

ENTERPRISE BANCORP INC /MA/

Form 10-Q

November 07, 2016

Table of Contents

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, 2016

Commission File Number: 001-33912

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts

04-3308902

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

222 Merrimack Street, Lowell, Massachusetts 01852

(Address of principal executive offices) (Zip code)

(978) 459-9000

(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 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  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. See definition for "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

As of November 1, 2016, there were 11,449,122 shares of the issuer's common stock outstanding- Par Value \$0.01 per share.



Table of Contents

ENTERPRISE BANCORP, INC.  
INDEX

	Page Number
<u>Cover Page</u>	<u>1</u>
<u>Index</u>	<u>2</u>
<u>PART I - FINANCIAL INFORMATION</u>	
<u>Item 1 Financial Statements</u>	<u>3</u>
<u>Consolidated Balance Sheets - September 30, 2016 and December 31, 2015</u>	<u>3</u>
<u>Consolidated Statements of Income -Three and nine months ended September 30, 2016 and 2015</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Income -Three and nine months ended September 30, 2016 and 2015</u>	<u>5</u>
<u>Consolidated Statement of Changes in Stockholders' Equity - Nine months ended September 30, 2016</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows - Nine months ended September 30, 2016 and 2015</u>	<u>7</u>
<u>Notes to Unaudited Consolidated Interim Financial Statements</u>	<u>8</u>
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>39</u>
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	<u>66</u>
<u>Item 4 Controls and Procedures</u>	<u>67</u>
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1 Legal Proceedings</u>	<u>68</u>
<u>Item 1A Risk Factors</u>	<u>68</u>
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>68</u>
<u>Item 3 Defaults Upon Senior Securities</u>	<u>68</u>
<u>Item 4 Mine Safety Disclosures</u>	<u>68</u>
<u>Item 5 Other Information</u>	<u>68</u>
<u>Item 6 Exhibits</u>	<u>69</u>
<u>Signature page</u>	<u>70</u>

Table of Contents

## PART I-FINANCIAL INFORMATION

Item 1 - Financial Statements  
 ENTERPRISE BANCORP, INC.  
 Consolidated Balance Sheets  
 (Unaudited)

(Dollars in thousands)	September 30, 2016	December 31, 2015
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$ 34,337	\$ 32,318
Interest-earning deposits	27,823	19,177
Total cash and cash equivalents	62,160	51,495
Investment securities at fair value	349,064	300,358
Federal Home Loan Bank stock	1,884	3,050
Loans held for sale	2,171	1,709
Loans, less allowance for loan losses of \$31,589 at September 30, 2016 and \$29,008 at December 31, 2015	1,954,265	1,830,954
Premises and equipment, net	33,861	30,553
Accrued interest receivable	8,467	7,790
Deferred income taxes, net	13,405	14,111
Bank-owned life insurance	28,582	28,018
Prepaid income taxes	57	57
Prepaid expenses and other assets	11,277	11,780
Goodwill	5,656	5,656
Total assets	\$ 2,470,849	\$ 2,285,531
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	\$ 2,221,609	\$ 2,018,148
Borrowed funds	671	53,671
Subordinated debt	14,831	14,822
Accrued expenses and other liabilities	17,504	18,287
Accrued interest payable	194	276
Total liabilities	\$ 2,254,809	\$ 2,105,204
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized; no shares issued	—	—
Common stock \$0.01 par value per share; 20,000,000 shares authorized; 11,448,502 shares issued and outstanding at September 30, 2016 (including 142,162 shares of unvested participating restricted awards), 10,377,787 shares issued and outstanding at December 31, 2015 (including 144,717 shares of unvested participating restricted awards)	114	104
Additional paid-in-capital	83,394	61,008
Retained earnings	126,543	116,941
Accumulated other comprehensive income	5,989	2,274
Total stockholders' equity	\$ 216,040	\$ 180,327
Total liabilities and stockholders' equity	\$ 2,470,849	\$ 2,285,531

See the accompanying notes to the unaudited consolidated interim financial statements.

3

---

Table of Contents

ENTERPRISE BANCORP, INC.  
 Consolidated Statements of Income  
 (Unaudited)

(Dollars in thousands, except per share data)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Interest and dividend income:				
Loans and loans held for sale	\$21,466	\$ 19,785	\$63,379	\$ 57,538
Investment securities	1,629	1,377	4,720	3,825
Other interest-earning assets	96	62	189	137
Total interest and dividend income	23,191	21,224	68,288	61,500
Interest expense:				
Deposits	1,138	1,022	3,325	3,033
Borrowed funds	2	10	79	32
Subordinated debt	234	232	695	837
Total interest expense	1,374	1,264	4,099	3,902
Net interest income	21,817	19,960	64,189	57,598
Provision for loan losses	1,386	250	2,503	2,100
Net interest income after provision for loan losses	20,431	19,710	61,686	55,498
Non-interest income:				
Investment advisory fees	1,162	1,182	3,593	3,568
Deposit and interchange fees	1,272	1,207	3,790	3,575
Income on bank-owned life insurance, net	182	157	564	358
Net gains on sales of investment securities	546	7	611	1,363
Gains on sales of loans	198	89	392	373
Other income	588	542	1,786	1,650
Total non-interest income	3,948	3,184	10,736	10,887
Non-interest expense:				
Salaries and employee benefits	10,948	10,255	32,458	29,934
Occupancy and equipment expenses	1,859	1,775	5,453	5,484
Technology and telecommunications expenses	1,577	1,428	4,548	4,223
Advertising and public relations expenses	591	641	2,087	2,180
Audit, legal and other professional fees	446	564	1,342	1,305
Deposit insurance premiums	347	299	997	889
Supplies and postage expenses	241	226	728	736
Investment advisory and custodial expenses	107	102	283	237
Other operating expenses	1,298	1,258	3,929	4,037
Total non-interest expense	17,414	16,548	51,825	49,025
Income before income taxes	6,965	6,346	20,597	17,360
Provision for income taxes	2,251	2,054	6,799	5,933
Net income	\$4,714	\$ 4,292	\$13,798	\$ 11,427
Basic earnings per share	\$0.41	\$ 0.41	\$1.28	\$ 1.11
Diluted earnings per share	\$0.41	\$ 0.41	\$1.27	\$ 1.10
Basic weighted average common shares outstanding	11,430,134	10,349,232	10,801,278	10,308,310
Diluted weighted average common shares outstanding	11,498,990	10,414,254	10,869,406	10,373,464

See the accompanying notes to the unaudited consolidated interim financial statements.



Table of Contents

ENTERPRISE BANCORP, INC.  
 Consolidated Statements of Comprehensive Income  
 (Unaudited)

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net income	\$4,714	\$4,292	\$13,798	\$11,427
Other comprehensive income (loss), net of taxes:				
Gross change in unrealized holding gains (losses) on investments arising during the period	(558 )	1,065	6,522	234
Income tax (expense) benefit	213	(388 )	(2,416 )	(70 )
Net unrealized holding gains (losses), net of tax	(345 )	677	4,106	164
Less: Reclassification adjustment for net gains included in net income				
Net realized gains on sales of securities during the period	546	7	611	1,363
Income tax expense	(196 )	(2 )	(220 )	(475 )
Reclassification adjustment for gains realized, net of tax	350	5	391	888
Total other comprehensive income (loss)	(695 )	672	3,715	(724 )
Comprehensive income	\$4,019	\$4,964	\$17,513	\$10,703



See the accompanying notes to the unaudited consolidated interim financial statements.

5

---

Table of Contents

## ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders' Equity  
(Unaudited)

(Dollars in thousands, except per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2015	\$ 104	\$ 61,008	\$ 116,941	\$ 2,274	\$ 180,327
Net income			13,798		13,798
Other comprehensive income, net				3,715	3,715
Tax benefit from stock compensation		229			229
Common stock dividend paid (\$0.39 per share)			(4,196 )		(4,196 )
Common stock issued under dividend reinvestment plan	—	1,023			1,023
Common stock issued other, net of expenses	9	19,784			19,793
Stock-based compensation, net	1	1,117			1,118
Stock options exercised, net	—	233			233
Balance at September 30, 2016	\$ 114	\$ 83,394	\$ 126,543	\$ 5,989	\$ 216,040

See the accompanying notes to the unaudited consolidated interim financial statements.

6

---

Table of Contents

ENTERPRISE BANCORP, INC.  
 Consolidated Statements of Cash Flows  
 (Unaudited)

	Nine months ended September 30,	
	2016	2015
(Dollars in thousands)		
Cash flows from operating activities:		
Net income	\$ 13,798	\$ 11,427
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,503	2,100
Depreciation and amortization	4,387	4,162
Stock-based compensation expense	1,349	1,365
Mortgage loans originated for sale	(19,943 )	(18,013 )
Proceeds from mortgage loans sold	19,873	19,432
Net gains on sales of loans	(392 )	(373 )
Net gains on sales of OREO	—	(154 )
Net gains on sales of investments	(611 )	(1,363 )
Income on bank-owned life insurance, net	(564 )	(358 )
Changes in:		
Accrued interest receivable	(677 )	(1,001 )
Prepaid expenses and other assets	357	7,807
Deferred income taxes	(1,490 )	(427 )
Accrued expenses and other liabilities	290	1,700
Subordinated debt issuance costs	9	(190 )
Accrued interest payable	(82 )	(314 )
Net cash provided by operating activities	18,807	25,800
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	4,729	13,677
Net proceeds (purchases) from FHLB capital stock	1,166	(882 )
Proceeds from maturities, calls and pay-downs of investment securities	16,708	21,276
Purchase of investment securities	(65,846 )	(73,940 )
Net increase in loans	(125,814)	(119,095)
Additions to premises and equipment, net	(7,033 )	(2,970 )
Proceeds from OREO sales and payments	—	1,015
Proceeds from bank-owned life insurance	405	—
Purchase of bank-owned life insurance	—	(11,390 )
Net cash used in investing activities	(175,685)	(172,309)
Cash flows from financing activities:		
Net increase in deposits	203,461	195,069
Net decrease in borrowed funds	(53,000 )	(34,729 )
Repayment of subordinated debt	—	(10,825 )
Proceeds from issuance of subordinated debt	—	15,000
Cash dividends paid	(4,196 )	(3,863 )
Proceeds from issuance of common stock	20,816	1,086
Proceeds from exercise of stock options, net of repurchases for tax withholdings	233	407
Tax benefit from stock-based compensation	229	4
Net cash provided by financing activities	167,543	162,149
Net increase in cash and cash equivalents	10,665	15,640

Edgar Filing: ENTERPRISE BANCORP INC /MA/ - Form 10-Q

Cash and cash equivalents at beginning of period	51,495	40,146
Cash and cash equivalents at end of period	\$62,160	\$55,786

Supplemental financial data:

Cash Paid For: Interest	\$4,098	\$4,216
Cash Paid For: Income Taxes	8,021	5,291

Supplemental schedule of non-cash investing activity:

Net purchases of investment securities not yet settled	1,215	—
--	-------	---

See accompanying notes to the unaudited consolidated interim financial statements.

7

---

Table of Contents

ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Interim Financial Statements

(1) Summary of Significant Accounting Policies

(a) Organization of Holding Company and Basis of Presentation

The accompanying unaudited consolidated interim financial statements and these notes should be read in conjunction with the December 31, 2015 audited consolidated financial statements and notes thereto contained in the 2015 Annual Report on Form 10-K of Enterprise Bancorp, Inc. (the "Company" or "Enterprise"), a Massachusetts corporation, as filed with the Securities and Exchange Commission (the "SEC") on March 15, 2016 (the "2015 Annual Report on Form 10-K"). The Company has not changed its accounting policies from those disclosed in its 2015 Annual Report on Form 10-K.

The Company's unaudited consolidated interim financial statements include the accounts of the Company and its wholly owned subsidiary, Enterprise Bank and Trust Company (the "Bank"). The Bank is a Massachusetts trust company organized in 1989. Substantially all of the Company's operations are conducted through the Bank and its subsidiaries.

The Bank's subsidiaries include Enterprise Insurance Services, LLC and Enterprise Investment Services, LLC, organized under the laws of the State of Delaware for the purposes of engaging in insurance sales activities and offering non-deposit investment products and services, respectively. In addition, the Bank has the following subsidiaries that are incorporated in the Commonwealth of Massachusetts and classified as security corporations in accordance with applicable Massachusetts General Laws: Enterprise Security Corporation; Enterprise Security Corporation II; and Enterprise Security Corporation III. The security corporations, which hold various types of qualifying securities, are limited to conducting securities investment activities that the Bank itself would be allowed to conduct under applicable laws.

At September 30, 2016, the Company had 23 full service branches serving the greater Merrimack Valley and North Central regions of Massachusetts and Southern New Hampshire. The Company also recently announced the anticipated opening of its 24<sup>th</sup> branch in Windham, NH in 2017, subject to the receipt of all requisite regulatory approvals. Through the Bank and its subsidiaries, the Company offers a range of commercial and consumer loan products, and deposit and cash management services. The Company also offers investment advisory and wealth management, trust and insurance services. The services offered through the Bank and its subsidiaries are managed as one strategic unit and represent the Company's only reportable operating segment.

The Federal Deposit Insurance Corporation (the "FDIC") and the Massachusetts Division of Banks (the "Division") have regulatory authority over the Bank. The Bank is also subject to certain regulatory requirements of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department. The business and operations of the Company are subject to the regulatory oversight of the Federal Reserve Board. The Division also retains supervisory jurisdiction over the Company.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and the instructions for Form 10-Q through the rules and interpretive releases of the SEC under federal securities law. In the opinion of management, the accompanying unaudited consolidated interim financial statements reflect all necessary adjustments consisting of normal recurring accruals for a fair presentation. All significant intercompany balances and transactions have been eliminated in the accompanying unaudited consolidated interim financial statements. Certain

previous years' amounts in the consolidated financial statements, and notes thereto, have been reclassified to conform to the current year's presentation. Interim results are not necessarily indicative of results to be expected for the entire year. The Company has evaluated subsequent events and transactions from September 30, 2016 through November 7, 2016 for potential recognition or disclosure as required by GAAP.

(b) Critical Accounting Estimates

In preparing the unaudited consolidated interim financial statements in conformity with GAAP, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. These assumptions and estimates affect the reported values of assets and liabilities as of the balance sheet date and income and expenses for the period then ended. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates should the assumptions and estimates used change over time due to changes in circumstances. Changes in those estimates resulting from continuing change in the economic environment and other factors will be reflected in the financial statements and results of operations in future periods.

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

As discussed in the Company's 2015 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill. Refer to Note 1, "Summary of Significant Accounting Policies," to the Company's consolidated financial statements included in the Company's 2015 Annual Report on Form 10-K for significant accounting policies. The Company has not changed its significant accounting policies from those disclosed in its 2015 Annual Report on Form 10-K.

(c) Reporting Comprehensive Income

Comprehensive income is defined as all changes to stockholders' equity except investments by and distributions to stockholders. Net income is one component of comprehensive income, with other components referred to in the aggregate as other comprehensive income. The Company's only other comprehensive income component is the net unrealized holding gains or losses on investments available-for-sale, net of deferred income taxes. Pursuant to Accounting Standards, the Company initially excludes these unrealized holding gains and losses from net income; however, they are later reported as reclassifications out of accumulated other comprehensive income into net income when the securities are sold. When securities are sold, the reclassification of realized gains and losses on available-for-sale securities are included on the Consolidated Statements of Income under the "non-interest income" subheading on the line item "net gains on sales of investment securities" and the related income tax expense is included in the line item "provision for income taxes," both of which are also detailed on the Consolidated Statements of Comprehensive Income under the subheading "reclassification adjustment for net gains included in net income."

(d) Restricted Investments

As a member of the Federal Home Loan Bank of Boston ("FHLB"), the Company is required to purchase certain levels of FHLB capital stock at par value in association with the Company's borrowing relationship from the FHLB. From time-to-time, the FHLB may initiate the repurchase, at par value, of "excess" levels of its capital stock held by member banks. This stock is classified as a restricted investment and carried at cost, which management believes approximates fair value. FHLB stock represents the only restricted investment held by the Company.

In conjunction with the other-than-temporary-impairment ("OTTI") review on available-for-sale investments (See Note 2, "Investments," for additional information), management also regularly reviews its holdings of FHLB stock for OTTI. Based on management's periodic review, the Company has not recorded any OTTI charges on this investment to date. If it was determined that a write-down of FHLB stock was required, impairment would be recognized through a charge to earnings.

(e) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts and the tax basis of assets and liabilities. The deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities will be adjusted accordingly through the provision for income taxes.

The Company's policy is to classify interest resulting from underpayment of income taxes as income tax expense in the first period the interest would begin accruing according to the provisions of the relevant tax law. The Company



classifies penalties resulting from underpayment of income taxes as income tax expense in the period for which the Company claims or expects to claim an uncertain tax position or in the period in which the Company's judgment changes regarding an uncertain tax position.

The income tax provisions will differ from the expense that would result from applying the federal statutory rate to income before taxes, due primarily to the impact of tax exempt interest from certain investment securities, loans and bank-owned life insurance.

The Company did not have any unrecognized tax benefits accrued as income tax liabilities or receivables or as deferred tax items at September 30, 2016. The Company is subject to U.S. federal and state income tax examinations by taxing authorities for the 2013 through 2015 tax years.

<u>Table of Contents</u>	ENTERPRISE BANCORP, INC. Notes to the Unaudited Consolidated Interim Financial Statements
--------------------------	--

(f) Capital Raised

In the second quarter of 2016, the Company completed a combined shareholder subscription rights offering and supplemental community offering, at an offering price of \$21.50 per share, under its SEC shelf registration statement that expired in September 2016. The Company issued 930 thousand shares of common stock and received gross proceeds of \$20.0 million (\$19.7 million, net of offering costs). The Company contributed the net proceeds to the Bank to support future asset growth and for general corporate purposes.

(g) Recent Accounting Pronouncements

Accounting pronouncements adopted by the Company

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-03, Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. Entities are required to apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. For public business entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption of the amendments is permitted for financial statements that have not been previously issued. The Company early adopted this ASU as of January 1, 2015 in relation to the Company's Fixed-to-Floating Rate Subordinated Notes issued in January 2015. This adoption did not have a material impact on the Company's financial statements or results of operations.

In January 2015, the FASB issued ASU No. 2015-01, "Income Statement-Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items." This ASU will align more closely GAAP income statement presentation guidance with International Audit Standards (IAS) 1, Presentation of Financial Statements, which prohibits the presentation and disclosure of extraordinary items. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this standard did not have an impact on the Company's financial statements.

Accounting pronouncements not yet adopted by the Company

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". This ASU is intended to create a single source of revenue guidance which is more principles based than current revenue guidance. The guidance affects any entity that either enters into contracts with customers to transfer goods or services, or enters into contracts for the transfer of non-financial assets, unless those contracts are within the scope of other standards. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" to amend the effective date of ASU 2014-09. The amendments in ASU 2014-09 are effective for annual and interim periods within fiscal years beginning after December 15, 2017. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The FASB has since issued additional related ASUs amendments intended to clarify certain aspects and improve understanding of the implementation guidance of Topic 606 but do not change the core principles of the guidance in Topic 606. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements of Topic 606. The Company is currently evaluating the potential impact of the ASU and its amendments on the Company's financial statements and results of operations.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments.

Among other things, the new guidance:

- Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income;
- Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and

ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.

The new guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the effects of this ASU on the Company's financial statements and results of operations.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which supersedes previous leasing guidance in Topic 840, Leases. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the effects of this ASU on the Company's financial statements and results of operations.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting." The amendments are intended to improve the accounting for employee share-based payments and affect all organizations that issue share-based payment awards to their employees. Several aspects of the accounting are simplified including, generally: a) income tax consequences; b) classification of awards as either equity or liabilities; c) accounting for forfeitures; and d) classification on the statement of cash flows. Among the changes, the amendment allows for entities to partially settle awards in cash up to the maximum individual statutory tax rate in the applicable jurisdiction and still qualify for equity classification; all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) will be recognized as income tax expense or benefit in the income statement; in addition, an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur; among other changes. The new standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company is currently evaluating the potential impact of the ASU on the Company's financial statements and results of operations.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326)." The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. Previously, when credit losses were measured under GAAP, an entity generally only considered past events and current conditions in measuring the incurred loss and generally recognition of the full amount of credit losses was delayed until the loss was probable of occurring. The amendments in this Update eliminate the probable initial recognition threshold in current GAAP and, instead, reflect an entity's current estimate of all expected credit losses.

The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset.

Credit losses on available-for-sale debt securities should be measured in a manner similar to current GAAP. However, the amendments in this Update require that credit losses be presented as an allowance rather than as a write-down. Unlike current GAAP, the Update provides for reversals of credit losses in future period net income in situations where the estimate of loss declines.

An entity will apply the amendments in this Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). For public business entities that are SEC filers, such as the Company, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating the potential impact of the ASU on the Company's financial statements and results of operations.

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

In August 2016, the FASB issued ASU 2016-15, "Statement of Cashflows - Classification of Certain Cash Receipts and Cash Payments. The amendments are intended to reduce diversity in practice related to the presentation of eight specific cashflow issues. For public business entities that are SEC filers, such as the Company, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Because this amendment primarily impacts the presentation and classification of information, the Company does not expect it to have a material impact on the Company's financial statements and results of operations.

## (2)Investments

The amortized cost and carrying values of investment securities at the dates specified are summarized as follows:

(Dollars in thousands)	September 30, 2016			
	Amortized cost	Unrealized gains	Unrealized losses	Fair Value
Federal agency obligations <sup>(1)</sup>	\$78,667	\$ 1,478	\$ —	\$80,145
Residential federal agency MBS <sup>(1)</sup>	87,678	1,215	187	88,706
Commercial federal agency MBS <sup>(1)</sup>	43,801	907	29	44,679
Municipal securities	107,768	3,822	34	111,556
Corporate bonds	10,850	284	3	11,131
Certificates of deposits <sup>(2)</sup>	950	20	—	970
Total fixed income securities	329,714	7,726	253	337,187
Equity investments	9,962	2,065	150	11,877
Total available-for-sale securities, at fair value	\$339,676	\$ 9,791	\$ 403	\$349,064

(Dollars in thousands)	December 31, 2015			
	Amortized cost	Unrealized gains	Unrealized losses	Fair Value
Federal agency obligations <sup>(1)</sup>	\$78,626	\$ 352	\$ 153	\$78,825
Residential federal agency MBS <sup>(1)</sup>	75,105	406	648	74,863
Commercial federal agency MBS <sup>(1)</sup>	23,908	—	363	23,545
Municipal securities	96,189	2,357	35	98,511
Corporate bonds	10,257	44	95	10,206
Certificates of deposits <sup>(2)</sup>	2,753	—	2	2,751
Total fixed income securities	286,838	3,159	1,296	288,701
Equity investments	10,043	1,966	352	11,657
Total available-for-sale securities, at fair value	\$296,881	\$ 5,125	\$ 1,648	\$300,358

These categories may include investments issued or guaranteed by government sponsored enterprises such as Fannie Mae ("FNMA"), Freddie Mac ("FHLMC"), Federal Farm Credit Bank ("FFCB"), or one of several Federal Home Loan Banks, as well as, investments guaranteed by Ginnie Mae ("GNMA"), a wholly-owned government entity.

