 |
| Special Mention | - | - | - | - | 5,226 | $ 5,226 | - | 5,226 |
| Substandard | - | - | - | - | 890 | $ 890 | 4,800 | 5,690 |
| **Grand Total** | **$1,763** | **$ 10** | **$ 1,491** | **$3,264** | **$520,590** | **$ 523,854** | **$ 4,800** | **$528,654** |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following table sets forth the detail and delinquency status of loans receivable, by performing and non-performing loans at December 31, 2015.

| *(in thousands)* | **Performing (Accruing) Loans** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **2015** | **31-60 Days Past Due** | **61-90 Days Past Due** | **Greater Than 90 Days** | **Total Past Due** | **Current** | **Total Performing Loans** | **Total Non-Accrual Loans** | **Total Loans** |
| Commercial & Industrial | | | | | | | | |
| Pass | $ 43 | $ 605 | $ 520 | $ 1,168 | $ 55,600 | $ 56,768 | $ - | $ 56,768 |
| Special Mention | - | - | - | - | - | - | - | - |
| Substandard | 2,977 | - | - | 2,977 | 7 | 2,984 | - | 2,984 |
| Total Commercial & Industrial | $ 3,020 | $ 605 | $ 520 | $ 4,145 | $ 55,607 | $ 59,752 | $ - | $ 59,752 |
| Commercial Real Estate | | | | | | | | |
| Pass | $ - | $ - | $ - | $ - | $ 237,996 | $ 237,996 | $ - | $ 237,996 |
| Special Mention | - | - | - | - | 5,322 | 5,322 | - | 5,322 |
| Substandard | 840 | - | - | 840 | 1,670 | 2,510 | - | 2,510 |
| Total Commercial Real Estate | $ 840 | $ - | $ - | $ 840 | $ 244,988 | $ 245,828 | $ - | $ 245,828 |
| Construction | | | | | | | | |
| Pass | $ - | $ - | $ - | $ - | $ 15,551 | $ 15,551 | $ - | $ 15,551 |
| Total Construction | $ - | $ - | $ - | $ - | $ 15,551 | $ 15,551 | $ - | $ 15,551 |
| Construction to Permanent | | | | | | | | |
| Pass | $ - | $ - | $ - | $ - | $ 4,880 | $ 4,880 | $ - | $ 4,880 |
| Special Mention | - | - | - | - | - | - | - | - |
| Substandard | - | - | - | - | - | - | - | - |
| Total Construction to Permanent | $ - | $ - | $ - | $ - | $ 4,880 | $ 4,880 | $ - | $ 4,880 |
| Residential Real Estate | | | | | | | | |
| Pass | $ 154 | $ 87 | $ 1,517 | $ 1,758 | $ 107,489 | $ 109,247 | $ - | $ 109,247 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Special Mention | - | - | - | - | - | - | - | - |
| Substandard | - | - | - | - | - | - | 1,590 | 1,590 |
| Total Residential Real Estate | $ 154 | $ 87 | $ 1,517 | $ 1,758 | $ 107,489 | $ 109,247 | $ 1,590 | $ 110,837 |
| Consumer/ Other | | | | | | | | |
| Pass | $ 309 | $ 2 | $ 9 | $ 320 | $ 47,198 | $ 47,518 | $ - | $ 47,518 |
| Special Mention | - | - | - | - | - | - | - | - |
| Substandard | - | - | - | - | - | - | 3 | 3 |
| Total Consumer/ Other | $ 309 | $ 2 | $ 9 | $ 320 | $ 47,198 | $ 47,518 | $ 3 | $ 47,521 |
| Total | | | | | | | | |
| Pass | $ 506 | $ 694 | $ 2,046 | $ 3,246 | $ 468,714 | $ 471,960 | - | $ 471,960 |
| Special Mention | - | - | - | - | 5,322 | 5,322 | - | 5,322 |
| Substandard | 3,817 | - | - | 3,817 | 1,677 | 5,494 | 1,593 | 7,087 |
| **Grand Total** | **$ 4,323** | **$ 694** | **$ 2,046** | **$ 7,063** | **$ 475,713** | **$ 482,776** | **$ 1,593** | **$ 484,369** |

December 31, 2015 loan balances have been reclassified to be consistent with the June 30, 2016 presentation.

