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.

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PART I- FINANCIAL INFORMATION

Item 1: Consolidated Financial Statements

PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands, except share data)	**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

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)

(In thousands, except per share amounts)	**Three Months Ended September 30, 2018**	**2017**	**Nine Months Ended September 30, 2018**	**2017**
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

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)

(In thousands)	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
	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)

(In thousands, except shares)	**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)

(In thousands)	**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	-

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.

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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

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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:

(In thousands)	**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.

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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.

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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:

(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized (Losses)**	**Fair Value**
September 30, 2018:				
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
December 31, 2017:				
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:

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

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.

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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.

(In thousands)	**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

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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:

(In thousands)	**September 30, 2018**	**December 31, 2017**
Loan portfolio segment:		
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.

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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.

(In thousands)	**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.

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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.

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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

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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:								

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

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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.

(In thousands)	Performing (Accruing) Loans							
As of September 30, 2018:	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**90 Days or Greater Past Due**	**Total**	**Current**	**Total Performing Loans**	**Non-accruing Loans**	**Loans Receivable Gross**
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:								

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.

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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.

(In thousands)	**Performing (Accruing) Loans**							
As of December 31, 2017:	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**90 Days or Greater Past Due**	**Total**	**Current**	**Total Performing Loans**	**Non-accruing Loans**	**Loans Receivable Gross**
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	