(2) Certificates of deposits ("CDs") represent term deposits issued by banks that are subject to FDIC insurance and purchased on the open market.

Included in the residential federal agency MBS category were collateralized mortgage obligations ("CMOs") totaling \$33.9 million and \$20.8 million at September 30, 2016 and December 31, 2015 respectively. All of the commercial MBS investments held by the Company were CMOs issued by U.S agencies.

At September 30, 2016, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a portion of the portfolio (approximately 18%) invested in individual common stock of entities in the financial services industry.

ENTERPRISE BANCORP, INC.  
Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

Net unrealized appreciation and depreciation on investments available-for-sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income (loss).

The net unrealized gain or loss in the Company's fixed income portfolio fluctuates as market interest rates rise and fall. Due to the fixed rate nature of this portfolio, as market rates fall, the value of the portfolio rises, and as market rates rise, the value of the portfolio declines. The unrealized gains or losses on fixed income investments will also decline as the securities approach maturity, or if the issuer is credit impaired. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on a fixed income investment is deemed to be other than temporary, the credit loss portion is charged to earnings and the noncredit portion is recognized in accumulated other comprehensive income.

The net unrealized gain or loss on equity securities will fluctuate based on changes in the market value of the mutual funds and individual securities held in the portfolio. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on an equity security is deemed to be other than temporary prior to a sale, the loss is charged to earnings.

The following tables summarize investments having temporary impairment, due to the fair market values having declined below the amortized costs of the individual investments, and the period that the investments have been temporarily impaired at September 30, 2016 and December 31, 2015.

(Dollars in thousands)	September 30, 2016						
	Less than 12 months		12 months or longer		Total		# of holdings
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
Federal agency obligations	\$—	\$ —	\$ —	\$ —	\$—	\$ —	
Residential federal agency MBS	17,008	106	8,650	81	25,658	187	9
Commercial federal agency MBS	9,305	29	—	—	9,305	29	4
Municipal securities	3,720	34	—	—	3,720	34	6
Corporate bonds	637	2	109	1	746	3	4
Certificates of deposit	—	—	—	—	—	—	—
Equity investments	—	—	2,826	150	2,826	150	3
Total temporarily impaired investments	\$30,670	\$ 171	\$ 11,585	\$ 232	\$42,255	\$ 403	26

(Dollars in thousands)	December 31, 2015						
	Less than 12 months		12 months or longer		Total		# of holdings
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
Federal agency obligations	\$27,420	\$ 153	\$ —	\$ —	\$27,420	\$ 153	
Residential federal agency MBS	20,517	275	10,935	373	31,452	648	14
Commercial federal agency MBS	23,545	363	—	—	23,545	363	9
Municipal securities	6,988	33	261	2	7,249	35	13
Corporate bonds	4,574	78	419	17	4,993	95	37
Certificates of deposit	1,976	2	—	—	1,976	2	10
Equity investments	4,204	351	24	1	4,228	352	5
Total temporarily impaired investments	\$89,224	\$ 1,255	\$ 11,639	\$ 393	\$100,863	\$ 1,648	96



Management regularly reviews the portfolio for securities with unrealized losses that could be other-than-temporarily impaired. During the nine months ended September 30, 2016 and 2015, the Company did not record any fair value impairment charges on its investments. Management attributes these unrealized losses to increases in market yields compared to the yields at the time the investments were purchased by the Company and the impact of market value

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

fluctuations on the equity portion of our portfolio. Management does not consider these investments to be other-than-temporarily impaired at September 30, 2016, because (1) the decline in market value is not attributable to credit quality for fixed income securities or a fundamental deterioration in the equity fund or issuers, and (2) the Company does not intend to, and it is more likely than not that it will not be required to, sell those investments prior to a market price recovery or maturity.

In assessing the Company's investments in federal agency mortgage-backed securities and federal agency obligations, the contractual cash flows of these investments are guaranteed by the respective government sponsored enterprise (FHLMC, FNMA, FFCB, or FHLB) or wholly-owned government corporation (GNMA). Accordingly, it is expected that the securities would not be settled at a price less than the par value of the Company's investments. Management's assessment of other fixed income investments within the portfolio includes reviews of market pricing, ongoing credit quality evaluations, assessment of the investments' materiality, and duration of the investments' unrealized loss position. In addition, the Company utilizes an outside registered investment adviser to manage the corporate and municipal bond portfolios, within prescribed guidelines set by management, and to provide assistance in assessing the credit risk of those portfolios. At September 30, 2016, the Company's corporate and municipal bond portfolios did not contain any securities below investment grade, as reported by major credit rating agencies. For equities and funds, management's assessment includes the severity of the declines, whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period and if the equity security or fund exhibits fundamental deterioration.

The contractual maturity distribution at September 30, 2016 of total fixed income investments was as follows:

(Dollars in thousands)	Amortized Fair	
	Cost	Value
Due in one year or less	\$ 14,615	\$ 14,666
Due after one, but within five years	102,882	104,944
Due after five, but within ten years	98,651	101,813
Due after ten years	113,566	115,764
Total fixed income securities	\$ 329,714	\$ 337,187

Scheduled contractual maturities shown above may not reflect the actual maturities of the investments. The actual MBS/CMO cash flows likely will be faster than presented above due to prepayments and amortization. Similarly, included in the carrying value of fixed income investments above are callable securities, comprised of municipal securities and corporate bonds totaling \$51.1 million, which can be redeemed by the issuer prior to the maturity presented above. Management considers these factors when evaluating the interest rate risk in the Company's asset-liability management program.

From time to time, the Company may pledge securities as collateral for deposit account balances of municipal deposit customers, and for borrowing capacity with the FHLB and the Federal Reserve Bank of Boston (the "FRB"). The fair value of securities pledged as collateral for these purposes was \$335.0 million at September 30, 2016.

Sales of investments, including pending trades, for the three and nine months ended September 30, 2016 and September 30, 2015 are summarized as follows:

(Dollars in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015

Edgar Filing: ENTERPRISE BANCORP INC /MA/ - Form 10-Q

Amortized cost of investments sold	\$2,354	\$1,456	\$4,118	\$12,314
Gross realized gains on sales	546	7	611	1,522
Gross realized losses on sales	—	—	—	(159 )
Total proceeds from sales of investments	\$2,900	\$1,463	\$4,729	\$13,677

See Note 11, "Fair Value Measurements," below for further information regarding the Company's fair value measurements for available-for-sale securities.

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

## (3)Loans

The Company specializes in lending to business entities, non-profit organizations, professionals and individuals. The Company's primary lending focus is on the development of high quality commercial relationships achieved through active business development efforts, long-term relationships with established commercial developers, strong community involvement and focused marketing strategies. Loans made to businesses include commercial mortgage loans, construction and land development loans, secured and unsecured commercial loans and lines of credit, and standby letters of credit. The Company also originates equipment lease financing for businesses. Loans made to individuals include conventional residential mortgage loans, home equity loans and lines, residential construction loans on primary and secondary residences, and secured and unsecured personal loans and lines of credit. The Company manages its loan portfolio to avoid concentration by industry and loan size to lessen its credit risk exposure.

See Note 4, "Allowance for Loan Losses," for information on the Company's credit risk management, non-accrual, impaired and troubled debt restructured loans and the allowance for loan losses.

Major classifications of loans at the periods indicated were as follows:

(Dollars in thousands)	September 30, 2016	December 31, 2015
Commercial real estate	\$ 1,008,362	\$ 936,921
Commercial and industrial	490,590	458,553
Commercial construction	215,432	202,993
Total commercial loans	1,714,384	1,598,467
Residential mortgages	172,556	169,188
Home equity loans and lines	90,116	83,373
Consumer	10,634	10,747
Total retail loans	273,306	263,308
Gross loans	1,987,690	1,861,775
Deferred loan origination fees, net	(1,836 )	(1,813 )
Total loans	1,985,854	1,859,962
Allowance for loan losses	(31,589 )	(29,008 )
Net loans	\$ 1,954,265	\$ 1,830,954

## Loan Categories

## - Commercial loans:

Commercial real estate loans include loans secured by both owner-use and non-owner occupied real estate. These loans are typically secured by a variety of commercial and industrial property types, including one-to-four and multi-family apartment buildings, office, industrial or mixed-use facilities, strip shopping centers, or other commercial properties, and are generally guaranteed by the principals of the borrower. Commercial real estate loans generally have repayment periods of approximately fifteen to twenty-five years. Variable interest rate loans have a variety of adjustment terms and underlying interest rate indices, and are generally fixed for an initial period before periodic rate adjustments begin.

Commercial and industrial loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), and term loans. Also included in commercial and industrial loans are loans partially guaranteed by the U.S. Small Business Administration ("SBA"), and loans under various programs and

agencies. Commercial and industrial credits may be unsecured loans and lines to financially strong borrowers, loans secured in whole or in part by real estate unrelated to the principal purpose of the loan or secured by inventories, equipment, or receivables, and are generally guaranteed by the principals of the borrower. Variable rate loans and lines in this portfolio have interest rates that are periodically adjusted, with loans generally having fixed initial periods. Commercial and industrial loans have average repayment periods of one to seven years.

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property, and loans for the purchase and improvement of raw land. These loans are secured in whole or in part by underlying real estate collateral and are generally guaranteed by the principals of the borrowers. Construction lenders work to cultivate long-term relationships with established commercial developers. The Company limits the amount of financing provided to any single developer for the construction of properties built on a speculative basis. Funds for construction projects are disbursed as pre-specified stages of construction are completed. Regular site inspections are performed, prior to advancing additional funds, at each construction phase, either by experienced construction lenders on staff or by independent outside inspection companies. Commercial construction loans generally are variable rate loans and lines with interest rates that are periodically adjusted and generally have terms of one to three years.

From time to time, the Company participates with other banks in the financing of certain commercial projects. Participating loans with other institutions provide banks the opportunity to retain customer relationships and reduce credit risk exposure among each participating bank, while providing customers with larger credit vehicles than the individual bank might be willing or able to offer independently. In some cases, the Company may act as the lead lender, originating and servicing the loans, but participating out a portion of the funding to other banks. In other cases, the Company may participate in loans originated by other institutions. In each case, the participating bank funds a percentage of the loan commitment and takes on the related pro-rata risk. In each case in which the Company participates in a loan, the rights and obligations of each participating bank are divided proportionately among the participating banks in an amount equal to their share of ownership and with equal priority among all banks. The balances participated out to other institutions are not carried as assets on the Company's financial statements. Loans originated by other banks in which the Company is a participating institution are carried in the loan portfolio at the Company's pro rata share of ownership. The Company performs an independent credit analysis of each commitment and a review of the participating institution prior to participation in the loan. Loans originated by other banks in which the Company is a participating institution amounted to \$86.8 million at September 30, 2016 and \$62.3 million at December 31, 2015.

Standby letters of credit are conditional commitments issued by the Company to guarantee the financial obligation or 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. If the letter of credit is drawn upon, a loan is created for the customer, generally a commercial loan, with the same criteria associated with similar commercial loans.

- Residential loans:

Enterprise originates conventional mortgage loans on one-to-four family residential properties. These properties may serve as the borrower's primary residence, or be vacation homes or investment properties. Loan to value limits vary, generally from 75% for multi-family, owner-occupied properties, up to 97% for single family, owner-occupied properties, with mortgage insurance coverage required for loan-to-value ratios greater than 80% based on program parameters. In addition, financing is provided for the construction of owner-occupied primary and secondary residences. Residential mortgage loans may have terms of up to 30 years at either fixed or adjustable rates of interest. Fixed and adjustable rate residential mortgage loans are generally originated using secondary market underwriting and documentation standards.

Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the Company, management may elect to sell those fixed and adjustable rate residential mortgage loans which are eligible for sale in the secondary market, or hold some or all of this residential loan production for the Company's portfolio. Mortgage loans are generally not pooled for sale, but instead sold on an individual basis. The Company may retain or sell the servicing when selling the loans. Loans sold are subject to

standard secondary market underwriting and eligibility representations and warranties over the life of the loan and are subject to an early payment default period covering the first four payments for certain loan sales. Loans classified as held for sale are carried as a separate line item on the balance sheet.

- Home equity loans and lines of credit:

Home equity term loans are originated for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the assessed or appraised value of the property securing the loan. Home equity loan payments consist of monthly principal and interest based on amortization ranging from three to fifteen years. The rates may also be fixed for three to fifteen years.

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

The Company originates home equity revolving lines of credit for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the appraised value of the property securing the loan. Home equity lines generally have interest rates that adjust monthly based on changes in the Prime Rate, although minimum rates may be applicable. Some home equity line rates may be fixed for a period of time and then adjusted monthly thereafter. The payment schedule for home equity lines requires interest only payments for the first ten years of the lines. Generally at the end of ten years, the line may be frozen to future advances, and principal plus interest payments are collected over a fifteen-year amortization schedule or, for eligible borrowers meeting certain requirements, the line availability may be extended for an additional interest only period.

- Consumer loans:

Consumer loans consist primarily of secured or unsecured personal loans, loans under energy efficiency financing programs in conjunction with Massachusetts public utilities, and overdraft protection lines on checking accounts extended to individual customers. The aggregate amount of overdrawn deposit accounts are reclassified as loan balances.

Loans serviced for others

At September 30, 2016 and December 31, 2015, the Company was servicing residential mortgage loans owned by investors amounting to \$18.4 million and \$18.5 million, respectively. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to \$62.4 million and \$52.7 million at September 30, 2016 and December 31, 2015, respectively. See the discussion above for further information regarding commercial participations.

Loans serving as collateral

Loans designated as qualified collateral and pledged to the FHLB for borrowing capacity are summarized below:

(Dollars in thousands)	September 30, 2016	December 31, 2015
Commercial real estate	\$ 263,718	\$ 281,802
Residential mortgages	122,635	118,855
Home equity	13,309	13,972
Total loans pledged to FHLB	\$ 399,662	\$ 414,629

(4) Allowance for Loan Losses

Inherent in the lending process is the risk of loss due to customer non-payment, or "credit risk." The Company seeks to lessen its credit risk exposure by managing its loan portfolio to avoid concentration by industry and loan size, and through sound underwriting practices and the risk management function; however, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio and economic conditions.

The allowance for loan losses is an estimate of probable credit risk inherent in the loan portfolio as of the specified balance sheet dates. The Company maintains the allowance at a level that it deems adequate to absorb all reasonably anticipated probable losses from specifically known and other credit risks associated with the portfolio. In making its assessment on the adequacy of the allowance, management considers several quantitative and qualitative factors that could have an effect on the credit quality of the portfolio, including individual assessment of larger and high risk



credits, delinquency trends and the level of non-performing loans, impaired, adversely classified, and restructured loans, net charge-offs, the growth and composition of the loan portfolio, expansion in the geographic market area, the experience level of lenders and changes in underwriting criteria, and the strength of the local and national economies, among other factors. However, despite prudent loan underwriting and ongoing credit risk management, adverse changes within the Company's market area or deterioration in the local, regional or national economic conditions could negatively impact the portfolio's credit risk profile and the Company's asset quality in the future.

There have been no material changes to the Company's underwriting practices, credit risk management system, or to the allowance assessment methodology used to estimate loan loss exposure as reported in the 2015 Annual Report on Form 10-K. Refer to heading "Allowance for probable loan losses methodology" contained in Note 4 "Allowance For Loan Losses," to the

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

Company's consolidated financial statements contained in the 2015 Annual Report on Form 10-K for further discussion of management's methodology used to estimate the loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance.

#### Allowance for probable loan losses methodology

On a quarterly basis, management prepares an estimate of the allowance necessary to cover estimated probable credit losses. The Company uses a systematic methodology to measure the amount of estimated loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology makes use of specific reserves for loans individually evaluated and deemed impaired, and general reserves for larger groups of homogeneous loans, which are collectively evaluated relying on a combination of qualitative and quantitative factors that may affect credit quality of the pool.

The balances of loans as of September 30, 2016 by segment and evaluation method are summarized as follows:

(Dollars in thousands)	Loans individually evaluated for impairment	Loans collectively evaluated for impairment	Gross Loans
Commercial real estate	\$ 14,533	\$ 993,829	\$ 1,008,362
Commercial and industrial	10,343	480,247	490,590
Commercial construction	3,059	212,373	215,432
Residential mortgages	297	172,259	172,556
Home equity loans and lines	499	89,617	90,116
Consumer	3	10,631	10,634
Total gross loans	\$ 28,734	\$ 1,958,956	\$ 1,987,690

The balances of loans as of December 31, 2015 by segment and evaluation method are summarized as follows:

(Dollars in thousands)	Loans individually evaluated for impairment	Loans collectively evaluated for impairment	Gross Loans
Commercial real estate	\$ 12,287	\$ 924,634	\$ 936,921
Commercial and industrial	7,810	450,743	458,553
Commercial construction	3,032	199,961	202,993
Residential mortgages	366	168,822	169,188
Home equity loans and lines	169	83,204	83,373
Consumer	24	10,723	10,747
Total gross loans	\$ 23,688	\$ 1,838,087	\$ 1,861,775

#### Credit quality indicators

Early detection of credit issues is critical to minimize credit losses. Accordingly, management regularly monitors internal credit quality indicators such as the risk classification of individual loans, adversely classified loans, past due and non-accrual loans, impaired and restructured loans, and the level of foreclosure activity, as well as trends in the general levels of these indicators. These credit quality indicators are discussed below.

#### Adversely classified loans

The Company's loan risk rating system classifies loans depending on risk of loss characteristics. The classifications range from "substantially risk free" for the highest quality loans and loans that are secured by cash collateral, through a satisfactory range of "minimal," "moderate," "better than average," and "average" risk, to the regulatory problem-asset classifications of "criticized," for loans that may need additional monitoring, and the more severe adverse classifications of "substandard," "doubtful," and "loss" based on criteria established under banking regulations.

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

Loans classified as substandard include those loans characterized by the distinct possibility that the Company will sustain some loss if deficiencies are not corrected. These loans are inadequately protected by the sound net worth and paying capacity of the borrower; repayment has become increasingly reliant on collateral liquidation or reliance on guarantees; credit weaknesses are well-defined; and borrower cash flow is insufficient to meet required debt service specified in loan terms and to meet other obligations, such as trade debt and tax payments.

Loans classified as doubtful have all the weaknesses inherent in a substandard rated loan with the added characteristic that the weaknesses make collection or full payment from liquidation, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until more exact status may be determined.

Loans classified as loss are generally considered uncollectible at present, although long-term recovery of part or all of loan proceeds may be possible. These "loss" loans would require a specific loss reserve or charge-off.

Adversely classified loans may be accruing or in non-accrual status and may be additionally designated as impaired or restructured, or some combination thereof. Loans which are evaluated to be of weaker credit quality are reviewed on a more frequent basis by management.

The following tables present the Company's credit risk profile for each class of loan in its portfolio by internally assigned risk rating category at the periods indicated.

(Dollars in thousands)	September 30, 2016				
	Substandard	Doubtful	Loss	Not Adversely Classified	Gross Loans
Commercial real estate	\$ 16,280	\$ —	\$ —	\$ 992,082	\$ 1,008,362
Commercial and industrial	13,044	182	2	477,362	490,590
Commercial construction	1,636	—	—	213,796	215,432
Residential mortgages	1,190	—	—	171,366	172,556
Home equity loans and lines	658	—	—	89,458	90,116
Consumer	31	—	—	10,603	10,634
Total gross loans	\$ 32,839	\$ 182	\$ 2	\$ 1,954,667	\$ 1,987,690

(Dollars in thousands)	December 31, 2015				
	Substandard	Doubtful	Loss	Not Adversely Classified	Gross Loans
Commercial real estate	\$ 12,487	\$ —	\$ —	\$ 924,434	\$ 936,921
Commercial and industrial	8,670	—	3	449,880	458,553
Commercial construction	1,776	—	—	201,217	202,993
Residential mortgages	1,278	—	—	167,910	169,188
Home equity loans and lines	503	—	5	82,865	83,373
Consumer	38	11	—	10,698	10,747
Total gross loans	\$ 24,752	\$ 11	\$ 8	\$ 1,837,004	\$ 1,861,775

Total adversely classified loans amounted to 1.66% of total loans at September 30, 2016, as compared to 1.33% at December 31, 2015. At September 30, 2016, as compared to December 31, 2015, adversely classified balances

increased, due primarily to four larger commercial relationships downgraded during the period with a net aggregate carrying value of approximately \$17.5 million, partially offset by payoffs, credit upgrades and principal payments. Although some weaknesses had been identified necessitating the downgrades, these loans continued to perform in accordance with their original terms.

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

## Past due and non-accrual loans

Loans on which the accrual of interest has been discontinued are designated as non-accrual and the classified portions are credit downgraded to one of the adversely classified categories noted above. Accrual of interest on loans is generally discontinued when a loan becomes contractually past due, with respect to interest or principal, by 90 days, or when reasonable doubt exists as to the full and timely collection of interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest payments received on loans in a non-accrual status are generally applied to principal on the books of the Company. Interest accruals are resumed on such loans only when payments are brought current and have remained current for a period of 180 days and when, in the judgment of management, the collectability of both principal and interest is reasonably assured. Additionally, deposit accounts overdrawn for 90 or more days are included in the consumer non-accrual balances below.

The following tables present an age analysis of past due loans as of the dates indicated.