**Impaired Loans**

Impaired loans consist of non-accrual loans, Troubled Debt Restructurings (“TDRs”), and loans previously classified as TDRs that have been upgraded. As of June 30, 2016, the Company’s impairment analysis resulted in identification of $14.8 million of impaired loans, for which specific reserves of $1.0 million were required at June 30, 2016, compared to $12.9 million of impaired loans at December 31, 2015, for which specific reserves of $3,000 were required. Loans that did not require specific reserves have sufficient collateral values, less costs to sell, supporting the carrying balances of the loans. In some cases, there may be no specific reserves because the Company already charged off the specific impairment. Once a borrower is in default, the Company is under no obligation to advance additional funds on unused commitments.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Troubled Debt Restructurings**

On a case-by-case basis, the Company 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 troubled debt restructured loan.

For the three and six months ended June 30, 2016 and 2015, there were no loans modified as a "troubled debt restructuring". At June 30, 2016 and December 31, 2015, there were no commitments to advance additional funds under troubled debt restructured loans.

Substantially all of our troubled debt restructured 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 these two methods. These modifications rarely result in the forgiveness of principal or accrued interest. In addition, we frequently obtain additional collateral or guarantor support when modifying commercial loans. If the borrower had demonstrated performance under the previous terms and our underwriting process shows the borrower has the capacity to continue to perform under the restructured terms, the loan will continue to accrue interest. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible. All troubled debt restructurings are classified as impaired loans, which are individually evaluated for impairment.

The following table summarizes impaired loans by loan portfolio class as of June 30, 2016:

| *(in thousands)* | **Recorded Investment** | **Principal Balance** | **Related Allowance** |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial & Industrial | $ 295 | $ 327 | $ - |

| | | | |
|---|---|---|---|
| Commercial Real Estate | 6,526 | 7,031 | - |
| Construction | - | 287 | - |
| Residential | 4,515 | 5,518 | - |
| Consumer/ Other | 544 | 629 | |
| Total: | $ 11,880 | $ 13,792 | $ - |
| | | | |
| With an allowance recorded: | | | |
| Commercial & Industrial | $ 2,977 | $ 2,977 | $ 1,018 |
| Commercial Real Estate | - | - | - |
| Construction | - | - | - |
| Residential | - | - | - |
| Consumer/ Other | 2 | 2 | 2 |
| Total: | $ 2,979 | $ 2,979 | $ 1,020 |
| | | | |
| Commercial & Industrial | $ 3,272 | $ 3,304 | $ 1,018 |
| Commercial Real Estate | 6,526 | 7,031 | - |
| Construction | - | 287 | - |
| Residential | 4,515 | 5,518 | - |
| Consumer/ Other | 546 | 631 | 2 |
| Total: | $ 14,859 | $ 16,771 | $ 1,020 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following table summarizes impaired loans by loan portfolio class as of December 31, 2015:

| *(in thousands)* | **Recorded Investment** | **Principal Balance** | **Related Allowance** |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial & Industrial | $ - | $ 96 | $ - |
| Commercial Real Estate | 7,745 | 8,259 | - |
| Construction | - | 287 | - |
| Construction to Permanent | - | - | - |
| Residential | 4,556 | 5,559 | - |
| Consumer/ Other | 547 | 633 | - |
| Total: | $ 12,848 | $ 14,834 | $ - |
| | | | |
| With an allowance recorded: | | | |
| Consumer | 3 | 3 | 3 |
| Total: | $ 3 | $ 3 | $ 3 |
| | | | |
| Commercial & Industrial | $ - | $ 96 | $ - |
| Commercial Real Estate | 7,745 | 8,259 | - |
| Construction | - | 287 | - |
| Residential | 4,556 | 5,559 | - |
| Consumer/ Other | 550 | 636 | 3 |
| Total: | $ 12,851 | $ 14,837 | $ 3 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following tables summarize additional information regarding impaired loans for the three and six months ended June 30, 2016 and 2015.

| | Three Months Ended June 30, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| *(in thousands)* | **Average Recorded Investment** | **Interest Income Recognized** | **Average Recorded Investment** | **Interest Income Recognized** |
| With no related allowance recorded: | | | | |
| Commercial & Industrial | $116 | $ - | $- | $ - |
| Commercial Real Estate | 7,524 | 79 | 8,025 | 94 |
| Residential | 4,525 | 31 | 3,392 | 32 |
| Consumer/ Other | 545 | 5 | 551 | 5 |
| Total: | $12,710 | $ 115 | $11,968 | $ 131 |
| With an allowance recorded: | | | | |
| Commercial & Industrial | $2,977 | $ - | $- | $ - |
| Commercial Real Estate | - | - | - | - |
| Residential | - | - | - | - |
| Consumer/ Other | 2 | - | - | - |
| Total: | $2,979 | $ - | $- | $ - |
| Commercial & Industrial | $3,093 | $ - | $- | $ - |
| Commercial Real Estate | 7,524 | 79 | 8,025 | 94 |
| Residential | 4,525 | 31 | 3,392 | 32 |
| Consumer/ Other | 547 | 5 | 551 | 5 |
| Total: | $15,688 | $ 115 | $11,968 | $ 131 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