(Dollars in thousands)	Balance at September 30, 2016						
	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans Past Due 90 days or more	Total Past Due Loans	Current Loans	Gross Loans	Non-accrual Loans
Commercial real estate	\$5,030	\$ 822	\$1,319	\$ 7,171	\$ 1,001,191	\$1,008,362	\$ 5,639
Commercial and industrial	198	385	1,236	1,819	488,771	490,590	3,128
Commercial construction	2,866	—	—	2,866	212,566	215,432	209
Residential mortgages	1,552	—	103	1,655	170,901	172,556	297
Home equity loans and lines	680	60	296	1,036	89,080	90,116	607
Consumer	106	4	8	118	10,516	10,634	8
Total gross loans	\$10,432	\$ 1,271	\$2,962	\$ 14,665	\$ 1,973,025	\$1,987,690	\$ 9,888

(Dollars in thousands)	Balance at December 31, 2015						
	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans Past Due 90 days or more	Total Past Due Loans	Current Loans	Gross Loans	Non-accrual Loans
Commercial real estate	\$1,641	\$ 1,532	\$3,256	\$ 6,429	\$ 930,492	\$ 936,921	\$ 8,506
Commercial and industrial	1,332	693	2,125	4,150	454,403	458,553	4,323
Commercial construction	581	—	7	588	202,405	202,993	335
Residential mortgages	354	280	57	691	168,497	169,188	366
Home equity loans and lines	634	9	73	716	82,657	83,373	288
Consumer	36	15	7	58	10,689	10,747	27
Total gross loans	\$4,578	\$ 2,529	\$5,525	\$ 12,632	\$ 1,849,143	\$ 1,861,775	\$ 13,845

The past due figures above may include those loans that have also been designated as non-accrual despite their payment due status. At September 30, 2016 and December 31, 2015, all loans 90 days or more past due were carried as non-accrual. Non-accrual loans that were not adversely classified amounted to \$254 thousand at September 30, 2016 and \$402 thousand at December 31, 2015. These balances primarily represented the guaranteed portions of

non-performing SBA loans. The majority of the non-accrual loan balances were also carried as impaired loans during the periods noted, and are discussed further below. The increase in loans 30-59 days past due category occurred primarily within the commercial real estate and

20

---

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

commercial construction portfolios at September 30, 2016, with the majority of these loans having subsequent payments made by mid-October.

The ratio of non-accrual loans to total loans amounted to 0.50% at September 30, 2016, 0.74% at December 31, 2015, and 0.81% at September 30, 2015. Non-accrual loan balances decreased due primarily to several larger commercial loan payoffs and principal payments, partially offset by additional loans added to non-accrual status during the period.

The Company's obligation to fulfill the additional funding commitments on non-accrual loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance, additional funding commitments may or may not be made at the Company's discretion. At September 30, 2016 additional funding commitments for non-accrual loans was not material.

#### Impaired loans

Impaired loans are individually significant loans for which management considers it probable that not all amounts due (principal and interest) in accordance with the original contractual terms will be collected. The majority of impaired loans are included within the non-accrual balances; however, not every loan on non-accrual status has been designated as impaired. Impaired loans include loans that have been modified in a troubled debt restructuring (or "TDR," see below). Impaired loans exclude large groups of smaller-balance homogeneous loans, such as residential mortgage loans and consumer loans, which are collectively evaluated for impairment, and loans that are measured at fair value, unless the loan is amended in a TDR.

Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Management considers the individual payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms. An impaired or TDR loan classification will be considered for upgrade based on the borrower's sustained performance over time and their improving financial condition. Consistent with the criteria for returning non-accrual loans to accrual status, the borrower must demonstrate the ability to continue to service the loan in accordance with the original or modified terms and, in the judgment of management, the collectability of the remaining balances, both principal and interest, are reasonably assured. In the case of TDR loans having had a modified interest rate, that rate must be at, or greater than, a market rate for a similar credit at the time of modification for an upgrade to be considered.

Impaired loans are individually evaluated for credit loss and a specific allowance reserve is assigned for the amount of the estimated probable credit loss. Refer to heading "Allowance for probable loan losses methodology" contained in Note 4 "Allowance For Loan Losses," to the Company's consolidated financial statements contained in the 2015 Annual Report on Form 10-K for further discussion of management's methodology used to estimate specific reserves for impaired loans.

The carrying value of impaired loans amounted to \$28.7 million and \$23.7 million at September 30, 2016 and December 31, 2015, respectively. Total accruing impaired loans amounted to \$19.0 million and \$10.1 million at September 30, 2016 and December 31, 2015, respectively, while non-accrual impaired loans amounted to \$9.7 million and \$13.6 million as of September 30, 2016 and December 31, 2015, respectively. In the current period, among other downgrades to impaired status, the credit rating of one larger commercial relationship (having both commercial real estate and commercial & industrial components) with a net carrying value of approximately \$7.8 million was downgraded to an adverse risk rating and also designated as accruing-impaired based on a review of the individual business circumstances. These downgrades were partially offset by principal pay-downs, credit upgrades, and charge-offs during the period.





## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

The following tables set forth the recorded investment in impaired loans and the related specific allowance allocated as of the dates indicated.

(Dollars in thousands)	Balance at September 30, 2016				
	Unpaid contractual principal balance	Total recorded investment in impaired loans	Recorded investment with no allowance	Recorded investment with allowance	Related specific allowance
Commercial real estate	\$ 16,332	\$ 14,533	\$ 12,568	\$ 1,965	\$ 518
Commercial and industrial	11,150	10,343	7,752	2,591	975
Commercial construction	3,098	3,059	1,632	1,427	473
Residential mortgages	391	297	297	—	—
Home equity loans and lines	646	499	499	—	—
Consumer	3	3	—	3	2
Total	\$ 31,620	\$ 28,734	\$ 22,748	\$ 5,986	\$ 1,968

(Dollars in thousands)	Balance at December 31, 2015				
	Unpaid contractual principal balance	Total recorded investment in impaired loans	Recorded investment with no allowance	Recorded investment with allowance	Related specific allowance
Commercial real estate	\$ 14,903	\$ 12,287	\$ 11,734	\$ 553	\$ 186
Commercial and industrial	9,816	7,810	5,253	2,557	1,078
Commercial construction	3,147	3,032	1,583	1,449	499
Residential mortgages	453	366	366	—	—
Home equity loans and lines	308	169	164	5	5
Consumer	25	24	—	24	24
Total	\$ 28,652	\$ 23,688	\$ 19,100	\$ 4,588	\$ 1,792

The following table presents the average recorded investment in impaired loans and the related interest recognized during the three months indicated:

(Dollars in thousands)	Three Months Ended September 30, 2016		Three Months Ended September 30, 2015	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
Commercial real estate	\$ 14,828	\$ 107	\$ 13,360	\$ 56
Commercial and industrial	9,889	69	8,567	16
Commercial construction	3,113	39	1,834	17
Residential mortgages	300	—	440	—
Home equity loans and lines	368	(2)	174	1
Consumer	13	1	47	—
Total	\$ 28,511	\$ 214	\$ 24,422	\$ 90

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

The following table presents the average recorded investment in impaired loans and the related interest recognized during the nine month periods indicated:

(Dollars in thousands)	Nine Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
Commercial real estate	\$ 12,399	\$ 214	\$ 14,277	\$ 153
Commercial and industrial	8,801	134	9,881	74
Commercial construction	3,059	113	2,142	59
Residential mortgages	304	—	449	—
Home equity loans and lines	307	(4 )	177	2
Consumer	18	1	48	—
Total	\$ 24,888	\$ 458	\$ 26,974	\$ 288

At September 30, 2016, additional funding commitments for impaired loans totaled \$394 thousand. The Company's obligation to fulfill the additional funding commitments on impaired loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance, additional funding commitments may or may not be made at the Company's discretion.

#### Troubled debt restructurings

Loans are designated as a TDR when, as part of an agreement to modify the original contractual terms of the loan as a result of financial difficulties of the borrower, the Bank grants the borrower a concession on the terms, that would not otherwise be considered. Typically, such concessions may consist of a reduction in interest rate to a below market rate, taking into account the credit quality of the note, extension of additional credit based on receipt of adequate collateral, or a deferment or reduction of payments (principal or interest) which materially alters the Bank's position or significantly extends the note's maturity date, such that the present value of cash flows to be received is materially less than those contractually established at the loan's origination. All loans that are modified are reviewed by the Company to identify if a TDR has occurred. TDR loans are included in the impaired loan category and, as such, these loans are individually evaluated and a specific reserve is assigned for the amount of the estimated probable credit loss.

Total TDR loans, included in the impaired loan balances above, as of September 30, 2016 and December 31, 2015, were \$24.1 million and \$17.1 million, respectively. The increase in TDR loans was primarily due to the impaired commercial relationship noted above, with a net carrying value of approximately \$7.8 million, also being designated as a TDR due to additional funding of \$1.5 million after the pledge of additional collateral by the borrower. TDR loans on accrual status amounted to \$18.9 million and \$10.1 million at September 30, 2016 and December 31, 2015, respectively. TDR loans included in non-performing loans amounted to \$5.2 million and \$7.1 million at September 30, 2016 and December 31, 2015, respectively. The Company continues to work with commercial relationships and enters into loan modifications to the extent deemed to be necessary or appropriate while attempting to achieve the best mutual outcome given the individual financial circumstances and future prospects of the borrower.

At September 30, 2016, additional funding commitments for TDR loans totaled \$394 thousand. The Company's obligation to fulfill the additional funding commitments on TDR loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance, additional funding commitments may or may not be made at the Company's discretion.



## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

The following tables present certain information regarding loan modifications classified as troubled debt restructurings.

Loans modified as troubled debt restructurings during the three-month period ended September 30, 2016 are detailed below.

(Dollars in thousands)	Three months ended September 30, 2016	
	Pre-modification Number of restructurings investment	Post-modification outstanding recorded investment
Commercial real estate	3 \$ 532	\$ 2,026
Commercial and industrial	2 224	200
Commercial construction	—	—
Residential mortgages	—	—
Home equity loans and lines	—	—
Consumer	—	—
Total	5 \$ 756	\$ 2,226

Payment defaults, during the three-month period ended September 30, 2016, on loans modified as troubled debt restructurings within the preceding twelve months are detailed below.

(Dollars in thousands)	Three months ended September 30, 2016	
	Number of modification TDAs that defaulted	Outstanding recorded investment
Commercial real estate	1 \$ 148	
Commercial and industrial	—	
Commercial construction	1 1,188	
Residential mortgages	—	
Home equity loans and lines	—	
Consumer	—	
Total	2 \$ 1,336	

Loans modified as troubled debt restructurings during the nine months ended September 30, 2016 are detailed below.

(Dollars in thousands)	Nine months ended September 30, 2016	
	Pre-modification Number of restructurings investment	Post-modification outstanding recorded investment
Commercial real estate	7 \$ 5,624	\$ 7,016
Commercial and industrial	8 2,282	2,237
Commercial construction	—	—

Residential mortgages	—	—	—
Home equity loans and lines	—	—	—
Consumer	—	—	—
Total	15	\$ 7,906	\$ 9,253

24

---

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

Payment defaults, during the nine months ended September 30, 2016, on loans modified as troubled debt restructurings within the preceding twelve months are detailed below.

	Nine months ended September 30, 2016	Number of modification of modification	Number of modification of modification
(Dollars in thousands)		TDRs that recorded defaulted	Principal amount
Commercial real estate	1	\$	148
Commercial and industrial	2		389
Commercial construction	1		1,188
Residential mortgages	—		—
Home equity loans and lines	—		—
Consumer	—		—
Total	4	\$	1,725

There were no subsequent charge-offs associated with the TDRs noted in the table above during the nine months ended September 30, 2016. At September 30, 2016, there were \$204 thousand specific reserves allocated to the TDRs entered into during the 2016 period as management considered it likely that the unreserved principal will ultimately be collected. Interest payments received on non-accruing TDRs in the table above which were applied to principal and not recognized in interest income during the nine months ended September 30, 2016 were not material.

There were no loans modified as troubled debt restructurings during the three month period ended September 30, 2015.

Payment defaults, during the three months ended September 30, 2015, on loans modified as troubled debt restructurings within the preceding twelve months are detailed below.

	Three months ended September 30, 2015	Number of modification of modification	Number of modification of modification
(Dollars in thousands)		TDRs that recorded defaulted	Principal amount
Commercial real estate	—	\$	—
Commercial and industrial	2		679
Commercial construction	—		—
Residential	—		—
Home Equity	—		—
Consumer	—		—
Total	2	\$	679

Loans modified as troubled debt restructurings during the nine month period ended September 30, 2015 are detailed below.

(Dollars in thousands)	Nine months ended September 30, 2015	
	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial real estate	3 \$ 269	\$ 274
Commercial and industrial	4 869	823
Commercial construction	—	—
Residential mortgages	—	—
Home equity loans and lines	—	—
Consumer	1 4	3
Total	8 \$ 1,142	\$ 1,100



## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

Payment defaults, during the nine month period ended September 30, 2015, on loans modified as troubled debt restructurings within the preceding twelve months are detailed below.

	Nine months ended September 30, 2015
(Dollars in thousands)	Number of modification TDRs outstanding that recorded default
Commercial real estate	— \$ —
Commercial and industrial	2 679
Commercial construction	— —
Residential	— —
Home Equity	— —
Consumer	— —
Total	2 \$ 679

At September 30, 2015, there were specific reserves of \$20 thousand allocated to the TDRs entered into during the 2015 period as management considered it likely that the unreserved principal would ultimately be collected. Interest payments received on non-accruing TDRs in the table above which were applied to principal and not recognized in interest income during the nine months ended amounted to \$18 thousand.

There were no subsequent charge-offs associated with the TDRs noted in the table above during the nine months ended September 30, 2015.

## Other real estate owned ("OREO")

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as OREO. When property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance, net of any unamortized deferred fees, or the estimated fair value of the property acquired, less estimated costs to sell, establishing a new cost basis. The estimated fair value is based on market appraisals and the Company's internal analysis. Any loan balance in excess of the estimated realizable fair value on the date of transfer is charged to the allowance for loan losses on that date. All costs incurred thereafter in maintaining the property, as well as subsequent declines in fair value, are charged to non-interest expense.

The Company carried no OREO at either September 30, 2016 or December 31, 2015. There were no sales on OREO during the nine months ended September 30, 2016; there were also no additions to OREO, or subsequent impairment write-downs during the period. During the nine months ended September 30, 2015, the Company recorded \$154 thousand of net gains on OREO sales; there were no subsequent write-downs of OREO during that period.

At September 30, 2016, the Company had consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process according to local requirements of the applicable jurisdictions totaling \$325 thousand compared with none at December 31, 2015.

## Allowance for loan loss activity

The allowance for loan losses is established through a provision for loan losses, a direct charge to earnings. Loan losses are charged against the allowance when management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged-off are credited to the allowance.

The allowance for loan losses amounted to \$31.6 million at September 30, 2016, compared to \$29.0 million at December 31, 2015, and \$28.1 million at September 30, 2015. For the nine months ended September 30, 2016 and September 30, 2015, the provision for loan losses amounted to \$2.5 million and \$2.1 million, respectively. The increase in the provision for 2016 was due primarily to credit downgrades (partially offset by a lower level of charge-offs), and the higher level of loan growth during the 2016 period, as compared to the 2015 period as noted below.

In determining the provision to the allowance for loan losses, management takes into consideration the level of loan growth and an estimate of credit risk, which includes such items as adversely classified and non-performing loans, the estimated

ENTERPRISE BANCORP, INC.  
Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

specific reserves needed for impaired loans, the level of net charge-offs, and the estimated impact of current economic conditions on credit quality. Loan growth for the nine months ended September 30, 2016 was \$125.9 million compared to \$118.0 million during the nine months ended September 30, 2015. Total non-performing loans as a percentage of total loans declined to 0.50% at September 30, 2016, compared to 0.81% at September 30, 2015. The Company recorded net recoveries of \$78 thousand for the nine months ended September 30, 2016, compared to net charge-offs of \$1.1 million for the nine months ended September 30, 2015. The balance of the allowance for loan losses allocated to impaired and classified loans amounted to \$4.1 million at September 30, 2016, compared to \$3.2 million at September 30, 2015. During the current period, management downgraded the credit rating three larger commercial relationships to "criticized" or "adverse" risk ratings, based on a review of their individual business circumstances, requiring higher levels of reserves in the current period, which increased the provision and the allowance to total loan ratio compared to December 31, 2015; however, these loans continue to perform in accordance with their original terms.

The allowance for loan losses to total loans ratio was 1.59% at September 30, 2016, 1.56% at December 31, 2015 and 1.57% at September 30, 2015. As noted above, during the nine months ended September 30, 2016, the credit ratings of three larger commercial relationships were downgraded to "criticized" or "adverse" risk-ratings, based on a review of their individual business circumstances, requiring higher levels of reserves in the current period which increased the allowance to total loan ratio compared to December 31, 2015.

Based on management's judgment as to the existing credit risks inherent in the loan portfolio, as discussed above under the heading "Credit Quality Indicators," management believes that the Company's allowance for loan losses is adequate to absorb probable losses from specifically known and other credit risks associated with the portfolio as of September 30, 2016.

Changes in the allowance for loan losses by portfolio segment for the three months ended September 30, 2016 are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at June 30, 2016	\$ 14,514	\$ 9,913	\$4,056	\$ 1,085	\$ 552	\$ 225	\$30,345
Provision	581	761	22	17	4	1	1,386
Recoveries	—	28	—	—	—	1	29
Less: Charge offs	—	151	—	—	—	20	171
Ending Balance at September 30, 2016	\$ 15,095	\$ 10,551	\$4,078	\$ 1,102	\$ 556	\$ 207	\$31,589

Changes in the allowance for loan losses by segment for the nine months ended September 30, 2016 are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at December 31, 2015	\$ 13,514	\$ 9,758	\$3,905	\$ 1,061	\$ 540	\$ 230	\$29,008
Provision	1,740	510	178	41	19	15	2,503
Recoveries	20	637	—	—	2	4	663
Less: Charge offs	179	354	5	—	5	42	585
Ending Balance at September 30, 2016	\$ 15,095	\$ 10,551	\$4,078	\$ 1,102	\$ 556	\$ 207	\$31,589
Ending allowance balance:							
Allocated to loans individually evaluated for impairment	\$ 518	\$ 975	\$473	\$ —	\$ —	\$ 2	\$1,968

Allocated to loans collectively evaluated for impairment	\$ 14,577	\$ 9,576	\$ 3,605	\$ 1,102	\$ 556	\$ 205	\$ 29,621
--	-----------	----------	----------	----------	--------	--------	-----------

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

Changes in the allowance for loan losses by segment for the three months ended September 30, 2015 are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at June 30, 2015	\$ 12,864	\$ 10,022	\$ 3,447	\$ 1,022	\$ 575	\$ 232	\$ 28,162
Provision	435	(311 )	207	(50 )	(52 )	21	250
Recoveries	—	65	—	—	1	2	68
Less: Charge offs	108	232	—	—	—	10	350
Ending Balance at September 30, 2015	\$ 13,191	\$ 9,544	\$ 3,654	\$ 972	\$ 524	\$ 245	\$ 28,130

Changes in the allowance for loan losses by segment for the nine months ended September 30, 2015 are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at December 31, 2014	\$ 12,664	\$ 9,245	\$ 3,384	\$ 989	\$ 608	\$ 231	\$ 27,121
Provision	630	1,268	245	(17 )	(99 )	73	2,100
Recoveries	5	232	25	—	15	14	291
Less: Charge offs	108	1,201	—	—	—	73	1,382
Ending Balance at September 30, 2015	\$ 13,191	\$ 9,544	\$ 3,654	\$ 972	\$ 524	\$ 245	\$ 28,130
Ending allowance balance:							
Allocated to loans individually evaluated for impairment	\$ 160	\$ 1,265	\$ 516	\$ —	\$ —	\$ 44	\$ 1,985
Allocated to loans collectively evaluated for impairment	\$ 13,031	\$ 8,279	\$ 3,138	\$ 972	\$ 524	\$ 201	\$ 26,145

## (5) Deposits

Deposits are summarized as follows:

(Dollars in thousands)	September 30, 2016	December 31, 2015
Non-interest bearing demand deposits	\$ 645,907	\$ 570,589
Interest bearing checking	346,957	313,674
Savings	181,653	167,304
Money market	815,861	692,114
Certificates of deposit \$250,000 or less	127,520	129,993
Certificates of deposit more than \$250,000	44,371	37,704
Total non-brokered deposits <sup>(1)</sup>	2,162,269	1,911,378
Brokered deposits <sup>(2)</sup>	59,340	106,770
Total deposits	\$ 2,221,609	\$ 2,018,148

<sup>(1)</sup> Includes reciprocal money market deposits and CDs received from participating banks in nationwide networks as a result of our customers electing to participate in programs to obtain full FDIC insurance. Essentially, the equivalent of the original deposit comes back to the Company as non-brokered deposits within the appropriate category under total deposits on the balance sheet.

<sup>(2)</sup> Primarily brokered CDs \$250,000 and under.



ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

## (6) Borrowed Funds and Subordinated Debt

Borrowed funds amounted to \$671 thousand at September 30, 2016, compared to \$53.7 million at December 31, 2015. At September 30, 2016 borrowed funds consisted of FHLB borrowings only. At December 31, 2015, the borrowed funds balance was comprised of FHLB borrowings of \$40.7 million and an overnight borrowing with a correspondent bank, totaling \$13.0 million.

The Company also carried subordinated debt of \$14.8 million at both September 30, 2016 and December 31, 2015, which consisted of \$15.0 million in aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Notes"), issued in January 2015, in a private placement to an accredited investor. The Notes, which are intended to qualify as Tier 2 capital for regulatory purposes, mature on January 30, 2030 (the "Maturity Date") and are callable by the Company, subject to regulatory approval, at a premium beginning January 30, 2020, and at par beginning January 30, 2025. The Notes pay interest at a fixed rate of 6.00% per annum through January 30, 2025, and beginning on January 31, 2025 through the Maturity Date, or any early redemption date, the interest rate on the Notes will adjust monthly at an interest rate of 3.90% plus 30-day LIBOR. Original note issuance costs were \$190 thousand and have been netted against the subordinated debt on the balance sheet in accordance with accounting guidance that the Company adopted in the first quarter of 2015. These costs are being amortized over the life of the Notes.

In March 2015, the Company used the net proceeds from the issuance of the Notes to pay off \$10.8 million of outstanding Junior Subordinated debentures that originated in 2000, from the sale of trust preferred securities by Enterprise Capital Trust (the "Trust"), a former subsidiary of the Company. The pay down of this debt allowed the trust preferred securities to be redeemed in full and the Trust to subsequently be dissolved in April 2015.

## (7) Derivatives and Hedging Activities

Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The commitments to sell loans are also considered derivative instruments. The Company generally does not pool mortgage loans for sale, but instead, sells the loans on an individual basis. To reduce the net interest rate exposure arising from its loan sale activity, the Company enters into the commitment to sell these loans at essentially the same time that the interest rate lock commitment is quoted on the origination of the loan. The Company estimates the fair value of these derivatives based on current secondary mortgage market prices. At September 30, 2016 and 2015, the estimated fair values of these derivative instruments were considered to be immaterial.

Beginning in the fourth quarter of 2015, the Company implemented a "Back-to-Back Swap" program whereby the Bank enters into an interest rate swap with a qualified commercial banking customer and simultaneously enters into an equal and opposite interest rate swap with a counterparty. The customer interest rate swap agreement allows commercial banking customers to convert a floating-rate loan payment to fixed-rate loan payment. The transaction structure effectively minimizes the Bank's net risk exposure resulting from such transactions. Customer related credit risk is minimized by the cross collateralization of the loan and the interest rate swap agreement.

Back-to-Back Swaps are not speculative but rather, result from a service the Company provides to certain customers. Back-to-Back Swaps do not meet hedge accounting requirements and therefore changes in the fair value of both the customer swaps and the counterparty swaps, which have an inverse equal relationship, are recognized directly in earnings. As such, there was no net gain or loss recognized in income on Back-to-Back Swaps during the three months ended September 30, 2016.

The Company had four interest-rate swaps at September 30, 2016 with an aggregate notional amount of \$26.8 million compared to two interest-rate swaps with an aggregate notional amount of \$10.1 million at December 31, 2015.

Asset derivatives and liability derivatives are included in prepaid expenses and other assets and accrued expenses and other liabilities on the consolidated balance sheets, respectively.

The table below presents the fair value and classification of the Company's derivative financial instruments for the periods presented:

	As of September 30, 2016	As of December 31, 2015
(Dollars in thousands)	Asset Liability Derivatives	Asset Liability Derivatives
Back-to-Back Swaps	\$ 318 \$ 318	\$ 16 \$ 16



## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

By using derivative financial instruments, the Company exposes itself to counterparty credit risk. Credit risk is the risk of failure by the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates credit risk for the Company. When the fair value of a derivative is negative, the Company owes the counterparty and, therefore, it does not possess credit risk. The credit risk in derivative instruments is mitigated by entering into transactions with highly-rated counterparties that management believes to be creditworthy. The Company did not have any counterparty credit risk exposure for derivative financial instruments at September 30, 2016.

Certain derivative agreements contain provisions that require the Company to post collateral if the derivative exposure exceeds a threshold amount. See the table below for amounts held at each period presented. The table below also presents the Company's asset and liability derivative positions and the potential effect of netting arrangements on its financial position, as of the periods presented.

September 30, 2016

	Gross Amounts of Recognized Asset/ Financial Position	Offset in the Statement of Liabilities of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross amounts not offset in the Statement of Financial Position	Collateral Received/Posted	Net Amount
(Dollars in thousands)						
Asset Derivatives						
Back-to-Back Swaps	\$ 318	\$ —	\$ 318	\$ —		\$ 318
Liability Derivatives						
Back-to-Back Swaps	\$ 318	\$ —	\$ 318	\$ 340		\$ (22 )

December 31, 2015

	Gross Amounts of Recognized Asset/ Financial Position	Offset in the Statement of Liabilities of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross amounts not offset in the Statement of Financial Position	Collateral Received/Posted	Net Amount
(Dollars in thousands)						
Asset Derivatives						
Back-to-Back Swaps	\$ 16	\$ —	\$ 16	\$ —		\$ 16
Liability Derivatives						
Back-to-Back Swaps	\$ 16	\$ —	\$ 16	\$ —		\$ 16

The Company has agreements with certain derivative counterparties that contain credit-risk-related contingent provisions. These provisions provide the counterparty with the right to terminate its derivative positions and require the Company to settle its obligations under the agreements if the Company defaults on certain of its indebtedness.

The Company also participates in loans originated by third party banks, where the originating bank utilizes a back-to-back interest rate swap structure; however, the Company is not a party to the swap agreements. Under the terms of the loan participations, the Company has accepted contingent liabilities that would only occur if the swaps were terminated early and there were outstanding losses not covered by the underlying borrowers and the borrowers' pledged collateral. If applicable, the Company's swap loss exposure would be equal to the percentage of the Company's participation in the underlying loan applied

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

to the originating bank's swap loss. At September 30, 2016, the Company had two such participation loans and management considers the risk of material swap loss exposure to be unlikely based on the swap mark-to-market and the borrower's underlying collateral and financial strength. At December 31, 2015, the Company did not have any of these agreements.

#### (8) Supplemental Retirement Plan and Other Postretirement Benefit Obligations

##### Supplemental Employee Retirement Plan ("SERP")

The Company has salary continuation agreements with two of its current executive officers and one former executive officer. These agreements provide for predetermined fixed-cash supplemental retirement benefits to be provided for a period of 20 years after each individual reaches a defined "benefit age." The individuals covered under the SERP have reached the defined benefit age and are receiving payments under the plan. Additionally, the Company has not recognized service costs in the current or prior year as each officer had previously attained their individually defined benefit age and was fully vested under the plan.

This non-qualified plan represents a direct liability of the Company, and as such has no specific assets set aside to settle the benefit obligation. The funded status is the aggregate amount accrued, or the "accumulated benefit obligation," which is equal to the present value of the benefits to be provided to the employee or any beneficiary. Because the Company's benefit obligations provide for predetermined fixed-cash payments, the Company does not have any unrecognized costs to be included as a component of accumulated other comprehensive income.

Total net periodic benefit costs, comprised of interest costs only, were \$31 thousand and \$93 thousand for both the three and nine months ended September 30, 2016, compared to \$31 thousand and \$94 thousand for the three and nine months ended September 30, 2015.

Benefits paid amounted to \$69 thousand and \$207 thousand for both the three and nine months ended September 30, 2016 and September 30, 2015. The Company anticipates accruing an additional \$31 thousand to the SERP during the remainder of 2016.

##### Supplemental Life Insurance

The Company has provided supplemental life insurance through split-dollar life insurance arrangements for certain executive and senior officers on whom the Bank owns bank-owned life insurance ("BOLI").

These arrangements provide a death benefit to the officer's designated beneficiaries that extend to postretirement periods for some of the supplemental life insurance plans. The Company has recognized a liability for these future postretirement benefits.

These non-qualified plans represent a direct liability of the Company, and as such has no specific assets set aside to settle the benefit obligation. The funded status is the aggregate amount accrued, or the "accumulated postretirement benefit obligation," which is the present value of the post-retirement benefits associated with this arrangement.

The following table illustrates the net periodic post-retirement benefit cost for the supplemental life insurance plans for the periods indicated:

Three months	Nine months
-----------------	----------------

	ended		ended	
	September		September	
	30,	30,	30,	30,
(Dollars in thousands)	2016	2015	2016	2015
Service Cost	\$(2 )	\$(1 )	\$(7 )	\$(3 )
Interest Cost	22	19	64	58
Net periodic post-retirement benefit cost	\$20	\$18	\$57	\$55

## (9) Stock-Based Compensation

The Company currently has three individual stock incentive plans: the 2003 plan as amended in 2009, the 2009 plan as amended in 2015 and the 2016 plan. The 2016 plan which was approved by the Company's stockholders at the May 2016 annual meeting, has essentially the same terms as the 2003 and 2009 plans. The plans permit the Board of Directors to grant, under various terms, both incentive and non-qualified stock options (for the purchase of newly issued shares of common stock), restricted stock, restricted stock units and stock appreciation rights to officers and other employees, directors and consultants.

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

These plans also allow for newly issued shares of common stock to be issued without restrictions to officers and other employees, directors and consultants. As of September 30, 2016, an aggregate of 469,745 shares remain available for future grants under the 2009 and 2016 plans. The 2003 plan is closed to future grants, although several awards previously granted under this plan remain outstanding and may be exercised in the future.

The Company's stock-based compensation expense includes stock options and stock awards to officers and other employees included in salary and benefits expense, and stock awards and stock compensation in lieu of cash fees to non-employee directors included in other operating expenses. Total stock-based compensation expense was \$444 thousand and \$1.3 million for the three and nine months ended September 30, 2016, compared to \$411 thousand and \$1.4 million for the three and nine months ended September 30, 2015.

#### Stock Option Awards

The Company recognized stock-based compensation expense related to stock option awards of \$63 thousand and \$205 thousand for the three and nine months ended September 30, 2016, compared to \$71 thousand and \$247 thousand for the three and nine months ended September 30, 2015.

The Company utilizes the Black-Scholes option valuation model in order to determine the per share grant date fair value of option grants.

The table below provides a summary of the options granted in 2016 and 2015.

	Nine Months Ended September 30,		
	2016	2015	
Options granted	31,047	27,376	
Term in years	10	10	
Weighted average assumptions used in the fair value model:			
Expected volatility	42	% 47	%
Expected dividend yield	3.02	% 2.90	%
Expected life in years	7	7	
Risk-free interest rate	1.91	% 1.95	%
Weighted average market price on date of grants	\$21.91	\$21.03	
Per share weighted average fair value	\$7.91	\$8.51	
Fair value as a percentage of market value at grant date	36	% 40	%

Options granted during the first nine months of 2016 and 2015 generally vest 50% in year two and 50% in year four, on the anniversary date of the awards. Vested options are only exercisable while the employee remains employed with the Bank and for a limited time thereafter. If a grantee's employment or other service relationship, such as service as a director, is terminated for any reason, then any stock options granted that have not vested as of the time of such termination generally must be forfeited, unless the Compensation Committee or the Board of Directors, as the case may be, waives such forfeiture requirement.

Refer to Note 11 "Stock-Based Compensation Plans" in the Company's 2015 Annual Report on Form 10-K for a further description of the assumptions used in the valuation model.

#### Stock Awards

Stock-based compensation expense recognized in association with stock awards amounted to \$322 thousand and \$939 thousand for the three and nine months ended September 30, 2016, compared to \$295 thousand and \$928 thousand for the three and nine months ended September 30, 2015.

Restricted stock awards are granted at the market price on the date of the grant. Employee awards generally vest over four years in equal portions beginning on or about the first anniversary date of the award or are performance based awards that vest

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

upon the Company achieving certain predefined performance objectives. Non-employee director awards generally vest over two years in equal portions beginning on or about the first anniversary date of the award.

The table below provides a summary of restricted stock awards granted in 2016 and 2015.

	Nine Months Ended September 30,	
	2016	2015
Restricted Stock Awards		
Two Year Vesting	9,060	7,276
Four Year Vesting	18,298	17,775
Performance-Based Vesting	35,071	30,262
Total Restricted Stock Awards	62,429	55,313

Weighted average grant date fair value \$21.90 \$21.03

If a grantee's employment or other service relationship, such as service as a director, is terminated for any reason, then any shares of restricted stock granted that have not vested as of the time of such termination generally must be forfeited, unless the Compensation Committee or the Board of Directors, as the case may be, waives such forfeiture requirement.

The restricted stock awards allow for the receipt of dividends, and the voting of all shares, whether or not vested, throughout the vesting periods at the same proportional level as common shares outstanding.

Upon vesting, restricted stock awards may be net share-settled to cover payment for employee tax obligations, resulting in shares of common stock being reacquired by the Company. In accordance with Chapter 156D of the Massachusetts General Laws, a statute known as the Massachusetts Business Corporation Act, which applies to Massachusetts corporations such as the Company, eliminates the concept of "treasury stock" and provides that shares a Massachusetts company reacquires will be treated as authorized but unissued shares.

Any shares that are returned to the Company prior to vesting or as payment for employee tax obligations upon vesting shall remain available for issuance under such plan, while the plan is still open.

#### Stock in Lieu of Directors' Fees

In addition to restricted stock awards discussed above, the non-employee members of the Company's Board of Directors may opt to receive newly issued shares of the Company's common stock in lieu of cash compensation for attendance at Board and Board Committee meetings. Stock-based compensation expense related to these directors' fees amounted to \$59 thousand and \$205 thousand for the three and nine months ended September 30, 2016, compared to \$45 thousand and \$190 thousand for the three and nine months ended September 30, 2015, and is included in other operating expenses. In January 2016, non-employee directors were issued 10,657 shares of common stock in lieu of 2015 annual cash fees of \$254 thousand at a market value price of \$23.86 per share, the market value of the common stock on the opt-in measurement date of January 2, 2015.

#### (10) Earnings per share

Basic earnings per share are calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding (including participating securities) during the year. The Company's only participating securities are unvested restricted stock awards that contain non-forfeitable rights to dividends.

Diluted earnings per share reflects the effect on weighted average shares outstanding of the number of additional shares outstanding if dilutive stock options were converted into common stock using the treasury stock method.



Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

The table below presents the increase in average shares outstanding, using the treasury stock method, for the diluted earnings per share calculation for the periods indicated:

	Three months ended September 30, 2016		Nine months ended September 30, 2015	
Basic weighted average common shares outstanding	11,430,134	10,349,232	10,801,278	10,308,310
Dilutive shares	68,856	65,022	68,127	65,154
Diluted weighted average common shares outstanding	11,498,990	10,414,254	10,869,405	10,373,464

As of September 30, 2016, there were 57,541 options outstanding that were determined to be anti-dilutive and therefore excluded from the calculation of dilutive shares for the nine months ended September 30, 2016. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

#### (11) Fair Value Measurements

The FASB defines the fair value of an asset or liability to be the price which a seller would receive in an orderly transaction between market participants (an exit price) and also establishes a fair value hierarchy segregating fair value measurements using three levels of inputs: (Level 1) quoted market prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs, including quoted prices for similar items in active markets, quoted prices for identical or similar items in markets that are not active, inputs such as interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates which provide a reasonable basis for fair value determination or inputs derived principally from observed market data; and (Level 3) significant unobservable inputs for situations in which there is little, if any, market activity for the asset or liability. Unobservable inputs must reflect reasonable assumptions that market participants would use in pricing the asset or liability, which are developed on the basis of the best information available under the circumstances.

The following tables summarize significant assets and liabilities carried at fair value and placement in the fair value hierarchy at the dates specified:

(Dollars in thousands)	September 30, 2016			
	Fair Value	Fair Value Measurements using:		
		(level 1)	(level 2)	(level 3)
Assets measured on a recurring basis:				
Fixed income securities	\$ 337,187	\$ —	\$ 337,187	\$ —
Equity securities	11,877	11,877	—	—
FHLB stock	1,884	—	—	1,884
Interest-rate swaps	318	—	318	—
Assets measured on a non-recurring basis:				
Impaired loans (collateral dependent)	3,951	—	—	3,951
Liabilities measured on a recurring basis:				
Interest-rate swaps	318	—	318	—

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

(Dollars in thousands)	December 31, 2015			
	Fair Value	Fair Value Measurements using:		
		(level 1)	(level 2)	(level 3)
Assets measured on a recurring basis:				
Fixed income securities	\$ 288,701	\$ —	\$ 288,701	\$ —
Equity securities	11,657	11,657	—	—
FHLB stock	3,050	—	—	3,050
Interest-rate swaps	16	—	16	—
Assets measured on a non-recurring basis:				
Impaired loans (collateral dependent)	2,516	—	—	2,516
Liabilities measured on a recurring basis:				
Interest-rate swaps	16	—	16	—

The Company did not have cause to transfer any assets between the fair value measurement levels during the nine months ended September 30, 2016 or the year ended December 31, 2015.

All of the Company's fixed income investments and equity securities that are considered "available-for-sale" are carried at fair value. The fixed income category above includes federal agency obligations, commercial and residential federal agency MBS, municipal securities, corporate bonds and certificates of deposits, as held at those dates. The Company utilizes third-party pricing vendors to provide valuations on its fixed income securities. Fair values provided by the vendors were generally determined based upon pricing matrices utilizing observable market data inputs for similar or benchmark securities in active markets and/or based on a matrix pricing methodology which employs The Bond Market Association's standard calculations for cash flow and price/yield analysis, live benchmark bond pricing and terms/condition data available from major pricing sources. Therefore, management regards the inputs and methods used by third-party pricing vendors to be "Level 2 inputs and methods" as defined in the "fair value hierarchy." The Company periodically obtains a second price from an impartial third party on fixed income securities to assess the reasonableness of prices provided by the primary independent pricing vendor.

The Company's equity portfolio fair value is measured based on quoted market prices for the shares; therefore, these securities are categorized as Level 1 within the fair value hierarchy.

The Bank is required to purchase FHLB stock at par value in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost which management believes approximates fair value; therefore, these securities are categorized as Level 3 measures. See Note 1, "Summary of Significant Accounting Policies," Item (d) for further information regarding the Company's fair value assessment of FHLB capital stock.

Impaired loan balances in the table above represent those collateral dependent impaired commercial loans where management has estimated the credit loss by comparing the loan's carrying value against the expected realizable fair value of the collateral (appraised value, or internal analysis less estimated cost to sell, adjusted as necessary for changes in relevant valuation factors subsequent to the measurement date). Certain inputs used in these assessments, and possible subsequent adjustments, are not always observable, and therefore, collateral dependent impaired loans are categorized as Level 3 within the fair value hierarchy. A specific allowance is assigned to the collateral dependent impaired loan for the amount of management's estimated probable credit loss. The specific allowances assigned to the collateral dependent impaired loans amounted to \$1.3 million at September 30, 2016 compared to \$1.4 million at December 31, 2015.

When OREO property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance, net of unamortized deferred fees, or the estimated fair value of the property acquired, less estimated costs to sell. The estimated fair value is based on market appraisals and the Company's internal analysis. Certain inputs used in appraisals or the Company's internal analysis are not always observable and therefore, OREO may be categorized as Level 3 within the fair value hierarchy. The Company carried no OREO at either September 30, 2016 or December 31, 2015.

The fair values for the interest-rate swap assets and liabilities represent a FASB Level 2 measurement and are based on settlement values adjusted for credit risks associated with the counterparties and the Company and observable market interest rate curves. The settlement values are based on discounted cash flow analysis, a widely accepted valuation technique, reflecting

## ENTERPRISE BANCORP, INC.

Table of Contents Notes to the Unaudited Consolidated Interim Financial Statements

the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves. Credit risk adjustments consider factors such as the likelihood of default by the Company and its counterparties, its net exposures and remaining contractual life. The change in value of interest-rate swap assets and liabilities attributable to credit risk was not significant during the reported periods. Refer also to Note 7, "Derivatives and Hedging Activities," for additional information on the Company's interest-rate swaps.

Standby letters of credit are conditional commitments issued by the Company to guarantee the financial obligation or performance of a customer to a third party. The fair value of these commitments was estimated to be the fees charged to enter into similar agreements, and accordingly these fair value measures are deemed to be FASB Level 2 measurements. In accordance with the FASB, the estimated fair values of these commitments are carried on the balance sheet as a liability and amortized to income over the life of the letters of credit, which are typically one year. The estimated fair value of these commitments carried on the balance sheet at September 30, 2016 and December 31, 2015 were deemed immaterial.

Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The commitments to sell loans are also considered derivative instruments. The Company generally does not pool mortgage loans for sale, but instead sells the loans on an individual basis. To reduce the net interest rate exposure arising from its loan sale activity, the Company enters into the commitment to sell these loans at essentially the same time that the interest rate lock commitment is quoted on the origination of the loan. The Company estimates the fair value of these derivatives based on current secondary mortgage market prices. These commitments are accounted for in accordance with FASB guidance. The fair values of the Company's derivative instruments are deemed to be FASB Level 2 measurements. At September 30, 2016 and December 31, 2015, the estimated fair value of the Company's derivative instruments was considered to be immaterial.

The following table presents additional quantitative information about assets measured at fair value on a recurring and non-recurring basis for which the Company utilized Level 3 inputs (significant unobservable inputs for situations in which there is little, if any, market activity for the asset or liability) to determine fair value as of September 30, 2016:

(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Unobservable Input Value or Range
Assets measured on a recurring basis:				
FHLB stock	\$1,884	FHLB Stated Par Value	N/A	N/A
Assets measured on a non-recurring basis:				
Impaired loans (collateral dependent)	\$3,951	Appraisal of collateral	Appraisal adjustments <sup>(1)</sup>	5% - 50%

<sup>(1)</sup> Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.

#### Estimated Fair Values of Assets and Liabilities

In addition to disclosures regarding the measurement of assets and liabilities carried at fair value on the balance sheet, the Company is also required to disclose fair value information about financial instruments for which it is practicable to estimate that value, whether or not recognized on the balance sheet.



Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

The carrying values, estimated fair values and placement in the fair value hierarchy of the Company's financial instruments for which fair value is only disclosed but not recognized on the balance sheet at the dates indicated are summarized as follows:

(Dollars in thousands)	September 30, 2016		Fair value measurement		
	Carrying Amount	Fair Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Financial assets:					
Loans held for sale	\$2,171	\$ 2,176	\$—	\$2,176	\$ —
Loans, net	1,954,265	1,961,363	—	—	1,961,363
Financial liabilities:					
Certificates of deposit (including brokered)	231,231	231,698	—	231,698	—
Borrowed funds	671	671	—	671	—
Subordinated debt	14,831	15,012	—	—	15,012
(Dollars in thousands)	December 31, 2015		Fair value measurement		
	Carrying Amount	Fair Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Financial assets:					
Loans held for sale	\$1,709	\$ 1,709	\$—	\$1,709	\$ —
Loans, net	1,830,954	1,845,009	—	—	1,845,009
Financial liabilities:					
Certificates of deposit (including brokered)	274,467	273,419	—	273,419	—
Borrowed funds	53,671	53,670	—	53,670	—
Subordinated debt	14,822	13,961	—	—	13,961

Excluded from the tables above are certain financial instruments with carrying values that approximated their fair value at the dates indicated, as they were short-term in nature or payable on demand. These include cash and cash equivalents, accrued interest receivable, non-term deposit accounts, and accrued interest payable. The respective carrying values of these instruments would all be considered to be classified within Level 1 of their fair value hierarchy.

Also excluded from these tables are the fair values of commitments for unused portion of lines of credit and letters of credit, which were estimated to be the fees currently charged to enter into similar agreements and are deemed to be immaterial, as well as commitments to originate non-mortgage loans which were short-term, at current market rates and estimated to have no significant change in fair value.

When determining fair values noted in the tables above, in cases where quoted fair values are not available, fair values are based upon estimates using various valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following methods and assumptions were used by the Company in estimating fair values of its financial instruments:

Loans held for sale: Loans held for sale are recorded at the lower of aggregate amortized cost or market value. The fair value is based on comparable market prices for loans with similar rates and terms.

Loans: The fair value of loans was determined using discounted cash flow analysis, using interest rates currently being offered by the Company. The incremental credit risk for adversely classified loans was considered in the determination of the fair value of the loans. This method of estimating fair value does not incorporate the exit price concept of fair value.

Financial liabilities: The fair values of certificates of deposit and borrowings were estimated using discounted cash flow analysis using rates offered by the Bank or advance rates offered by the FHLB on September 30, 2016 and December 31, 2015

Table of Contents ENTERPRISE BANCORP, INC.  
Notes to the Unaudited Consolidated Interim Financial Statements

for similar instruments. The fair value of subordinated debt was estimated using discounted cash flow analysis using a market rate of interest at September 30, 2016 and December 31, 2015.

Limitations: The estimates of fair value of financial instruments were based on information available at September 30, 2016 and December 31, 2015 and are not indicative of the fair market value of those instruments as of the date of this Quarterly Report on Form 10-Q. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. The fair value of the Company's time deposit liabilities do not take into consideration the value of the Company's long-term relationships with depositors, which may have significant value.