| | Six Months Ended June 30, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| *(in thousands)* | **Average Recorded Investment** | **Interest Income Recognized** | **Average Recorded Investment** | **Interest Income Recognized** |
| With no related allowance recorded: | | | | |
| Commercial & Industrial | $148 | $ - | $1 | $ - |
| Commercial Real Estate | 7,597 | 159 | 8,160 | 188 |
| Residential | 4,535 | 62 | 3,459 | 63 |
| Consumer/ Other | 546 | 9 | 552 | 9 |
| Total: | $12,826 | $ 230 | $12,172 | $ 260 |
| With an allowance recorded: | | | | |
| Commercial & Industrial | $1,914 | $ - | $- | $ - |
| Commercial Real Estate | - | - | - | - |
| Residential | - | - | - | - |
| Consumer/ Other | 2 | - | 1 | - |
| Total: | $1,916 | $ - | $1 | $ - |
| Commercial & Industrial | $2,062 | $ - | $1 | $ - |
| Commercial Real Estate | 7,597 | 159 | 8,160 | 188 |
| Residential | 4,535 | 62 | 3,459 | 63 |
| Consumer/ Other | 548 | 9 | 553 | 9 |
| Total: | $14,742 | $ 230 | $12,173 | $ 260 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Note 4: Other Real Estate Owned**

At June 30, 2016, Other Real Estate Owned ("OREO") consisted of a single property which consists of raw land and is suitable for multi-use construction. The following table presents a summary of OREO activity for the six months ended June 30, 2016:

| *(in thousands)* | **OREO** |
|---|---|
| Balance at December 31, 2015 | $ - |
| Transfers from loans | 840 |
| Gain recognized in acquisition | 11 |
| Balance at June 30, 2016 | $ 851 |

The recognized gain represents the amount by which fair market value of the property, net of estimated liquidation costs, exceeded the remaining loan balance as of the date possession was taken of the property.

As of and for the six months ended June 30, 2015, there was no OREO activity.

**Note 5: Deposits**

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

| *(in thousands)* | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Non-interest bearing | $75,244 | $85,065 |

| | | |
|---|---|---|
| Interest bearing | | |
| NOW | 28,745 | 28,684 |
| Savings | 124,196 | 106,291 |
| Money market | 18,486 | 19,522 |
| Time certificates, less than $250,000 | 125,668 | 139,455 |
| Time certificates, $250,000 or more | 16,812 | 17,509 |
| Brokered Deposits | 57,185 | 48,154 |
| Total interest bearing | 371,092 | 359,615 |
| Total Deposits | $446,336 | $444,680 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Note 6: 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. Grants under the Plan may take the form of stock options, restricted stock and phantom stock units. Up to three million shares of the Company’s common stock and one million phantom stock units may be issued under the Plan, subject to certain limitations. As of June 30, 2016, 2,819,216 shares of common stock and one million phantom stock units are available for issuance under the Plan.

Restricted stock grants are available to directors and employees and generally vest in annual installments over a three, four or five year period from the date of grant, as determined by the Compensation Committee of the Company’s Board of Directors. Vesting may be accelerated under certain circumstances. The Company expenses the grant date fair value of all share-based compensation over the requisite vesting periods on a prorated straight-line basis. During the three and six months ended June 30, 2016, the Company recorded $0.2 million and $0.3 million of total stock-based compensation, respectively. During the three and six months ended June 30, 2015, the Company recorded $0.1 million and $0.2 million of total stock-based compensation, respectively.

During the six months ended June 30, 2016, the Company issued 5,884 shares of restricted stock to directors and 52,200 shares of restricted stock to employees under the 2012 Stock Plan.