Because no active market exists for a portion of the Company's financial instruments, fair value estimates were based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates were based on existing on- and off-balance sheet financial instruments without an attempt to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments, including premises and equipment and foreclosed real estate.

In addition, the tax ramifications related to the realization of the unrealized appreciation and depreciation can have a significant effect on fair value estimates and have not been considered in any of the estimates. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.



Table of Contents

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

Management's discussion and analysis should be read in conjunction with the Company's (also referred to herein as "Enterprise," "us," "we" or "our") unaudited consolidated interim financial statements and notes thereto contained in this report and the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Annual Report on Form 10-K").

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q (this "Form 10-Q") contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including statements concerning plans, objectives, future events or performance and assumptions and other statements that are other than statements of historical fact. Forward-looking statements may be identified by reference to a future period or periods or by use of forward-looking terminology such as "anticipates," "believes," "expects," "intends," "may," "plans," "pursue," "views" and similar terms or expressions. Various statements contained in Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 3 - "Quantitative and Qualitative Disclosures About Market Risk" of this Form 10-Q including, but not limited to, statements related to management's views on the banking environment and the economy, competition and market expansion opportunities, the interest rate environment, credit risk and the level of future non-performing assets and charge-offs, potential asset and deposit growth, future non-interest expenditures and non-interest income growth, and borrowing capacity are forward-looking statements. The Company cautions readers that such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties that could cause the Company's actual results to differ materially from those expressed in, or implied by, the forward looking statement. The forward-looking statements in this Form 10-Q are based on information available to the Company as of the date of hereof, and the Company undertakes no obligation to publicly update or otherwise revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by applicable law. The following important factors, among others, could cause the Company's results for subsequent periods to differ materially from those expressed in any forward-looking statement made in this Form 10-Q: (i) changes in interest rates could negatively impact net interest income; (ii) changes in the business cycle and downturns in the local, regional or national economies, including deterioration in the local real estate market, could negatively impact credit and/or asset quality and result in credit losses and increases in the Company's allowance for loan losses; (iii) changes in consumer spending could negatively impact the Company's credit quality and financial results; (iv) increasing competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services could adversely affect the Company's competitive position within its market area and reduce demand for the Company's products and services; (v) deterioration of securities markets could adversely affect the value or credit quality of the Company's assets and the availability of funding sources necessary to meet the Company's liquidity needs; (vi) changes in technology, including the increased cyber-security risk and identity theft, could adversely impact the Company's operations and increase technology-related expenditures; (vii) increases in employee compensation and benefit expenses could adversely affect the Company's financial results; (viii) changes in laws and regulations that apply to the Company's business and operations, including without limitation, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Jumpstart Our Business Startups Act (the "JOBS Act"), the Basel III rules adopted by the federal banking regulators and the additional regulations that will be forthcoming as a result thereof, could cause the Company to incur additional costs and adversely affect the Company's business environment, operations and financial results; (ix) changes in accounting standards, policies and practices, as may be adopted or established by the regulatory agencies, the Financial Accounting Standards Board ("FASB"), or the Public Company Accounting Oversight Board could negatively impact the Company's financial results; (x) our ability to enter new markets successfully and capitalize on growth opportunities, including the receipt of required regulatory approvals; (xi) future regulatory compliance costs, including any increase caused by new regulations imposed by the Consumer Finance Protection Bureau; and (xii) the risks and uncertainties described in the documents that the Company files or furnishes to the Securities and Exchange

Commission (the "SEC"), including those discussed under "Risk Factors" in Item 1A of the Company's 2015 Annual Report on Form 10-K, which could have a material adverse effect on the Company's business, financial condition and results of operations. Therefore, the Company cautions readers not to place undue reliance on any such forward-looking information and statements.

## Table of Contents

### Overview

#### Executive Summary

Net income for the three months ended September 30, 2016 amounted to \$4.7 million, an increase of \$422 thousand, or 10%, compared to the same three-month period in 2015. Diluted earnings per share were \$0.41 for both the three months ended September 30, 2016 and 2015. Net income for the nine months ended September 30, 2016 amounted to \$13.8 million, an increase of \$2.4 million, or 21%, compared to the nine months ended September 30, 2015. Diluted earnings per share were \$1.27 for the nine months ended September 30, 2016, an increase of 15%, compared to the nine months ended September 30, 2015. In 2016, diluted earnings per share for the quarter ended September 30, 2016 fully includes the dilutive impact of the Company's recent equity offering and the nine months ended September 30, 2016 includes the dilutive effect from June 23 to September 30. See "Capital Resources" below for more information on the offering.

The increase in our 2016 earnings compared to 2015 is largely driven by our growth over the last twelve months. Loans, total assets, and deposits, excluding brokered deposits, have increased 11%, 13%, and 17%, respectively, as compared to September 30, 2015.

Strategically, our focus remains on organic growth and continually planning for and investing in our future. Our 23<sup>rd</sup> branch, on Route 101A in Nashua, NH, opened in early July 2016. We have also recently announced that we anticipate opening our 24<sup>th</sup> branch office in Windham, NH in 2017, which will fill a gap in our New Hampshire footprint.

#### Composition of Earnings

The Company's earnings are largely dependent on its net interest income, which is the difference between interest earned on loans and investments and the cost of funding (primarily deposits and borrowings). Net interest income expressed as a percentage of average interest earning assets is referred to as net interest margin. The Company reports net interest margin on a tax equivalent basis ("margin").

Net interest income for the three months ended September 30, 2016 amounted to \$21.8 million, an increase of \$1.9 million, or 9%, compared to the same period in 2015. Net interest income for the nine months ended September 30, 2016 amounted to \$64.2 million, an increase of \$6.6 million, or 11%, compared to the nine months ended September 30, 2015. The increase in net interest income was due primarily to loan growth. Average loan balances (including loans held for sale) increased \$185.6 million and \$181.8 million for the three and nine months ended September 30, 2016, respectively, compared to the same 2015 period averages. Net interest margin was 3.86% for the three months ended September 30, 2016 compared to 3.98% for the three months ended September 30, 2015. The third quarter of 2016 was impacted by higher balances in low-yielding interest-earning assets from short-term customer deposits. Net interest margin was 3.96% for the nine months ended September 30, 2016, compared to 3.97% for the nine months ended September 30, 2015.

For the three months ended September 30, 2016 and September 30, 2015, the provision for loan losses amounted to \$1.4 million and \$250 thousand, respectively. For the nine months ended September 30, 2016 and September 30, 2015, the provision for loan losses amounted to \$2.5 million and \$2.1 million, respectively.

In determining the provision to the allowance for loan losses, management takes into consideration the level of loan growth (including new loan growth which requires a provision for general reserves) and an estimate of credit risk, which includes such items as adversely classified and non-performing loans, the estimated specific reserves needed for impaired loans, the level of net charge-offs, and the estimated impact of current economic conditions on credit quality.

Loan growth for the nine months ended September 30, 2016 was \$125.9 million compared to \$118.0 million during the nine months ended September 30, 2015. Loan growth in 2016 was particularly strong in the third quarter compared to the same quarter in 2015. Total non-performing loans as a percentage of total loans declined to 0.50% at September 30, 2016, compared to 0.81% at September 30, 2015. The Company recorded net recoveries of \$78 thousand for the nine months ended September 30, 2016, compared to net charge-offs of \$1.1 million for the nine months ended September 30, 2015. The balance of the allowance for loan losses allocated to impaired and classified loans amounted to \$4.1 million at September 30, 2016, compared to \$3.2 million at September 30, 2015. During the current period, management downgraded the credit rating of three larger commercial relationships to "criticized" or "adverse" risk ratings, based on a review of their individual business circumstances, requiring higher levels of reserves in the current period, which increased the provision and the allowance to total loan ratio compared to December 31, 2015; however, these loans continue to perform in accordance with their original terms.

## Table of Contents

The allowance for loan losses to total loans ratio was 1.59% at September 30, 2016, 1.56% at December 31, 2015 and 1.57% at September 30, 2015. In general, the credit quality of the loan portfolio is improving, in part due to improved economic conditions over the past twelve months; however, individual loan downgrades, such as those noted above, which will occur due to individual business circumstances, slightly increased the allowance to total loan ratio. For further information regarding loan quality statistics and the allowance for loan losses, see the sections below under the heading "Financial Condition" titled "Asset Quality" and "Allowance for Loan Losses."

Non-interest income for the three months ended September 30, 2016 amounted to \$3.9 million, an increase of \$764 thousand, or 24%, compared to the same quarter last year. This increase was primarily due to an increase in net gains on the sales of investment securities. Non-interest income for the nine months ended September 30, 2016 amounted to \$10.7 million, a decrease of \$151 thousand, or 1%, compared to the nine months ended September 30, 2015. This decrease was due primarily to a decrease in net gains on the sales of investment securities, partially offset by increases in deposit and interchange fees and income on bank-owned life insurance.

Non-interest expense for the quarter ended September 30, 2016 amounted to \$17.4 million, an increase of \$866 thousand, or 5%, compared to the same quarter in the prior year. For the nine months ended September 30, 2016, non-interest expense amounted to \$51.8 million, an increase of \$2.8 million, or 6%, over the nine months ended September 30, 2015. Increases in expenses over the prior year primarily related to increases in the Company's strategic growth and market expansion initiatives, particularly salaries and benefits and technology expenses.

## Sources and Uses of Funds

The Company's primary sources of funds are customer and brokered deposits, Federal Home Loan Bank ("FHLB") borrowings, current earnings and proceeds from the sales, maturities and pay-downs on loans and investment securities. The Company may also, from time to time, utilize overnight borrowings from correspondent banks. Additionally, funding for the Company may be generated through equity transactions, including the dividend reinvestment and direct stock purchase plan or exercise of stock options, and occasionally the issuance of debt securities or the sale of new stock. During the second quarter of 2016, the Company completed an offering of shares of its common stock through a rights offering to its existing stockholders and a supplemental community offering to new members ("share offering"), raising approximately \$20.0 million in new capital (\$19.7 million, net of offering costs), and contributed the net proceeds to the Bank. These funds are intended to be used to originate loans, purchase investment securities, conduct operations, expand the branch network, and pay dividends to stockholders.

The investment portfolio is primarily used to provide liquidity, manage the Company's asset-liability position and to invest excess funds, providing additional sources of revenue. Total investments, one of the key components of interest earning assets, amounted to \$349.1 million at September 30, 2016, and comprised 14% of total assets at September 30, 2016 compared to 13% at December 31, 2015.

Enterprise's main asset strategy is to grow loans, the largest component of interest earning assets, with a focus on high quality commercial loans. Total loans increased \$125.9 million, since December 31, 2015 and amounted to \$1.99 billion at September 30, 2016, comprising 80% of total assets at September 30, 2016, compared to 81% at December 31, 2015. Total commercial loans amounted to \$1.71 billion, or 86% of gross loans, at September 30, 2016, which was consistent with the composition at December 31, 2015.

Management's preferred strategy for funding asset growth is to grow relationship-based deposit balances, preferably transactional deposits (comprised of demand deposit accounts, interest and business checking accounts and traditional savings accounts). Asset growth in excess of transactional deposits is typically funded through non-transactional deposits (comprised of money market accounts, commercial tiered rate or "investment savings" accounts and term certificates of deposit) and wholesale funding (brokered deposits and borrowed funds).

At September 30, 2016, total deposits, excluding brokered deposits, amounted to \$2.16 billion, an increase of \$250.9 million, or 13%, from December 31, 2015 balances. Non-brokered deposit growth since December 31, 2015 occurred in all deposit categories with the largest growth noted in money markets and checking accounts.

Wholesale funding amounted to \$60.0 million at September 30, 2016, compared to \$160.4 million at December 31, 2015, a decrease of \$100.4 million, or 63%. Wholesale funding included FHLB advances of \$671 thousand and \$40.7 million at September 30, 2016 and December 31, 2015, respectively, and brokered deposits of \$59.3 million and \$106.8 million at September 30, 2016 and December 31, 2015, respectively. At December 31, 2015, the Company also had an overnight

## Table of Contents

borrowing of \$13.0 million with a correspondent bank. Borrowed fund balances, FHLB advances and other borrowings, have declined \$53.0 million since December 31, 2015. Brokered deposits, comprised solely of CDs, have decreased \$47.4 million, or 44%, during the nine months ended September 30, 2016. The Company's level of wholesale funding has declined over the current year as deposit growth has exceeded loan growth.

### Opportunities and Risks

The Company's ability to achieve its long-term strategic growth and market share objectives will depend in part upon the Company's continued success in differentiating itself in the market place and its ability to strengthen its competitive position. Enterprise faces robust competition to attract and retain customers within existing and neighboring geographic markets. National and larger regional banks have a local presence in the Company's market area. These larger banks have certain competitive advantages, including greater financial resources and the ability to make larger loans to a single borrower. Numerous local savings banks, commercial banks, cooperative banks and credit unions also compete in the Company's market area. The expanded commercial lending capabilities of credit unions and the shift to commercial lending by traditional savings banks means that both of these types of traditionally consumer-orientated institutions now compete for the Company's targeted commercial customers. In addition, the non-taxable status of credit unions allows them certain advantages as compared to taxable institutions such as Enterprise. Competition for loans, deposits and cash management services, investment advisory assets, and insurance business also comes from other businesses that provide financial services, including consumer finance companies, mortgage brokers and lenders, private lenders, insurance companies, securities brokerage firms, institutional mutual funds, registered investment advisors, internet based banks, non-bank payment and funding channels, and other financial intermediaries. Consolidation within the industry, customer disenfranchisement with larger national/international banks, banks exiting certain business lines and/or markets, the cost of compliance with new government regulations, and the continued low interest rate environment have and are expected to continue to have an impact on the regional competitive market. The Company also faces increasing competition within its marketplace on the pricing of loans. This is expected to be an ongoing competitive challenge; however, the Company is committed to maintaining asset quality and focuses its sales efforts on building long-term relationships, rather than competing for individual transactions or easing loan terms. In addition, the increased use and advances in technology such as internet and mobile banking, non-bank payment channels, electronic transaction processing and cyber-security, are expected to have a significant impact on the future competitive landscape confronting financial service businesses.

The Company's business model is to provide a full range of diversified financial products and services through a highly-trained staff of knowledgeable banking professionals, with in-depth understanding of our markets, commitment to open and honest communication with clients and dedication to active community service. Management believes the Company has differentiated itself from the competition by building a solid reputation within the local market as a dependable commercial-focused community bank, delivering consistent and exceptional customer service, offering competitive products and taking an active role in support of the communities we serve. The Company's banking professionals are committed to upholding the Company's core values, including significant and active involvement in many charitable and civic organizations, and community development programs throughout our service area. This long-held commitment to community not only contributes to the welfare of the communities we serve, it also helps to fuel the local economy and has led to a strong referral network with local businesses, non-profit organizations and community leaders. Management believes the Company's community service reputation and culture positions the Company to be a leading provider of banking, investment advisory and wealth management, trust and insurance services in its growing market area.

The Company actively seeks to increase deposit share and strengthen its competitive position through continuous reviews of deposit product offerings, cash management and ancillary services and state-of-the-art delivery channels, targeted to businesses, non-profits, professional practice groups, municipalities and consumers' needs. These products and services are delivered by experienced local banking professionals who possess strong technical skills, and

function as trusted advisors to clients. In addition, Enterprise carefully plans deposit expansion through new branch development, identifying offices strategically located to complement existing locations while expanding the Company's geographic market footprint. In early July 2016, our 23<sup>rd</sup> branch, on Route 101A in Nashua, NH, opened and the Company recently announced the anticipated opening of its 24<sup>th</sup> branch office in Windham, NH, in 2017. Branch expansion is aimed at achieving not only deposit market share growth, but also is intended to contribute to loan originations and generate referrals for investment advisory and wealth management, trust and insurance services, residential mortgages and cash management products.

Management believes that Enterprise is also well equipped to capitalize on market potential to grow both the commercial and residential loan portfolios through strong business development efforts, while utilizing a disciplined and consistent lending approach and credit review practices, which have served to provide quality asset growth over varying economic cycles during the Company's history. The Company has a skilled lending sales force with a broad breadth of business knowledge and depth of lending experience to draw upon, supported by a highly qualified and experienced commercial credit review function.



## Table of Contents

The Company's investment services, including advisory, customized investment management, trust and brokerage services, provide for additional income diversification. The Company's investment advisory and management services channel derives revenues primarily from investment management fees based on assets under management. The Company's brokerage services channel revenue is split between fees based on assets under management and commissions. Management believes that the Company's investment services are distinguished from the competition by a client-centric open architecture approach in which clients work with a dedicated portfolio manager to hand-select funds with styles that match the client's investment goals. The Company's goal is to design and maintain portfolios that provide the income, growth potential, and risk tolerances that match the clients' comfort levels and exceeds their financial expectations. The Company's investment advisory team consists of a variety of certified financial and licensed brokerage professionals adept in a number of financial and investment disciplines dedicated to providing personalized investment service to each client.

Management continues to undertake significant strategic initiatives, including investments in employee training and development, marketing and public relations, technology and electronic delivery methods, ongoing improvements, renovations or strategic relocation of existing facilities and the continued development of recently added branches. Industry consolidation also provides management the opportunity to recruit experienced banking professionals with market knowledge who complement the Enterprise sales and service culture. While management recognizes that such investments increase expenses in the short term, Enterprise believes that such initiatives are a necessary investment in the long-term growth and earnings potential of the Company and help the Company to capitalize on opportunities in the current marketplace for community banks such as Enterprise. However, lower than expected returns on these investments, such as slower than anticipated loan and deposit growth in new branches and/or lower than expected fee or other income generated from new technology or initiatives, could decrease anticipated revenues and net income on such investments in the future.

Any prolonged deterioration of the general economic environment in the national or local New England economy could have adverse repercussions on local industries, leading to increased unemployment and mortgage foreclosures, deterioration of local commercial real estate values, and other unforeseen consequences, which could have a severe negative impact on the Company's financial condition, capital position, liquidity, and performance. In addition, the loan portfolio consists primarily of commercial real estate, commercial and industrial, and commercial construction loans. These types of loans are typically larger and are generally viewed as having more risk of default than owner occupied residential real estate loans or consumer loans. Any significant deterioration in the credit quality of the commercial loan portfolio or underlying collateral values due to a downturn in the economic environment, or other factors, could have a material adverse effect on the Company's financial condition and results of operations. The risk of loss due to customers' non-payment of loans or lines of credit is called "credit risk." Credit risk management is reviewed below in this Item 2 under the headings "Credit Risk," "Asset Quality" and "Allowance for Loan Losses."

The value of the investment portfolio as a whole, or individual securities held, including restricted FHLB capital stock, could be negatively impacted by any sustained volatility in the financial markets or in credit markets, or fundamental deterioration in credit quality of the individual security, fund or issuer, which could possibly result in the recognition of additional other-than-temporary-impairment ("OTTI") charges in the future.

A decline in the aggregate balance of the assets under management could decrease investment advisory fee income. The Company's ability to maintain or increase investment assets under management is subject to a number of factors, including competition from investment management companies and alternative investment options, fluctuations in financial markets and various economic conditions, among others.

In addition, a sustained low interest rate environment could negatively impact the Company's net interest income and results of operations. Interest rate risk is reviewed in more detail under the heading Item 3, "Quantitative and

Qualitative Disclosures About Market Risk," below.

Liquidity management is the coordination of activities so that cash needs are anticipated and met, readily and efficiently. Liquidity management is reviewed further below in this Item 2 under the heading "Liquidity."

Federal banking agencies require the Company and the Bank to meet minimum capital requirements. Effective January 1, 2015, the Company and the Bank implemented the Basel III regulatory capital framework. For information regarding the current capital requirements applicable to the Company and the Bank and their respective capital levels at September 30, 2016, in addition to the recent capital raised through a share offering, see the section entitled "Capital Resources" contained in this Item 2 below. As of September 30, 2016, the Company met the definition of "well capitalized" under the applicable Federal Reserve Board regulations and the Bank qualified as "well capitalized" under the prompt corrective action regulations of Basel

43

---

## Table of Contents

III and the FDIC; however, future unanticipated charges against capital, or changes in regulatory requirements such as the phase-in requirements under Basel III, could impact those regulatory capital designations.

In addition, any further changes in government regulation or oversight, including, but not limited to, the implementation by the federal regulatory agencies of the various requirements contained in the Dodd-Frank Act and new consumer financial protection laws enacted by the Consumer Financial Protection Bureau, could affect the Company in substantial and unpredictable ways, including, but not limited to, subjecting the Company to additional operating, governance and compliance costs, potentially influencing the Company's business decisions, or causing potential loss of revenue due to the impact of an enhanced regulatory structure on the banking industry as a whole.

Compliance risk includes the threat of fines, civil money penalties, lawsuits and restricted growth opportunities resulting from violations and/or non-conformance with laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards. The Company maintains a Compliance Management Program (the "CMP") designed to meet regulatory and legislative requirements. The CMP provides a framework for tracking and implementing regulatory changes, monitoring the effectiveness of policies and procedures, conducting compliance risk assessments, and educating employees in matters relating to regulatory compliance. The Audit Committee of the Board of Directors oversees the effectiveness of the CMP.

Operational risk includes the threat of loss from inadequate or failed internal processes, people, systems or external events, due to, among other things: fraud or error; the inability to deliver products or services; failure to maintain a competitive position; lack of, or insufficient information security, cyber security or physical security; inadequate procedures or controls followed by third-party service providers; or violations of ethical standards. In addition to intensive and ongoing employee training, employee and customer awareness campaigns, controls to manage operational risk include, but are not limited to, technology administration, information security, third-party management, and disaster recovery and business continuity planning. The Banking Technology Steering Committee of the Board of Directors oversees the information security program, monitors the results of third-party testing and risk assessments, and responses to breaches of customer data, among other technology, security and business continuity related functions.

The Company's technology administration includes policies and guidelines for the design, procurement, installation, management and acceptable use of hardware, software and network devices. The Company's technology project standards are designed to provide risk based oversight, coordinate and communicate ideas, and to prioritize and manage project implementation in a manner consistent with corporate objectives.

The Company has implemented layered security approaches for all delivery channels to mitigate rising cyber-security risks. Management utilizes a combination of third-party information security assessments, key technologies and ongoing internal evaluations to provide a level of protection of non-public personal information, to continually monitor and attempt to safeguard information on its operating systems and those of third-party service providers, and to quickly detect Distributed Denial of Service attacks. The Company also utilizes firewall technology and a combination of software and third-party monitoring to detect intrusion, guard against unauthorized cyber access, and continuously identify and prevent computer viruses on the Company's information systems. To minimize debt card losses, the Company works with a third-party provider to establish parameters for allowable transaction activity, monitor transactions, and alert customers of potential fraudulent activity.

The Company has a third-party risk management program designed to provide a mechanism to enable management to determine what risk, if any, a particular vendor or customer exposes the Company to, and to rate and mitigate that risk by properly performing initial and ongoing due diligence when selecting or maintaining relationships with critical third-party providers and customers who in turn provide financial services or products to their own customers.

The Company's Disaster Recovery and Business Continuity Program consists of the information and procedures required to enable a rapid recovery from an occurrence that would disable the Company's operations for an extended period, due to circumstances such as: loss of personnel; loss of data and/or loss of facilities, under various scenarios, including unintentional, malicious or criminal intentions; or loss of access to, or the physical destruction or damage of, facilities, infrastructure or systems. The plan, which is reviewed annually, establishes responsibility for assessing a disruption of business, contains alternative strategies for the continuance of critical business functions during an emergency situation, assigns responsibility for restoring services, and sets priorities by which critical services will be restored. A bank-owned and maintained secondary data center location provides the Company back-up network processing capabilities and flexibility to relocate key operational personnel if needed.

The Company has developed Incident Response Policy and Procedures in order to guide its actions in responding to real and suspected information security incidents. This includes unlawful, unauthorized, or unacceptable actions that involve a computer system or a computer network such as Distributed Denial of Service attacks, Corporate Account Takeover schemes, or an event

## Table of Contents

that has potentially compromised customers' non-public personal information. Additionally, an event that disrupts one of the Bank's service channels, whether as a result of a security incident or not, is also considered an incident requiring a response under this program. The reaction to an incident aims to reduce potential damage and loss and to protect and restore confidence through timely communication and the restoration of normal operating conditions for computers, services and information.

Any system of controls or contingency plan, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the controls and procedures will be met. Any breakdown in the integrity of these information systems, infrastructure, or cyber-security measures, or the Company's inability to identify, respond and correct such breakdown, could result in a loss of customer business, expose customers' personal information to unauthorized parties, damage the Company's reputation, subject the Company to increase costs and additional regulatory scrutiny, and expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company's business, financial condition and results of operations.

This Opportunities and Risks discussion should be read in conjunction with Item 1A "Risk Factors," and the section titled "Opportunities and Risk" contained in Item 7 "Management's Discussion and Analysis of Financial Conditions and Results of Operations" included in the Company's 2015 Annual Report on Form 10-K, which address numerous other factors and details that could adversely affect the Company's business, reputation, its future results of operations and financial condition.

### Accounting Policies/Critical Accounting Estimates

As discussed in the Company's 2015 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill. The Company has not changed its significant accounting and reporting policies from those disclosed in its 2015 Annual Report on Form 10-K.

### Financial Condition

Total assets increased \$185.3 million, or 8%, since December 31, 2015, to \$2.47 billion at September 30, 2016. The balance sheet composition and changes since December 31, 2015 are discussed below.

#### Cash and cash equivalents

Cash and cash equivalents is comprised of cash on hand and cash items due from banks, interest-earning deposits (deposit accounts, excess cash balances, money markets, and money market mutual funds accounts) and fed funds sold. Cash and cash equivalents amounted to 3% of total assets at September 30, 2016, compared to 2% at December 31, 2015. Balances in cash and cash equivalents will fluctuate due primarily to the timing of net deposit flows, borrowing and loan inflows and outflows, investment purchases and maturities, calls and sales proceeds, and the immediate liquidity needs of the Company.

#### Investments

At September 30, 2016, the carrying value of the investment portfolio amounted to \$349.1 million, an increase of \$48.7 million, or 16%, since December 31, 2015 primarily due to excess cash generated from deposit growth exceeding loan growth.



Table of Contents

The following table summarizes the fair value of investments at the dates indicated:

(Dollars in thousands)	September 30, 2016		December 31, 2015		September 30, 2015	
	Amount	Percent	Amount	Percent	Amount	Percent
Federal agency obligations <sup>(1)</sup>	\$80,145	23.0 %	\$78,825	26.3 %	\$69,352	24.7 %
Residential federal agency MBS <sup>(1)</sup>	88,706	25.4 %	74,863	24.9 %	96,616	34.4 %
Commercial federal agency MBS <sup>(1)</sup>	44,679	12.8 %	23,545	7.8 %	—	— %
Municipal securities	111,556	31.9 %	98,511	32.8 %	90,902	32.3 %
Corporate bonds	11,131	3.2 %	10,206	3.4 %	9,309	3.3 %
Certificates of deposits <sup>(2)</sup>	970	0.3 %	2,751	0.9 %	3,822	1.4 %
Total fixed income securities	337,187	96.6 %	288,701	96.1 %	270,001	96.1 %
Equity investments	11,877	3.4 %	11,657	3.9 %	11,026	3.9 %
Total available-for-sale investments at fair value	\$349,064	100.0%	\$300,358	100.0%	\$281,027	100.0%

These categories may include investments issued or guaranteed by government sponsored enterprises such as Fannie Mae ("FNMA"), Freddie Mac ("FHLMC"), Federal Farm Credit Bank ("FFCB"), or one of several Federal Home Loan Banks, as well as, investments guaranteed by Ginnie Mae ("GNMA"), a wholly-owned government entity.

(2) Certificates of deposits ("CDs") represent term deposits issued by banks that are subject to FDIC insurance and purchased on the open market.

Included in the residential federal agency MBS category were collateralized mortgage obligations ("CMOs") totaling \$33.9 million, \$20.8 million, and \$16.5 million at September 30, 2016, December 31, 2015 and September 30, 2015, respectively. All of the commercial MBS investments held by the Company were CMOs issued by U.S agencies.

During the nine months ended September 30, 2016, the Company purchased \$64.8 million in securities and had principal pay downs, calls and maturities totaling \$16.7 million. In addition, management sold securities with an amortized cost of approximately \$4.1 million realizing net gains on sales of \$611 thousand during the nine months ended September 30, 2016.

Net unrealized gains on the investment portfolio amounted to \$9.4 million at September 30, 2016 compared to \$3.5 million and \$4.7 million at December 31, 2015 and September 30, 2015, respectively. The Company attributes the increase in net unrealized gains in the current period primarily due to the impact of decreases in current market yields. Unrealized gains or losses will only be recognized in the statements of income if the investments are sold. However, should an investment be deemed "other than temporarily impaired," the Company is required to write-down the fair value of the investment.

See also Note 2, "Investment Securities," and Note 11, "Fair Value Measurements," to the Company's unaudited consolidated interim financial statements contained in Item 1 above for further information regarding the Company's unrealized gains and losses on debt and equity securities, including information about investments in an unrealized loss position for which an other-than-temporary impairment has or has not been recognized, and investments pledged as collateral, as well as the Company's fair value measurements for available-for-sale securities.

#### Federal Home Loan Bank Stock

The Bank is required to purchase stock of the FHLB at par value in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost, which management believes approximates fair value. The carrying amount of FHLB stock was \$1.9 million for the period ended September 30, 2016, \$3.1 million at

December 31, 2015 and \$4.2 million at September 30, 2015.

See Note 1, "Summary of Significant Accounting Policies," Item (d), "Restricted Investments," to the Company's unaudited consolidated interim financial statements contained in Item 1 above for further information regarding the Company's investment in FHLB stock.



Table of Contents

## Loans

Total loans represented 80% of total assets at September 30, 2016, compared to 81% at December 31, 2015. Total loans increased \$125.9 million, or 7%, compared to December 31, 2015, and \$195.2 million, or 11%, since September 30, 2015. The mix of loans within the portfolio remained relatively unchanged with commercial loans amounting to approximately 86% of gross loans, reflecting a continued focus on commercial loan growth.

The following table sets forth the loan balances by certain loan categories at the dates indicated and the percentage of each category to gross loans.

(Dollars in thousands)	September 30, 2016		December 31, 2015		September 30, 2015	
	Amount	Percent	Amount	Percent	Amount	Percent
Commercial real estate	\$1,008,362	50.7 %	\$936,921	50.3 %	\$922,167	51.5 %
Commercial and industrial	490,590	24.7 %	458,553	24.7 %	431,029	24.0 %
Commercial construction	215,432	10.9 %	202,993	10.9 %	184,927	10.3 %
Total commercial loans	1,714,384	86.3 %	1,598,467	85.9 %	1,538,123	85.8 %
Residential mortgages	172,556	8.7 %	169,188	9.1 %	162,414	9.1 %
Home equity loans and lines	90,116	4.5 %	83,373	4.4 %	81,195	4.5 %
Consumer	10,634	0.5 %	10,747	0.6 %	10,520	0.6 %
Total retail loans	273,306	13.7 %	263,308	14.1 %	254,129	14.2 %
Gross loans	1,987,690	100.0 %	1,861,775	100.0 %	1,792,252	100.0 %
Deferred fees, net	(1,836 )		(1,813 )		(1,644 )	
Total loans	1,985,854		1,859,962		1,790,608	
Allowance for loan losses	(31,589 )		(29,008 )		(28,130 )	
Net loans	\$1,954,265		\$1,830,954		\$1,762,478	

As of September 30, 2016, commercial real estate loans increased \$71.4 million, or 8%, compared to December 31, 2015, and increased 9% compared to September 30, 2015. Commercial real estate loans are typically secured by one-to-four and multi-family apartment buildings, office, industrial or mixed-use facilities, strip shopping centers or other commercial properties.

Commercial and industrial loans increased \$32.0 million, or 7.0%, compared to December 31, 2015, and increased 14% as compared to September 30, 2015. These loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), and term loans. Also included in commercial and industrial loans are loans partially guaranteed by the U.S. Small Business Administration ("SBA"), and loans under various programs and agencies.

Commercial construction loans increased by \$12.4 million, or 6%, since December 31, 2015, and increased 16% as compared to September 30, 2015. Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property and loans for the purchase and improvement of raw land.

Retail loan balances increased by \$10.0 million, or 4%, since December 31, 2015, and have increased by 8% since September 30, 2015. The increase over the same period in the prior year was primarily within the residential secured portfolios.

At September 30, 2016, commercial loan balances participated out to various banks amounted to \$62.4 million, compared to \$52.7 million at December 31, 2015, and \$51.0 million at September 30, 2015. These balances

participated out to other institutions are not carried as assets on the Company's financial statements. Commercial loans originated by other banks in which the Company is a participating institution are carried at the pro-rata share of ownership and amounted to \$86.8 million, \$62.3 million and \$65.7 million at September 30, 2016, December 31, 2015, and September 30, 2015, respectively. In each case, the participating bank funds a percentage of the loan commitment and takes on the related pro-rata risk. The rights and obligations of each participating bank are divided proportionately among the participating banks in an amount equal to their share of ownership and with equal priority among all banks. Participating loans with other institutions provide banks the opportunity to retain customer relationships and reduce credit risk exposure among each participating bank, while providing customers with larger credit vehicles than the individual bank might be willing or able to offer independently.

## Table of Contents

See Note 3, "Loans," to the Company's unaudited consolidated interim financial statements contained in Item 1 for information on loans serviced for others and loans pledged as collateral.

### Credit Risk

Inherent in the lending process is the risk of loss due to customer non-payment, or "credit risk." The Company's commercial lending focus may entail significant additional credit risks compared to long-term financing on existing, owner-occupied residential real estate. The Company seeks to lessen its credit risk exposure by managing its loan portfolio to avoid concentration by industry and loan size, and through sound underwriting practices and the risk management function; however, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio and economic conditions.

The credit risk management function focuses on a wide variety of factors, including, among others, current and expected economic conditions, the real estate market, the financial condition of borrowers, the ability of borrowers to adapt to changing conditions or circumstances affecting their business and the continuity of borrowers' management teams. Early detection of credit issues is critical to minimize credit losses. Accordingly, management regularly monitors these factors, among others, through ongoing credit reviews by the Credit Department, an external loan review service, reviews by members of senior management, as well as reviews by the Loan Committee and the Board of Directors. This review includes the assessment of internal credit quality indicators such as the risk classification of loans, individual review of problem assets, past due and non-accrual loans, impaired and restructured loans, and the level of foreclosure activity, as well as trends in the general levels of these indicators.

The Company's loan risk rating system classifies loans depending on risk of loss characteristics. The classifications range from "substantially risk free" for the highest quality loans and loans that are secured by cash collateral, through a satisfactory range of "minimal," "moderate," "better than average," and "average" risk, to the regulatory problem-asset classification of "criticized," for loans that may need additional monitoring, and the more severe adverse classifications of "substandard," "doubtful," and "loss" based on criteria established under banking regulations. Loans classified as "substandard" include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans classified as "doubtful" have all the weaknesses inherent in a substandard rated loan with the added characteristic that the weaknesses make collection or full payment from liquidation, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Loans classified as "loss" are generally considered uncollectible at present, although long term recovery of part or all of loan proceeds may be possible. These "loss" loans would require a specific loss reserve or charge-off. Adversely classified loans may be accruing or in non-accrual status and may be additionally designated as restructured and/or impaired, or some combination thereof. Loans which are evaluated to be of weaker credit quality are reviewed on a more frequent basis by management.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans and the classified portions are credit downgraded to one of the adversely classified categories noted above. Accrual of interest on loans is generally discontinued when a loan becomes contractually past due, with respect to interest or principal, by 90 days, or when reasonable doubt exists as to the full and timely collection of interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest accruals are resumed on such loans only when payments are brought current and have remained current for a period of 180 days or when, in the judgment of management, the collectability of both principal and interest is reasonably assured. Interest payments received on loans in a non-accrual status are generally applied to principal on the books of the Company.

Impaired loans are individually significant loans for which management considers it probable that not all amounts due (principal and interest) in accordance with original contractual terms will be collected. The majority of impaired loans

are included within the non-accrual balances; however, not every loan in non-accrual status has been designated as impaired. Impaired loans include loans that have been modified in a troubled debt restructuring (or "TDR", see below). Impaired loans exclude large groups of smaller-balance homogeneous loans, such as residential mortgage loans and consumer loans, which are collectively evaluated for impairment, and loans that are measured at fair value, unless the loan is amended in a TDR.

Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Management considers the individual payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms.

Impaired loans are individually evaluated for credit loss and a specific allowance reserve is assigned for the amount of the estimated probable credit loss. When a loan is deemed to be impaired, management estimates the credit loss by comparing the loan's carrying value against either 1) the present value of the expected future cash flows discounted at the loan's effective

## Table of Contents

interest rate; 2) the loan's observable market price; or 3) the expected realizable fair value of the collateral, in the case of collateral dependent loans. A specific allowance is assigned to the impaired loan for the amount of estimated probable credit loss. Impaired loans are charged off, in whole or in part, when management believes that the recorded investment in the loan is uncollectible.

Loans are designated as a TDR when, as part of an agreement to modify the original contractual terms of the loan as a result of financial difficulties of the borrower, the Bank grants the borrower a concession on the terms that would otherwise not be considered. Typically, such concessions may consist of a reduction in interest rate to a below market rate, taking into account the credit quality of the note, extension of additional credit based on receipt of adequate collateral, or a deferment or reduction of payments (principal or interest), which materially alters the Bank's position or significantly extends the note's maturity date, such that the present value of cash flows to be received is materially less than those contractually established at the loan's origination. All loans that are modified are reviewed by the Company to identify if a TDR has occurred. TDR loans are included in the impaired loan category and as such, these loans are individually reviewed and evaluated, and a specific reserve is assigned for the amount of the estimated probable credit loss.

An impaired or TDR loan classification will be considered for upgrade based on the borrower's sustained performance over time and their improving financial condition. Consistent with the criteria for returning non-accrual loans to accrual status, the borrower must demonstrate the ability to continue to service the loan in accordance with the original or modified terms and, in the judgment of management, the collectability of the remaining balances, both principal and interest, are reasonably assured. In the case of TDR loans having had a modified interest rate, that rate must be at, or greater than, a market rate for a similar credit at the time of modification for an upgrade to be considered.

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as OREO. When property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance, net of any unamortized deferred fees, or the estimated fair value of the property acquired, less estimated costs to sell, establishing a new cost basis. The estimated fair value is based on market appraisals and the Company's internal analysis. Any loan balance in excess of the estimated realizable fair value on the date of transfer is charged to the allowance for loan losses on that date. All costs incurred thereafter in maintaining the property, as well as subsequent declines in fair value are charged to non-interest expense.

Non-performing assets are comprised of non-accrual loans, deposit account overdrafts that are more than 90 days past due and OREO. The designation of a loan or other asset as non-performing does not necessarily indicate that loan principal and interest will ultimately be uncollectible. However, management recognizes the greater risk characteristics of these assets and therefore considers the potential risk of loss on assets included in this category in evaluating the adequacy of the allowance for loan losses. Despite prudent loan underwriting, adverse changes within the Company's market area, or deterioration in local, regional or national economic conditions, could negatively impact the Company's level of non-performing assets in the future.

## Asset Quality

At September 30, 2016 and December 31, 2015, the Company had adversely classified loans (loans carrying "substandard," "doubtful" or "loss" classifications) amounting to \$33.0 million and \$24.8 million, respectively. Total adversely classified loans amounted to 1.66% of total loans at September 30, 2016 as compared to 1.33% at December 31, 2015. The increase in adversely classified balances was due primarily to commercial relationships downgraded during the period, as discussed below, partially offset by principal payments and payoffs.

Adversely classified loans that were performing but possessed potential weaknesses and, as a result, could ultimately become non-performing loans amounted to \$23.4 million at September 30, 2016 and \$11.3 million at December 31, 2015. The remaining balances of adversely classified loans were non-accrual loans, amounting to \$9.6 million and \$13.4 million at September 30, 2016 and December 31, 2015, respectively. Non-accrual loans that were not adversely classified amounted to \$254 thousand and \$402 thousand at September 30, 2016 and December 31, 2015, respectively, and primarily represented the guaranteed portions of non-performing SBA loans. In the current period, the credit ratings of four larger commercial relationships with aggregate net carrying value of approximately \$17.5 million were downgraded to criticized or adverse risk-ratings, based on a review of their individual business circumstances, including one commercial relationship additionally designated as impaired. Although some weaknesses had been identified necessitating the downgrades, these loans continued to perform in accordance with their original terms.

Table of Contents

The following table sets forth information regarding non-performing assets, TDR loans and delinquent loans 60-89 days past due as to interest or principal, held by the Company at the dates indicated:

(Dollars in thousands)	September 30, 2016	December 31, 2015	September 30, 2015	
Non-Accrual loan summary:				
Commercial real estate	\$5,639	\$8,506	\$8,762	
Commercial and industrial	3,128	4,323	4,673	
Commercial construction	209	335	329	
Residential	297	366	436	
Home equity	607	288	206	
Consumer	—	19	39	
Total non-accrual loans	9,880	13,837	14,445	
Overdrafts > 90 days past due	8	8	7	
Total non-performing loans	9,888	13,845	14,452	
OREO	—	—	—	
Total non-performing assets	\$9,888	\$13,845	\$14,452	
Total Loans	\$1,985,854	\$1,859,962	\$1,790,608	
Accruing TDR loans not included above	\$18,917	\$10,053	\$8,418	
Delinquent loans 60-89 days past due and still accruing	\$572	\$2,021	\$2,404	
Loans 60-89 days past due and still accruing to total loans	0.03	% 0.11	% 0.13	%
Adversely classified loans to total loans	1.66	% 1.33	% 1.32	%
Non-performing loans to total loans	0.50	% 0.74	% 0.81	%
Non-performing assets to total assets	0.40	% 0.61	% 0.66	%
Allowance for loan losses	\$31,589	\$29,008	\$28,130	
Allowance for loan losses to non-performing loans	319.47	% 209.52	% 194.64	%
Allowance for loan losses to total loans	1.59	% 1.56	% 1.57	%

The net decrease in total non-performing loans, and the resulting decrease in the ratio of non-performing loans as a percentage of total loans outstanding, was due primarily to several larger commercial loan payoffs and principal payments, partially offset by additional loans added to non-accrual status during the period. The majority of non-accrual loans were also carried as impaired loans during the periods and the changes since December are discussed further below.

Total impaired loans amounted to \$28.7 million and \$23.7 million at September 30, 2016 and December 31, 2015, respectively. Total accruing impaired loans amounted to \$19.0 million and \$10.1 million at September 30, 2016 and December 31, 2015, respectively, while non-accrual impaired loans amounted to \$9.7 million and \$13.6 million as of September 30, 2016 and December 31, 2015, respectively. The increase in impaired loans was primarily due to one large commercial relationship with a net carrying value of approximately \$7.8 million, which was downgraded to an adverse risk-rating and also designated as accruing-impaired, based on a review of its individual business circumstances, partially offset by principal pay-downs, credit upgrades, and charge-offs during the period.

In management's opinion, the majority of impaired loan balances at September 30, 2016 and December 31, 2015 were supported by expected future cash flows or, for those collateral dependent loans, the net realizable value of the underlying collateral. Based on management's assessment at September 30, 2016, impaired loans totaling \$22.7 million required no specific reserves and impaired loans totaling \$6.0 million required specific reserve allocations of \$2.0 million. At December 31, 2015, impaired loans totaling \$19.1 million required no specific reserves and impaired loans totaling \$4.6 million required specific reserve allocations of \$1.8 million. Management closely monitors these relationships for collateral or credit deterioration.

Total TDR loans included in the impaired loan amounts above as of September 30, 2016 and December 31, 2015 were \$24.1 million and \$17.1 million, respectively. The increase in TDR loans was primarily due to the impaired commercial relationship noted above, with a net carrying value of approximately \$7.8 million, also being designated as a TDR. TDR loans on accrual

50

---



## Table of Contents

status amounted to \$18.9 million and \$10.1 million at September 30, 2016 and December 31, 2015, respectively. TDR loans included in non-performing loans amounted to \$5.2 million and \$7.1 million at September 30, 2016 and December 31, 2015, respectively. The Company continues to work with commercial relationships and enters into loan modifications to the extent deemed to be necessary or appropriate while attempting to achieve the best mutual outcome given the individual financial circumstances and future prospects of the borrower.

The Company carried no OREO at either September 30, 2016 or December 31, 2015. There were no sales on OREO during the nine months ended September 30, 2016; there were also no additions to OREO, or subsequent impairment write-downs during the period. During the nine months ended September 30, 2015, the Company recorded \$154 thousand of net gains on OREO sales; there were no subsequent write downs of OREO during that period.

Management believes that the loan portfolio continued to experience a level of modest credit stabilization during the 2016 period. However, management believes that the general credit profile of the portfolio and individual commercial relationships will continue to be affected by lagging effects that the economic environment has had on the regional and local commercial markets.

### Allowance for Loan Losses

On a quarterly basis, management prepares an estimate of the allowance necessary to cover estimated probable credit losses. The allowance for loan losses is an estimate of probable credit risk inherent in the loan portfolio as of the specified balance sheet dates. The Company maintains the allowance at a level that it deems adequate to absorb all reasonably anticipated probable losses from specifically known and other credit risks associated with the portfolio.