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

| **<u>Three months ended June 30, 2016:</u>** | **Number of Shares Awarded** | **Weighted Average Grant Date Fair Value** |
|---|---|---|
| Non-vested at March 31, 2016 | 113,938 | $ 14.06 |

| | | |
|---|---|---|
| Granted | - | - |
| Vested | (2,526) | 14.72 |
| Forfeited | (4,213) | 11.31 |
| Non-vested at June 30, 2016 | 107,199 | $ 14.16 |

**Six months ended June 30, 2016:**

| | | |
|---|---|---|
| Non-vested at December 31, 2015 | 55,854 | $ 12.83 |
| Granted | 58,084 | 15.25 |
| Vested | (2,526) | 14.72 |
| Forfeited | (4,213) | 11.31 |
| Non-vested at June 30, 2016 | 107,199 | $ 14.16 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The following is a summary of the status of the Company's restricted shares as of June 30, 2015, and changes therein during periods indicated.

| **Three months ended June 30, 2015:** | **Number of Shares Awarded** | **Weighted Average Grant Date Fair Value** |
|---|---|---|
| Non-vested at March 31, 2015 | 81,923 | $12.93 |
| Granted | - | - |
| Vested | (225) | 17.25 |
| Non-vested at June 30, 2015 | 81,698 | $12.92 |
| | | |
| **Six months ended June 30, 2015:** | | |
| Non-vested at December 31, 2014 | 79,208 | $12.79 |
| Granted | 2,940 | 17.00 |
| Vested | (450) | 17.25 |
| Non-vested at June 30, 2015 | 81,698 | $12.92 |

Expected future stock award expense related to the non-vested restricted awards as of June 30, 2016, is $1.3 million, which is expected to be recognized over an average period of 2.56 years.

The Company had no outstanding stock options at June 30, 2016.

The Company offers a 401K retirement plan (the "401K"), which provides for tax-deferred salary deductions for eligible employees. Employees may choose to make voluntary contributions to the 401K, limited to an annual maximum amount as set forth periodically by the Internal Revenue Service. The Company matches 50% of such contributions, up to a maximum of six percent. During the three and six months ended June 30, 2016, compensation expense under the Plan aggregated $0.04 million and $0.08 million, respectively. During the three and six months ended June 30, 2015, compensation expense under the Plan aggregated $0.03 million and $0.09 million, respectively.

**Note 7: Income Taxes**

For the three and six months ended June 30, 2016, the Company recorded income tax expense of $0.4 million and $0.8 million, respectively. This compares to income tax expense of $0.5 million and $0.7 million, respectively, for the three and six months ended June 30, 2015.

Deferred tax assets decreased $0.7 million from $13.8 million at December 31, 2015 to $13.1 million at June 30, 2016. This decrease was due to deferred taxes being applied to the tax liability arising from current year taxable income.

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, the valuation allowance may be increased.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Note 8: Income per share**

The Company is required to present basic income per share and diluted income per share in its consolidated statements of operations. Basic income per share amounts are computed by dividing net income by the weighted average number of common shares outstanding. Diluted income 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 restricted stocks and would be 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 income per share.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

The Company had no outstanding stock options as of June 30, 2016 or December 31, 2015. The following is information about the computation of income per share for the three and six months ended June 30, 2016 and 2015:

| Three months ended June 30, 2016 | Net Income | Weighted Average Common Shares Outstanding | Amount |
|---|---|---|---|
| Basic Income Per Share | $613,863 | 3,957,012 | $ 0.16 |
| Effect of Dilutive Securities | | | |
| Non-vested Restricted Stock Grants | N/A | 1,073 | N/A |
| Diluted Income Per Share | 613,863 | 3,958,085 | $ 0.16 |

| Three months Ended June 30, 2015 | Net Income | Weighted Average Common Shares Outstanding | Amount |
|---|---|---|---|
| Basic Income Per Share | $ 689,000 | 3,872,073 | $ 0.18 |
| Effect of Dilutive Securities | | | |
| Non-vested Restricted Stock Grants | N/A | 21,093 | N/A |
| Diluted Income Per Share | $ 689,000 | 3,893,166 | $ 0.18 |

| Six months ended June 30, 2016 | Net Income | Weighted Average<br><br>Common Shares | Amount |
|---|---|---|---|

| | | Outstanding | |
|---|---|---|---|
| Basic Earnings Per Share | $1,267,260 | 3,956,609 | $ 0.32 |
| Effect of Dilutive Securities | | | |
| Non-vested Restricted Stock Grants | N/A | 33,366 | N/A |
| Diluted Earnings Per Share | 1,267,260 | 3,989,975 | $ 0.32 |

| **Six months Ended June 30, 2015** | **Net Income** | **Weighted Average Common Shares Outstanding** | **Amount** |
|---|---|---|---|
| Basic Income Per Share | $978,000 | 3,871,960 | $ 0.25 |
| Effect of Dilutive Securities | | | |
| Non-vested Restricted Stock Grants | N/A | 20,992 | N/A |
| Diluted Income Per Share | $978,000 | 3,892,952 | $ 0.25 |

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Note 9: Borrowings**

Federal Home Loan Bank borrowings

The Company is a member of the Federal Home Loan Bank of Boston ("FHLB"). The Company has the ability to borrow from the FHLB based on a certain percentage of the value of the Company's qualified collateral, as defined in the FHLB Statement of Products Policy, comprised mainly of mortgage-backed securities and loans segregated as collateral for the FHLB.

At June 30, 2016 and December 31, 2015, outstanding advances from the FHLB aggregated $128.0 million and $132.0 million respectively. The advances outstanding at June 30, 2016 had maturities ranging from one day to sixty months with rates ranging from 2.7 basis points to 57 basis points. The FHLB borrowings are collateralized by a mixture of real estate loans and securities with a book value of $131.3 million as of June 30, 2016.

Junior subordinated debt owed to unconsolidated trust

The subordinated debentures of $8.2 million are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. These obligations qualify as Tier 1 capital. The subordinated debentures, which bear interest at three-month LIBOR plus 3.15% (3.79% at June 30, 2016), mature on March 26, 2033. Beginning in the second quarter of 2009, the Company deferred quarterly interest payments on the subordinated debentures for twenty consecutive quarters as permitted under the terms of the debentures. The Company made a payment of approximately $1.6 million in June 2014, which brought the debt current as of that date. Interest payments since June 2014 have been deferred at the Company's option, however interest expense continues to be accrued and charged to operations. At June 30, 2016, interest owed for the subordinated debt was $0.6 million.

Note Payable

In September 2015, the Company executed a $2.0 million Note Payable for the purchase of its Fairfield, CT branch, which had formerly been leased by the Company. The note has a ten-year term and bears interest at a fixed rate of 1.75%. The Company makes interest and principal payments monthly. The note is secured by a first Mortgage Deed and Security Agreement on the property purchased.

**Note 10: Financial Instruments with Off-Balance Sheet Risk**

In the normal course of business, the Company 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 the Company has in particular classes of financial instruments.

The contractual amount of commitments to extend credit and standby letters of credit represents the total amount of potential accounting loss should the contracts be fully drawn upon, the customers default, and the value of any existing collateral become worthless. The Company uses the same credit policies in approving commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer’s creditworthiness on a case-by-case basis. Management believes that the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

Financial instruments whose contractual amounts represent credit risk at June 30, 2016 are as follows:

| Commitments to extend credit: | *(in thousands)* |
|---|---|
| Future loan commitments | $ 15,186 |
| Home equity lines of credit | 21,464 |
| Unused lines of credit | 22,684 |
| Undisbursed construction loans | 20,204 |
| Financial standby letters of credit | 1,262 |
| | **$ 80,800** |

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 by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include residential and commercial property, deposits and securities. The Company has established a reserve of $5,000 as of June 30, 2016 for these commitments which is included in accrued expenses and other liabilities.

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Guarantees that are not derivative contracts are recorded on the Company's consolidated balance sheet at their fair value at inception. Any instruments deemed to be derivatives would be accounted for as a fair value or cash flow hedge as appropriate.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**Notes to consolidated financial statements (Unaudited)**

**Note 11: Regulatory and Operational Matters**

The Company's and the Bank's capital and capital ratios at June 30, 2016 and December 31, 2015 were:

| | Actual | | Minimum | | Capital Requirements Minimum with Capital Buffer | | Well Capitalized | |
|---|---|---|---|---|---|---|---|---|
| *(dollars in thousands)* | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **<u>June 30, 2016</u>** | | | | | | | | |
| <u>The Company:</u> | | | | | | | | |
| Tier 1 Leverage Capital (to Average Assets) | $61,113 | 9.97 % | $24,522 | 4.00 % | N/A | N/A | N/A | N/A |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 53,113 | 9.56 % | 25,011 | 4.50 % | N/A | N/A | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 61,113 | 11.00 % | 33,348 | 6.00 % | N/A | N/A | N/A | N/A |
| Total Capital (to Risk Weighted Assets) | | | | | | | | |