In making its assessment on the adequacy of the allowance, management considers several quantitative and qualitative factors that could have an effect on the credit quality of the portfolio including individual assessment of larger and high risk credits, delinquency trends and the level of non-performing loans, impaired, adversely classified, and restructured loans, net charge-offs, the growth and composition of the loan portfolio, expansion in geographic market area, the experience level of lenders and changes in underwriting criteria, and the strength of the local and national economy, among other factors. Except for loans specifically identified as impaired, as discussed above, the estimate is a two-tiered approach that allocates loan loss reserves to "regulatory problem assets" loans by classified credit rating and to non-classified loans by credit type. The general loss allocations take into account the quantitative historic loss experience, qualitative factors such as those identified above, as well as regulatory guidance and industry data. The allowance for loan losses is established through a provision for loan losses, which is a direct charge to earnings. Loan losses are charged against the allowance when management believes that the collectability of loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance.

Management closely monitors the credit quality of individual delinquent and non-performing relationships, industry concentrations, the local and regional real estate market and current economic conditions. The level of delinquent and non-performing assets is largely a function of economic conditions and the overall banking environment. Despite prudent loan underwriting, adverse changes within the Company's market area, or deterioration in the local, regional or national economic conditions could negatively impact the Company's level of non-performing assets in the future.

Management continues to closely monitor the necessary allowance levels, including specific reserves. The allowance for loan losses to total loans ratio was 1.59% at September 30, 2016, 1.56% at December 31, 2015, and 1.57% at September 30, 2015. In the current period, the credit ratings of three larger commercial relationships were downgraded to "criticized" or "adverse" risk-ratings, based on a review of their individual business circumstances, requiring higher levels of reserves in the current period which increased the allowance to total loan ratio compared to December 31, 2015.

Based on the foregoing, as well as management's judgment as to the existing credit risks inherent in the loan portfolio, as discussed above under the headings "Credit Risk" and "Asset Quality," management believes that the Company's allowance for loan losses is adequate to absorb probable losses from specifically known and other probable credit risks associated with the portfolio as of September 30, 2016.

Table of Contents

The following table summarizes the activity in the allowance for loan losses for the periods indicated:

(Dollars in thousands)	Nine Months Ended September 30,	
	2016	2015
Balance at beginning of year	\$29,008	\$27,121
Provision charged to operations	2,503	2,100
Recoveries on charged-off loans:		
Commercial real estate	20	5
Commercial and industrial	637	232
Commercial construction	—	25
Residential	—	—
Home equity	2	15
Consumer	4	14
Total recoveries	663	291
Charged-off loans		
Commercial real estate	179	108
Commercial and industrial	354	1,201
Commercial construction	5	—
Residential	—	—
Home equity	5	—
Consumer	42	73
Total Charged off	585	1,382
Net loans charged-off (recovered)	(78 )	1,091
Ending Balance	\$31,589	\$28,130
Annualized net loans charged-off (recovered): Average loans outstanding	(0.01 )%	0.09 %

Refer to "Credit Risk," "Asset Quality" and "Allowance for Loan Losses" contained in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in the Company's 2015 Annual Report on Form 10-K for additional information regarding the Company's credit risk management process and allowance for loan losses.

Table of Contents

## Deposits

The following table sets forth the deposit balances by certain categories at the dates indicated and the percentage of each category to total deposits.

(Dollars in thousands)	September 30, 2016		December 31, 2015		September 30, 2015	
	Amount	Percent	Amount	Percent	Amount	Percent
Non-interest bearing demand deposits	\$645,907	29.1 %	\$570,589	28.3 %	\$559,367	28.5 %
Interest bearing checking	346,957	15.6 %	313,674	15.5 %	320,579	16.3 %
Total checking	992,864	44.7 %	884,263	43.8 %	879,946	44.8 %
Savings	181,653	8.2 %	167,304	8.3 %	168,175	8.6 %
Money markets	815,861	36.7 %	692,114	34.3 %	638,029	32.5 %
Total savings/money markets	997,514	44.9 %	859,418	42.6 %	806,204	41.1 %
Certificates of deposit	171,891	7.7 %	167,697	8.3 %	165,554	8.4 %
Total non-brokered deposits <sup>(1)</sup>	2,162,269	97.3 %	1,911,378	94.7 %	1,851,704	94.3 %
Brokered deposits <sup>(2)</sup>	59,340	2.7 %	106,770	5.3 %	111,911	5.7 %
Total deposits	\$2,221,609	100.0 %	\$2,018,148	100.0 %	\$1,963,615	100.0 %

<sup>(1)</sup> Includes reciprocal money market deposits and CDs received from participating banks in nationwide networks as a result of our customers electing to participate in programs to obtain full FDIC insurance. Essentially, the equivalent of the original deposit comes back to the Company as non-brokered deposits within the appropriate category under total deposits on the balance sheet.

<sup>(2)</sup> Primarily brokered CDs \$250,000 and under.

As of September 30, 2016, deposits, excluding brokered deposits, increased \$250.9 million, or 13%, since December 31, 2015, and \$310.6 million, or 17%, since September 30, 2015. Non-brokered deposit growth since December 31, 2015 occurred in all deposit categories with the largest growth noted in money markets and checking accounts.

Wholesale funding, which includes brokered deposits and borrowed funds, amounted to \$60.0 million at September 30, 2016, compared to \$160.4 million at December 31, 2015, a decrease of \$100.4 million, or 63%. Wholesale funding has declined as deposit growth has exceeded loan growth.

From time to time, management utilizes brokered deposits as cost effective wholesale funding sources to support continued loan growth and as part of the Company's asset-liability management strategy to protect against rising rates. Brokered deposits may be comprised of overnight money market deposits and selected term CDs gathered from nationwide bank networks or from large money center banks; however, at September 30, 2016, December 31, 2015, and September 30, 2015 brokered deposits were comprised only of brokered CDs. Brokered CDs decreased \$47.4 million, or 44%, during the nine months ended September 30, 2016. Brokered CDs outstanding at September 30, 2016 had a weighted average remaining life of approximately 1.7 years.

## Borrowed Funds and Subordinated Debt

Borrowed funds amounted to \$671 thousand at September 30, 2016, compared to \$53.7 million at December 31, 2015 and \$24.2 million at September 30, 2015. Borrowed fund balances have declined \$53.0 million, since year end as deposit growth has outpaced loan growth.

At September 30, 2016 and September 30, 2015, borrowed funds consisted of FHLB borrowings only. At December 31, 2015, the borrowed funds balance was comprised of FHLB borrowings of \$40.7 million and an overnight borrowing with a correspondent bank, totaling \$13.0 million.

At September 30, 2016, the Bank had the capacity to borrow additional funds from the FHLB of up to approximately \$433.0 million and capacity to borrow from the FRB Discount Window of approximately \$117.0 million.

## Table of Contents

The Company also had \$14.8 million of outstanding subordinated debt at September 30, 2016, December 31, 2015 and September 30, 2015, which consisted of \$15.0 million in aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Notes") issued in January 2015, in a private placement to an accredited investor. The Notes, which are intended to qualify as Tier 2 capital for regulatory purposes, mature on January 30, 2030 (the "Maturity Date") and are callable by the Company, subject to regulatory approval, at a premium beginning January 30, 2020 and at par beginning January 30, 2025. The Notes pay interest at a fixed rate of 6.00% per annum through January 30, 2025 and beginning on January 31, 2025 through the Maturity Date, or any early redemption date, the interest rate on the Notes will adjust monthly at an interest rate of 3.90% plus 30-day LIBOR. Original debt issuance costs were \$190 thousand and have been netted against the subordinated debt on the balance sheet in accordance with accounting guidance which the Company adopted in the first quarter of 2015. These costs are being amortized over the life of the Notes.

In March 2015, the Company used the net proceeds from the \$15.0 million in Notes to pay off its outstanding debt of \$10.8 million. See also Note 6, "Borrowed Funds and Subordinated Debt," to the Company's unaudited consolidated interim financial statements contained in Item 1 above for further information regarding the Company's previous debt.

## Liquidity

Liquidity is the ability to meet cash needs arising from, among other things, fluctuations in loans, investments, deposits and borrowings. Liquidity management is the coordination of activities so that cash needs are anticipated and met readily and efficiently. The Company's liquidity policies are set and monitored by the Company's Board of Directors. The Company's asset-liability objectives are to engage in sound balance sheet management strategies, maintain liquidity, provide and enhance access to a diverse and stable source of funds, provide competitively priced and attractive products to customers and conduct funding at a low cost relative to current market conditions. Funds gathered are used to support current commitments, to fund earning asset growth, and to take advantage of selected leverage opportunities.

The Company's liquidity is maintained by projecting cash needs, balancing maturing assets with maturing liabilities, monitoring various liquidity ratios, monitoring deposit flows, maintaining cash flow within the investment portfolio, and maintaining wholesale funding resources.

At September 30, 2016, the Company's wholesale funding sources included borrowing capacity at the FHLB and brokered deposits. In addition, the Company maintains fed fund purchase arrangements with correspondent banks and access to the FRB Discount Window.

Management believes that the Company has adequate liquidity to meet its obligations. However, if, as a result of general economic conditions or other events, these sources of external funding become restricted or are eliminated, the Company may not be able to raise adequate funds or may incur substantially higher funding costs or operating restrictions in order to raise the necessary funds to support the Company's operations and growth.

The Company has in the past also increased capital and liquidity by offering shares of the Company's common stock for sale to its existing stockholders and new investors. See "Capital Resources," below for information on the Company's recent share offering.

## Capital Resources

The Company believes its current capital is adequate to support ongoing operations. As of September 30, 2016, the Company met the definition of "well capitalized" under the applicable Federal Reserve Board regulations and the Bank qualified as "well capitalized" under the prompt corrective action regulations of Basel III and the FDIC.



Table of Contents

Effective January 1, 2015, the Company and the Bank implemented the Basel III regulatory capital framework. The current regulatory requirements, and the Company's and the Bank's actual capital amounts and ratios are presented as of September 30, 2016 in the tables below.

(Dollars in thousands)	Actual		Minimum Capital for Capital Adequacy Purposes		Minimum Capital To Be Well Capitalized*	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>The Company</b>						
Total Capital (to risk weighted assets)	\$246,392	11.74 %	\$ 167,927	8.00 %	N/A	N/A
Tier 1 Capital (to risk weighted assets)	\$204,395	9.74 %	\$ 125,945	6.00 %	N/A	N/A
Tier 1 Capital (to average assets) or Leverage ratio	\$204,395	8.41 %	\$ 97,176	4.00 %	N/A	N/A
Common equity tier 1 capital (to risk weighted assets)	\$204,395	9.74 %	\$ 94,459	4.50 %	N/A	N/A
<b>The Bank</b>						
Total Capital (to risk weighted assets)	\$245,262	11.68 %	\$ 167,923	8.00 %	\$209,904	10.00 %
Tier 1 Capital (to risk weighted assets)	\$218,096	10.39 %	\$ 125,942	6.00 %	\$167,923	8.00 %
Tier 1 Capital (to average assets) or Leverage ratio	\$218,096	8.98 %	\$ 97,174	4.00 %	\$121,467	5.00 %
Common equity tier 1 capital (to risk weighted assets)	\$218,096	10.39 %	\$ 94,457	4.50 %	\$136,437	6.50 %

\*For the Bank to qualify as "well capitalized," it must maintain at least the minimum ratios listed. These requirements do not apply to the Company.

Under Basel III, capital ratio requirements for all banking organizations increased and include a "capital conservation buffer," which is being phased in through 2019, and is in addition to each risk-weighted capital ratio at a level of 2.50%. If a banking organization dips into its capital conservation buffer it may be restricted in its ability to pay dividends and discretionary bonus payments to its executive officers. The capital conservation buffer requirement phase in began in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019.

The Basel III minimum capital ratio requirements as applicable to the Company and the Bank in 2019 after the full phase-in period are summarized in the table below:

(Dollars in thousands)	Basel III Minimum for Capital Adequacy Purposes	Basel III Additional Capital Conservation Buffer	Basel III "Adequate" Ratio with Capital Conservation Buffer
Total Capital (to risk weighted assets)	8.00%	2.50%	10.50%
Tier 1 Capital (to risk weighted assets)	6.00%	2.50%	8.50%
Tier 1 Capital (to average assets) or Leverage ratio	4.00%	—%	4.00%
Common equity tier 1 capital (to risk weighted assets)	4.50%	2.50%	7.00%

In the second quarter of 2016, the Company completed a combined shareholder subscription rights offering and supplemental community offering, at an offering price of \$21.50 per share, under its \$40 million shelf registration statement that expired in September 2016. The Company issued 930 thousand shares of common stock and received gross proceeds of \$20.0 million (\$19.7 million, net of offering costs). The Company contributed the net proceeds to the Bank to support future asset growth and for general corporate purposes.



The Company maintains a dividend reinvestment plan and direct stock purchase plan (the "DRSPP"). The DRSPP enables stockholders, at their discretion, to elect to reinvest cash dividends paid on their shares of the Company's common stock by purchasing additional shares of common stock from the Company at a purchase price equal to fair market value. Under the DRSPP, stockholders and new investors also have the opportunity to purchase shares of the Company's common stock without brokerage fees, subject to monthly minimums and maximums.

For the nine months ended September 30, 2016, the Company paid \$4.2 million in cash dividends. Stockholders utilized the dividend reinvestment portion of the DRSPP to purchase an aggregate of 42,509 shares of the Company's common stock totaling \$1.0 million. The direct purchase component of the DRSPP was used by stockholders to purchase 1,313 shares of the Company's common stock totaling \$31 thousand during the nine months ended September 30, 2016.

Table of Contents

On October 18, 2016, the Company announced a quarterly dividend of \$0.13 per share to be paid on December 1, 2016 to stockholders of record as of November 10, 2016. The 2016 dividend rate represents a 4.0% increase over the 2015 dividend rate.

**Assets Under Management**

Total assets under management, includes total assets, investment assets under management, and loans serviced for others. Investment assets under management and loans serviced for others are not carried as assets on the Company's balance sheet.

The Company provides a wide range of investment advisory and wealth management services, including brokerage, trust, and investment management (together, "investment advisory services"). Also included in the investment assets under management total are customers' commercial sweep arrangements that are invested in third-party money market mutual funds.

Investment assets under management, which are carried at fair market value, increased \$31.4 million, or 5%, since December 31, 2015 and increased \$37.7 million, or 6%, since September 30, 2015.

Total assets under management increased \$226.3 million, or 7%, since December 31, 2015 and \$325.2 million, or 11% since September 30, 2015.

The following table sets forth the value of assets under management and its components at the dates indicated.

(Dollars in thousands)	September 30, 2016	December 31, 2015	September 30, 2015
Total assets	\$ 2,470,849	\$ 2,285,531	\$ 2,195,314
Loans serviced for others	80,836	71,272	68,891
Investment assets under management	709,781	678,377	672,076
Total assets under management	\$ 3,261,466	\$ 3,035,180	\$ 2,936,281

**Results of Operations**

Three Months Ended September 30, 2016 vs. Three Months Ended September 30, 2015

Unless otherwise indicated, the reported results are for the three months ended September 30, 2016 with the "same period," the "comparable period," and "prior period" being the three months ended September 30, 2015. Average yields are presented on a tax equivalent basis.

The Company's third quarter 2016 net income amounted to \$4.7 million, compared to \$4.3 million for the same period in 2015, an increase of \$422 thousand, or 10%. Diluted earnings per common share were \$0.41 for both the three months ended September 30, 2016 and September 30, 2015. Diluted earnings per share for the quarter ended September 30, 2016 fully includes the dilutive impact of the share offering.

**Net Interest Income**

The Company's net interest income for the quarter ended September 30, 2016 amounted to \$21.8 million, compared to \$20.0 million for the quarter ended September 30, 2015, an increase of \$1.9 million, or 9%. The increase in net interest income over the comparable period was due primarily to revenue generated from loan growth.

### Net Interest Margin

The Company's tax equivalent net interest margin ("margin") was 3.86% for the three months ended September 30, 2016 compared to 3.98% for the quarter ended September 30, 2015. The third quarter of 2016 was impacted by higher balances in low-yielding interest-earning assets from short-term customer deposits.

Table of Contents

## Rate / Volume Analysis

The following table sets forth the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense during the three months ended September 30, 2016 compared to the three months ended September 30, 2015. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (1) volume (change in average portfolio balance multiplied by prior period average rate); (2) interest rate (change in average interest rate multiplied by prior period average balance); and (3) rate and volume (the remaining difference).

(Dollars in thousands)	Net Change	Increase (decrease) due to		
		Volume	Rate	Rate/ Volume
<b>Interest Income</b>				
Loans and loans held for sale	\$1,681	\$2,120	\$(275)	\$(164)
Investment securities	252	349	(7)	(90)
Other interest earning assets <sup>(1)</sup>	34	95	(24)	(37)
Total interest earnings assets	1,967	2,564	(306)	(291)
<b>Interest Expense</b>				
Interest checking, savings and money market	122	91	28	3
Certificates of deposit	39	5	33	1
Brokered CDs	(45)	(96)	87	(36)
Borrowed funds	(8)	(9)	11	(10)
Subordinated debt	2	—	1	1
Total interest-bearing funding	110	(9)	160	(41)
Change in net interest income	\$1,857	\$2,573	\$(466)	\$(250)

<sup>(1)</sup> Income on other interest-earning assets includes interest on deposits and fed funds sold, and dividends on FHLB Stock.

Table of Contents

The following table presents the Company's average balance sheet, net interest income and average rates for the three months ended September 30, 2016 and 2015.

## AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS

(Dollars in thousands)	Three Months Ended September 30, 2016			Three Months Ended September 30, 2015		
	Average Balance	Interest	Average Yield <sup>(1)</sup>	Average Balance	Interest	Average Yield <sup>(1)</sup>
<b>Assets:</b>						
Loans and loans held for sale <sup>(2)</sup>	\$ 1,945,196	\$ 21,466	4.45 %	\$ 1,759,611	\$ 19,785	4.52 %
Investments <sup>(3)</sup>	319,844	1,629	2.65 %	267,364	1,377	2.66 %
Other interest earning assets <sup>(4)</sup>	67,111	96	0.57 %	26,614	62	0.93 %
Total interest earnings assets	2,332,151	23,191	4.09 %	2,053,589	21,224	4.23 %
Other assets	108,485			92,629		
Total assets	\$ 2,440,636			\$ 2,146,218		
<b>Liabilities and stockholders' equity:</b>						
Int chkg, savings and money market	\$ 1,300,326	653	0.20 %	\$ 1,109,271	531	0.19 %
Certificates of deposit	171,105	297	0.69 %	167,333	258	0.61 %
Brokered CDs	65,688	188	1.14 %	111,900	233	0.83 %
Borrowed funds	1,095	2	0.77 %	10,544	10	0.36 %
Subordinated debt <sup>(5)</sup>	14,829	234	6.26 %	14,817	232	6.24 %
Total interest-bearing funding	1,553,043	1,374	0.35 %	1,413,865	1,264	0.35 %
Net interest rate spread			3.74 %			3.88 %
Demand deposits	656,158	—		543,360	—	
Total deposits, borrowed funds and subordinated debt	2,209,201	1,374	0.25 %	1,957,225	1,264	0.26 %
Other liabilities	17,224			14,427		
Total liabilities	2,226,425			1,971,652		
Stockholders' equity	214,211			174,566		
Total liabilities and stockholders' equity	\$ 2,440,636			\$ 2,146,218		
Net interest income		\$ 21,817			\$ 19,960	
Net interest margin (tax equivalent)			3.86 %			3.98 %

Average yields are presented on a tax equivalent basis. The tax equivalent effect associated with loans and

(1) investments, which was not included in the interest amount above, was \$778 thousand and \$634 thousand for the quarters ended September 30, 2016 and September 30, 2015, respectively.

(2) Average loans and loans held for sale include non-accrual loans and are net of average deferred loan fees.

(3) Average investments are presented at average amortized cost.

(4) Average other interest earning assets include interest earning deposits, fed funds sold and FHLB stock.

(5) The subordinated debt issued in January 2015 is net of average deferred debt issuance costs.

## Table of Contents

### Interest and Dividend Income

For the third quarter of 2016, total interest and dividend income amounted to \$23.2 million, an increase of \$2.0 million, or 9%, compared to the prior period. The increase resulted primarily from an increase of \$278.6 million, or 14%, in the average balance of interest earning assets, mainly loans, partially offset by a 14 basis points decline in the yield.

Interest income on loans and loans held for sale, which accounts for the majority of interest income, amounted to \$21.5 million for the three months ended September 30, 2016, an increase of \$1.7 million, or 8%, over the comparable period, due primarily to loan growth, partially offset by a 7 basis point decline in loan yields. The average balances of loans and loans held for sale increased \$185.6 million, or 11%, for the three months ended September 30, 2016 compared to the same period in 2015.

Income on investment securities amounted to \$1.6 million, an increase of \$252 thousand, or 18%, compared to the same period in 2015. This increase primarily resulted from an increase of \$52.5 million, or 20%, in the average balance of investment securities.

Income on other interest-earning assets amounted to \$96 thousand, an increase of \$34 thousand, or 55%, compared to the same quarter in the prior year. This increase primarily resulted from a \$40.5 million increase in the average balance of other interest-earning assets, partially offset by a 36 basis point decrease in the yields. The decline in yield was due in large part to higher balances in low-yielding interest-earning deposits at the Federal Reserve due to short-term customer deposits.

### Interest Expense

For the three months ended September 30, 2016, total interest expense amounted to \$1.4 million, an increase of \$110 thousand, or 9%, compared to the prior period. The increase in interest expense was primarily due to higher average balances in interest checking, savings and money market accounts.

Interest expense on interest checking, savings and money market accounts amounted to \$653 thousand, an increase of \$122 thousand, or 23%, compared to the same prior year period due primarily to an increase in average balances of \$191.1 million, or 17%.

Interest expense on CDs amounted to \$297 thousand, and increase of \$39 thousand, or 15%, compared to the same period in the prior period, primarily due to a change in rates. The average rate increased 8 basis points and amounted to 0.69%.

Interest expense on brokered CDs amounted to \$188 thousand, a decrease of \$45 thousand, or 19%, compared to the comparable period in 2015, due primarily to a decrease in average balances, partially offset by an increase in average rates. Average balances decreased \$46.2 million, or 41%, while average rates increased 31 basis points. Changes in both the average balances and average rates are due to the maturities of lower yielding shorter-term brokered CDs.

For the three months ended September 30, 2016, the average balance of non-interest bearing demand deposits increased \$112.8 million, or 21%, as compared to the same period in 2015. Non-interest bearing demand deposits are an important component of the Company's core funding strategy. This non-interest bearing funding source represented 30% of total average deposit balances for the three months ended September 30, 2016, compared to 28% for the three months ended September 30, 2015, respectively.

### Provision for Loan Loss

The provision for loan losses amounted to \$1.4 million for three months ended September 30, 2016, an increase of \$1.1 million compared to the same period last year. The increase in the provision for 2016 was due primarily to credit downgrades (partially offset by a lower level of charge-offs) and the higher level of loan growth during the 2016 period, as compared to the 2015 period. In determining the provision to the allowance for loan losses, management takes into consideration the level of loan growth and an estimate of credit risk, which includes such items as adversely classified and non-performing loans, the estimated specific reserves needed for impaired loans, the level of net charge-offs, and the estimated impact of current economic conditions on credit quality.

## Table of Contents

The provision for loan losses is a significant factor in the Company's operating results. For further discussion regarding the provision for loan losses and management's assessment of the adequacy of the allowance for loan losses see "Credit Risk," "Asset Quality," and "Allowance for Loan Losses" under "Financial Condition" in this Item 2 above, and "Credit Risk," "Asset Quality," and "Allowance for Loan Losses" in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2015 Annual Report on Form 10-K. There have been no material changes to the Company's underwriting practices or to the allowance for loan loss methodology used to estimate loan loss exposure as reported in the Company's 2015 Annual Report on Form 10-K.

### Non-Interest Income

Non-interest income for the three months ended September 30, 2016 amounted to \$3.9 million, an increase of \$764 thousand, or 24%, as compared to the same period. The significant changes are discussed below:

• Net gains on sales of investment securities increased \$539 thousand. Investment sales are typically driven by market opportunities.

Loans sold generated net gains on loan sales of \$198 thousand and \$89 thousand for the three months ended September 30, 2016 and 2015, respectively. The increase in gains on loan sales was primarily driven by increased loan volume in the current quarter.

### Non-Interest Expense

Non-interest expense for the three months ended September 30, 2016 amounted to \$17.4 million, an increase of \$866 thousand, or 5%, compared to the same period in 2015. The significant changes are discussed below:

• Salaries and employee benefits increased \$693 thousand, or 7%, to support the Company's strategic growth and market expansion initiatives since the prior period.

Technology and telecommunications expense increased \$149 thousand, or 10%, primarily as a result of investments to support our strategic growth, network infrastructure and security, improve our service capabilities and enhance business continuity.

• Audit, legal and other professional costs decreased \$118 thousand, or 21%, due to lower other professional and audit costs in the current quarter.

### Results of Operations

#### Nine Months Ended September 30, 2016 vs. Nine Months Ended September 30, 2015

Unless otherwise indicated, the reported results are for the nine months ended months ended September 30, 2016 with the "same period," the "comparable period," "prior year," and "prior period" being the nine months ended months ended September 30, 2015. Average yields are presented on a tax equivalent basis.

The Company's net income for the nine months ended September 30, 2016 amounted to \$13.8 million compared to \$11.4 million for the same period in 2015, an increase of \$2.4 million, or 21%. Diluted earnings per share were \$1.27 and \$1.10 for the nine months ended September 30, 2016 and September 30, 2015, respectively, an increase of 15%. In 2016, diluted earnings per share includes the dilutive impact of the share offering from June 23 to September 30.



#### Net Interest Income

The Company's net interest income for the nine months ended September 30, 2016 was \$64.2 million compared to \$57.6 million for the nine months ended September 30, 2015, an increase of \$6.6 million, or 11%. The increase in net interest income over the comparable period was due primarily to revenue generated from loan growth.

#### Net Interest Margin

The Company's margin was 3.96% for the nine months ended September 30, 2016, compared to 3.97% for the nine months ended September 30, 2015.

Table of Contents

## Rate / Volume Analysis

The following table sets forth the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense during the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (1) volume (change in average portfolio balance multiplied by prior period average rate); (2) interest rate (change in average interest rate multiplied by prior period average balance); and (3) rate and volume (the remaining difference).

(Dollars in thousands)	Net Change	Increase (decrease) due to		
		Volume	Rate	Rate/ Volume
<b>Interest Income</b>				
Loans and loans held for sale	\$5,841	\$6,196	\$(115)	\$(240)
Investment securities	895	1,148	56	(309)
Other interest earning assets <sup>(1)</sup>	52	20	28	4
Total interest earnings assets	6,788	7,364	(31)	(545)
<b>Interest Expense</b>				
Interest checking, savings and money market	279	237	—	42
Certificates of deposit	85	(14)	103	(4)
Brokered CDs	(72)	(204)	180	(48)
Borrowed funds	47	19	18	10
Subordinated debt	(142)	(56)	(91)	5
Total interest-bearing funding	197	(18)	210	5
Change in net interest income	\$6,591	\$7,382	\$(241)	\$(550)

<sup>(1)</sup> Income on other interest-earning assets includes interest on deposits and fed funds sold, and dividends on FHLB Stock.

Table of Contents

The following table presents the Company's average balance sheet, net interest income and average rates for the nine months ended months ended September 30, 2016 and 2015.

## AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS

(Dollars in thousands)	Nine months ended September 30, 2016			Nine months ended September 30, 2015		
	Average Balance	Interest	Average Yield <sup>(1)</sup>	Average Balance	Interest	Average Yield <sup>(1)</sup>
<b>Assets:</b>						
Loans and loans held for sale <sup>(2)</sup>	\$1,897,372	\$63,379	4.52 %	\$1,715,527	\$57,538	4.53 %
Investments <sup>(3)</sup>	307,203	4,720	2.67 %	249,236	3,825	2.64 %
Other interest earning assets <sup>(4)</sup>	35,544	189	0.71 %	30,937	137	0.59 %
Total interest earnings assets	2,240,119	68,288	4.21 %	1,995,700	61,500	4.23 %
Other assets	104,158			91,299		
Total assets	\$2,344,277			\$2,086,999		
<b>Liabilities and stockholders' equity:</b>						
Int chkg, savings and money market	\$1,231,888	1,866	0.20 %	\$1,073,759	1,587	0.20 %
Certificates of deposit	168,911	842	0.67 %	172,125	757	0.59 %
Brokered CDs	80,782	617	1.02 %	114,338	689	0.81 %
Borrowed funds	19,281	79	0.55 %	12,100	32	0.35 %
Subordinated debt <sup>(5)</sup>	14,826	695	6.26 %	15,904	837	7.03 %
Total interest-bearing funding	1,515,688	4,099	0.36 %	1,388,226	3,902	0.38 %
Net interest rate spread			3.85 %			3.85 %
Demand deposits	616,686	—		512,181	—	
Total deposits, borrowed funds and subordinated debt	2,132,374	4,099	0.26 %	1,900,407	3,902	0.27 %
Other liabilities	15,572			14,566		
Total liabilities	2,147,946			1,914,973		
Stockholders' equity	196,331			172,026		
Total liabilities and stockholders' equity	\$2,344,277			\$2,086,999		
Net interest income		\$64,189			\$57,598	
Net interest margin (tax equivalent)			3.96 %			3.97 %

Average yields are presented on a tax equivalent basis. The tax equivalent effect associated with loans and investments, which was not included in the interest amount above, was \$2.3 million for the nine months ended September 30, 2016 and \$1.7 million for the comparable period in 2015.

(2) Average loans and loans held for sale include non-accrual loans and are net of average deferred loan fees.

(3) Average investment balances are presented at average amortized cost.

(4) Average other interest earning assets includes interest-earning deposits, fed funds sold, and FHLB stock.

(5) The subordinated debt issued in January 2015 is net of average deferred debt issuance costs.

## Table of Contents

### Interest and Dividend Income

Total interest and dividend income amounted to \$68.3 million for the nine months ended September 30, 2016, an increase of \$6.8 million, or 11%, compared to the prior period. The increase resulted primarily from an increase of \$244.4 million, or 12%, in the average balance of interest earning assets, mainly loans, partially offset by a slight decrease in yields of 2 basis points.

Interest income on loans and loans held for sale, which accounts for the majority of interest income, amounted to \$63.4 million, an increase of \$5.8 million, or 10%, over the comparable period, due primarily to loan growth. The average loans and loans held for sale balances increased \$181.8 million, or 11%, compared to the prior period. The average yield on loans and loans held for sale amounted to 4.52% for the nine months ended September 30, 2016, a decline of 1 basis point since the same period in 2015.

Income on investment securities amounted to \$4.7 million, an increase of \$895 thousand, or 23%, compared to the same period in 2015. This increase primarily resulted from an increase in the average balance of investment securities by \$58.0 million, or 23%. The average yield on investment securities also increased 3 basis points.

Income on other interest-earning assets amounted to \$189 thousand, an increase of \$52 thousand, or 38%, compared to the same quarter in the prior year. This increase resulted from both an increase in rates and average balances. The average yield on other interest-earning assets increased 12 basis points and the average balance increased \$4.6 million, or 15%.

### Interest Expense

For the nine months ended September 30, 2016, total interest expense amounted to \$4.1 million, an increase of \$197 thousand, or 5% over the same period in 2015 due primarily to increases in the average balances of interest checking, savings and money market accounts, partially offset by lower interest expense associated with the Company's subordinated debt.

Interest expense on interest checking, savings and money market accounts amounted to \$1.9 million, an increase of \$279 thousand, or 18%, compared to the comparable prior year period due primarily to an increase in average balances of \$158.1 million, or 15%.

Interest expense on CDs amounted to \$842 thousand, an increase of \$85 thousand, or 11%, over the same period in 2015 due primarily to an increase in the average rate of 8 basis points.

Interest expense on brokered CDs amounted to \$617 thousand, a decrease of \$72 thousand, or 10%, primarily due to a decrease in the average balance, partially offset by an increase in the average rate. The average balance decreased \$33.6 million, or 29%, while the average rate increased 21 basis points. Changes in both the average balances and average rates are due to the maturities of lower yielding shorter-term brokered CDs.

Interest expense on borrowed funds amounted to \$79 thousand, an increase of \$47 thousand due to increases in both the average balances and the average rate. The average balance increased \$7.2 million, or 59%, and the average rate increased 20 basis points.

Interest expense on subordinated debt amounted to \$695 thousand, a decrease of \$142 thousand, or 17%, over the same period in 2015. The decrease resulted from a decrease in both the average rate and in the average balance. The average rate declined to 6.26% from 7.03% in the comparable period as a result of the lower rate on the Notes issued

in January 2015. The average balances decreased \$1.1 million due to the timing of the issuance of the Notes versus the redemption in full in March 2015 of the \$10.8 million of outstanding Junior Subordinated debentures that originated in 2000, from the sale of trust preferred securities by Enterprise Capital Trust, a former subsidiary of the Company.

For the nine months ended September 30, 2016, the average balance of non-interest bearing demand deposits increased \$104.5 million, or 20%, as compared to the same period in 2015. Non-interest bearing demand deposits are an important component of the Company's core funding strategy. This non-interest bearing funding represented 29% and 27% of total average deposit balances for the nine months ended months ended September 30, 2016 and 2015, respectively.

## Table of Contents

### Provision for Loan Loss

The provision for loan losses amounted to \$2.5 million for the nine months ended September 30, 2016, an increase of \$403 thousand compared to the same period last year. The increase in the provision for 2016 was due primarily to credit downgrades (partially offset by a lower level of charge-offs) and the higher level of loan growth during the 2016 period, as compared to the 2015 period. In determining the provision to the allowance for loan losses, management takes into consideration the level of loan growth and an estimate of credit risk, which includes such items as adversely classified and non-performing loans, the estimated specific reserves needed for impaired loans, the level of net charge-offs, and the estimated impact of current economic conditions on credit quality.

The provision for loan losses is a significant factor in the Company's operating results. For further discussion regarding the provision for loan losses and management's assessment of the adequacy of the allowance for loan losses see "Credit Risk," "Asset Quality," and "Allowance for Loan Losses" under "Financial Condition" in this Item 2 above, and "Credit Risk," "Asset Quality," and "Allowance for Loan Losses" in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2015 Annual Report on Form 10-K. There have been no material changes to the Company's underwriting practices or to the allowance for loan loss methodology used to estimate loan loss exposure as reported in the Company's 2015 Annual Report on Form 10-K.

There have been no material changes to the Company's underwriting practices or to the allowance for loan loss methodology used to estimate loan loss exposure as reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. The provision for loan losses is a significant factor in the Company's operating results.

### Non-Interest Income

Non-interest income for the nine months ended September 30, 2016 amounted to \$10.7 million, a decrease of \$151 thousand, or 1%, as compared to the nine months ended September 30, 2015, due primarily to a reduction in net gains on sales of investment securities of \$752 thousand. Investment sales are typically driven by market opportunities. The changes partially offsetting this decrease are discussed below:

• Deposit and interchange fees increased \$215 thousand, or 6% due primarily to an increase in ATM interchange income from higher debit card volume and to a lesser extent an increase in overdraft fees.

• Income on bank-owned life insurance increased \$206 thousand, or 58%, due primarily to the purchase of additional BOLI investments in the third quarter of 2015.

### Non-Interest Expense

Non-interest expense for the nine months ended September 30, 2016 amounted to \$51.8 million, an increase of \$2.8 million, or 6%, compared to the same period in 2015. The significant changes are discussed below:

• Salaries and employee benefits increased by \$2.5 million, or 8%, to support the Company's strategic growth and market expansion initiatives since the prior period.

• Technology and telecommunications expense increased \$325 thousand, or 8%, primarily as a result of investments to support our strategic growth, network infrastructure and security, improve our service capabilities and enhance business continuity.

Deposit insurance premiums increased \$108 thousand, or 12%, primarily due to the Company's growth.

#### Income Taxes

The effective tax rate for the nine months ended September 30, 2016 was 33.0%, compared to 34.2% for the nine months ended September 30, 2015. The decline in the effective rate was primarily due to an increase in the level of tax exempt income compared to the same period in the prior year.

## Table of Contents

### Recent Accounting Pronouncements

For information regarding recently adopted accounting pronouncements by the Company, see "Accounting pronouncements adopted by the Company" in Item (g) in Note 1, "Summary of Significant Accounting Policies," under the heading "Recent Accounting Pronouncements."

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU is intended to create a single source of revenue guidance which is more principles based than current revenue guidance. The guidance affects any entity that either enters into contracts with customers to transfer goods or services, or enters into contracts for the transfer of non-financial assets, unless those contracts are within the scope of other standards. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" to amend the effective date of ASU 2014-09. The amendments in ASU 2014-09 are effective for annual and interim periods within fiscal years beginning after December 15, 2017. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The FASB has since issued additional related ASUs amendments intended to clarify certain aspects and improve understanding of the implementation guidance of Topic 606 but do not change the core principles of the guidance in Topic 606. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements of Topic 606. The Company is currently evaluating the potential impact of the ASU and its amendments on the Company's financial statements and results of operations.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments.

Among other things, the new guidance:

- Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income;
- Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and
- Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.

The new guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the effects of this ASU on the Company's financial statements and results of operations.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which supersedes previous leasing guidance in Topic 840, Leases. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the effects of this ASU on the Company's financial statements and results of operations.



In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting." The amendments are intended to improve the accounting for employee share-based payments and affect all organizations that issue share-based payment awards to their employees. Several aspects of the accounting are simplified including, generally: a) income tax consequences; b) classification of awards as either equity or liabilities; c) accounting for forfeitures; and d) classification on the statement of cash flows. Among the changes, the amendment allows for entities to partially settle awards in cash up to the maximum individual statutory tax rate in the applicable jurisdiction and still qualify for equity classification; all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) will be recognized as income tax expense or benefit in the income statement; in addition, an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur; among other changes. The new standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company is currently evaluating the potential impact of the ASU on the Company's financial statements and results of operations.

## Table of Contents

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326)." The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. Previously, when credit losses were measured under GAAP, an entity generally only considered past events and current conditions in measuring the incurred loss and generally recognition of the full amount of credit losses was delayed until the loss was probable of occurring. The amendments in this Update eliminate the probable initial recognition threshold in current GAAP and, instead, reflect an entity's current estimate of all expected credit losses.

The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset.

Credit losses on available-for-sale debt securities should be measured in a manner similar to current GAAP. However, the amendments in this Update require that credit losses be presented as an allowance rather than as a write-down. Unlike current GAAP, the Update provides for reversals of credit losses in future period net income in situations where the estimate of loss declines.

An entity will apply the amendments in this Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). For public business entities that are SEC filers, such as the Company, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating the potential impact of the ASU on the Company's financial statements and results of operations.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cashflows - Classification of Certain Cash Receipts and Cash Payments. The amendments are intended to reduce diversity in practice related to the presentation of eight specific cashflow issues. For public business entities that are SEC filers, such as the Company, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Because this amendment primarily impacts the presentation and classification of information, the Company does not expect it to have a material impact on the Company's financial statements and results of operations.

### Item 3 - Quantitative and Qualitative Disclosures About Market Risk

The Company's primary market risk is interest rate risk. Oversight of interest rate risk management is the responsibility of the Board of Directors. Annually, the Board reviews and approves the Company's asset-liability management policy, which provides management with guidelines for controlling interest rate risk, as measured through net interest income sensitivity to changes in interest rates, within certain tolerance levels. The Board also establishes and monitors guidelines for the Company's liquidity and capital ratios.

The Company's asset-liability management strategies and guidelines are reviewed on a periodic basis by management and presented and discussed with the Board on at least a quarterly basis. These strategies and guidelines are revised based on changes in interest rate levels, general economic conditions, competition in the marketplace, the current interest rate risk position of the Company, anticipated growth and other factors.

One of the principal factors in maintaining planned levels of net interest income is the ability to design effective strategies to manage the impact of interest rate changes on future net interest income. Quarterly, management completes a net interest income sensitivity analysis, which is presented to the Board. This analysis includes a simulation of the Company's net interest income under various interest rate scenarios. Variations in the interest rate environment affect numerous factors, including prepayment speeds, reinvestment rates, maturities of investments (due to call provisions), and interest rates on various asset and liability accounts.

The Company can be subject to margin compression depending on the economic environment and the shape of the yield curve. Under the Company's current balance sheet position, the Company's margin generally performs slightly better over time in a rising rate environment, while it generally decreases in a declining rate environment and when the yield curve is flattening or inverted.

## Table of Contents

Under a flattening yield curve scenario, margin compression occurs as the spread between the cost of funding and the yield on interest earning assets narrows. Under this scenario the degree of margin compression is highly dependent on the Company's ability to fund asset growth through lower cost deposits. However, if the curve is flattening, while short-term rates are rising, the adverse impact on margin may be somewhat delayed, as increases in the Prime Rate will initially result in the Company's asset yields re-pricing more quickly than funding costs.

Under an inverted yield curve situation, shorter-term rates exceed longer-term rates, and the impact on margin is similar but more adverse than the flat curve scenario. Again, however, the extent of the impact on margin is highly dependent on the Company's balance sheet mix.

In a declining rate environment, margin compression will eventually occur as the yield on interest earning assets decreases more rapidly than decreases in funding costs. The primary causes would be the impact of interest rate decreases (including decreases in the Prime Rate) on adjustable rate loans and the fact that decreases in deposit rates may be limited or lag decreases in the Prime Rate.

Net interest margin remained relatively flat through June 2016, but declined during the third quarter of 2016 primarily due to higher balances in low-yielding interest-earning assets from short-term customer deposits. Additional margin compression may occur if the yield curve continues to flatten and loans re-price downward while the cost of deposits remains at the same level.

There have been no material changes in the results of the Company's net interest income sensitivity analysis as reported in the Company's 2015 Annual Report on Form 10-K. At September 30, 2016, management continues to consider the Company's primary interest rate risk exposure to be margin compression that may result from changes in interest rates and/or changes in the mix of the Company's balance sheet components. This would include the mix of fixed versus variable rate loans and investments on the asset side, and higher cost versus lower cost deposits and overnight borrowings versus term borrowings and certificates of deposit on the liability side.

## Item 4 - Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

The Company maintains a set of disclosure controls and procedures and internal controls designed to ensure that the information required to be disclosed in reports that it files or submits to the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

The Company carried out an evaluation as of the end of the period covered by this report under the supervision and with the participation of the Company's management, including its principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective as of September 30, 2016.

### Changes in Internal Control over Financial Reporting

There has been no change in the Company's internal control over financial reporting that has occurred during the Company's most recent fiscal quarter (i.e., the three months ended September 30, 2016) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



Table of Contents

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

There are no material pending legal proceedings to which the Company or its subsidiaries are a party or to which any of its property is subject, other than ordinary routine litigation incidental to the business of the Company. Management does not believe resolution of any present litigation will have a material adverse effect on the consolidated financial condition or results of operations of the Company.

Item 1A - Risk Factors

Management believes that there have been no material changes in the Company's risk factors as reported in the Company's 2015 Annual Report on Form 10-K.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3 - Defaults upon Senior Securities

Not Applicable.

Item 4 - Mine Safety Disclosures

Not Applicable.

Item 5 - Other Information

Not Applicable.

Table of Contents

Item 6 - Exhibits

EXHIBIT INDEX

---

Exhibit No. Description

- 3.1 Amended and Restated Articles of Organization of the Company, incorporated by reference to the Company's Current Report on Form 8-K filed June 10, 2013.
- 3.2 Amended and Restated Bylaws of the Company, as amended as of January 15, 2013, incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on January 22, 2013.
- 4.1 Renewal Rights Agreement dated as of December 11, 2007 by and between the Company and Computershare Trust Company, N.A., as Rights Agent, including Terms of Series A Junior Participating Preferred Stock, Summary of Rights to Purchase Shares of Series A Junior Participating Preferred Stock, and Form of Rights Certificate attached as Exhibits A, B and C thereto, incorporated by reference to Exhibit 4.5 to the Company's Current Report on Form 8-K filed on December 13, 2007.
- 31.1\* Certification of Principal Executive Officer under Securities Exchange Act Rule 13a-14(a)
- 31.2\* Certification of Principal Financial Officer under Securities Exchange Act Rule 13a-14(a)
- 32\* Certification of Principal Executive Officer and Principal Financial Officer under 18 U.S.C. § 1350 Furnished Pursuant to Securities Exchange Act Rule 13a-14(b)
- 101\* The following materials from Enterprise Bancorp, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2016 were formatted in XBRL (eXtensible Business Reporting Language):
- (i) Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015;
  - (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2016 and 2015;
  - (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016 and 2015;
  - (iv) Consolidated Statements of Changes in Equity for the nine months ended September 30, 2016;
  - (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015; and
  - (vi) Notes to Unaudited Consolidated Interim Financial Statements.

---

\*Filed herewith

Table of Contents

SIGNATURES

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

ENTERPRISE BANCORP, INC.

DATE: November 7, 2016 By: /s/ James A. Marcotte

James A. Marcotte  
Executive Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)