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SUSSEX BANCORP
Form 10KSB
March 27, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-KSB

(Mark One)

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

For the fiscal year ended: December 31, 2001 -----

OR

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

For the transition period from _____ to _____

Commission file number 0-29030 -----

SUSSEX BANCORP

(Name of small business issuer as specified in its charter)

New Jersey -----

22-3475473 -----

(State of other jurisdiction of incorporation or organization)

(I.R.S. employer identification no.)

399 Route 23, Franklin, New Jersey -----

07416 -----

(973) 827-2914 -----

(Address of principal executive offices) (Zip Code) (Issuer's Telephone Number Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, no par value -----

American Stock Exchange -----

Title of Each Class

Name of Exchange on Which Registered

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark whether the Issuer: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934, as amended, 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 X No___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of Issuer's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. (x)

The aggregate market value of the voting stock held by non-affiliates of the Issuer as of February 28, 2002 was \$13,413,295. The number of shares of the Issuer's Common Stock, no par value, outstanding as of February 28, 2002 was 1,660,147.

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For the fiscal year ended December 31, 2001, the Issuer had total revenues of \$ 13,217,000.

DOCUMENTS INCORPORATED BY REFERENCE

	10-KSB Item -----	Document Incorporated -----
Item 6.	Management's Discussion and Analysis or Plan of Operation	2001 Annual Report to Shareholders
Item 7.	Financial Statements	2001 Annual report to Shareholders
Item 9.	Directors and Executive Officers of the Company; Compliance with Section 16(a) of the Exchange Act.	Proxy Statement for 2002 Annual Meeting of Shareholders to be filed no later than April 29, 2002.
Item 10.	Executive Compensation	Proxy Statement for 2002 Annual Meeting of Shareholders to be filed no later than April 29, 2002.
Item 11.	Security Ownership of Certain Beneficial Owners and Management	Proxy Statement for 2002 Annual Meeting of Shareholders to be filed no later than April 29, 2002.
Item 12.	Certain Relationships and Related Transactions	Proxy Statement for 2002 Annual Meeting of Shareholders to be filed no later than April 29, 2002.

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PART I

ITEM 1: Description of Business

General

Sussex Bancorp (the "Company" or "Registrant") is a one-bank holding company incorporated under the laws of the State of New Jersey in January, 1996

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to serve as a holding company for Sussex Bank (the "Bank"). The company was organized at the direction of the Board of Directors of the Bank for the purpose of acquiring all of the capital stock of the Bank (the "Acquisition"). Pursuant to the New Jersey Banking Act of 1948, as amended, (the "Banking Act"), and pursuant to approval of the shareholders of the Bank, the Company acquired the Bank and became its holding company on November 20, 1996. As part of the Acquisition, shareholders of the Bank received one share of common stock, no par value ("Common Stock") of the Company for each outstanding share of the common stock of the Bank, \$2.50 per share par value ("Bank Common Stock"). The only significant asset of the Company is its investment in the Bank. The Company's main office is located at 399 Route 23, Franklin, Sussex County, New Jersey 07416.

The Bank is a commercial bank formed under the laws of the State of New Jersey in 1975. The Bank operates from its main office at 399 Route 23, Franklin, New Jersey 07416, and its seven branch offices located at 7 Church Street, Vernon, New Jersey; 266 Clove Road, Montague, New Jersey; 33 Main Street, Sparta, New Jersey; 455 Route 23, Wantage, New Jersey; 15 Trinity Street, Newton, New Jersey; 100 Route 206, Augusta, New Jersey; and 165 Route 206, Andover, New Jersey. In the second half of 2001, the name of the Bank was changed from The Sussex County State Bank to Sussex Bank.

Effective October 1, 2001, the Company acquired all of the outstanding stock of Tri-State Insurance Agency, Inc. ("Tri-State"). Tri-State is a full service insurance agency located in Augusta, New Jersey. The purchase price paid by the Company for Tri-State was comprised of an upfront payment of \$350,000 at closing, and deferred payments on the first, second and third anniversaries of the closing of \$700,000 each, to be satisfied through a mix of cash and common stock of the Company, subject to adjustment based upon the net income of Tri-State as a subsidiary of the Bank.

As part of the acquisition, each of the principals of Tri-State have entered into an employment agreement providing for their employment by Tri-State for a period of at least five years. After the initial five-year term, the employment agreement will automatically renew for additional three-year periods unless twelve months prior to the end of the initial term either party provides notice of its intention not to renew.

The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "FRB"). The Bank's deposits are insured by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits. The operations of the Company and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the "Department"). The principal executive offices of the Company are located at 399 Route 23, Franklin, New Jersey 07416, and the telephone number is (973) 827-2914.

Business of the Company

The Company's primary business is ownership and supervision of the Bank and Tri-State, a subsidiary of the Bank. The Company, through the Bank, conducts a traditional commercial banking business, and offers services including personal and business checking accounts and time deposits, money market accounts and regular savings accounts. The Company structures its specific services and charges in a manner designed to attract the business of the small and medium sized business and professional community as well as that of individuals residing, working and shopping in the Sussex County, New Jersey trade area serviced by the Company. The Company engages in a wide range of lending activities and offers commercial, consumer, mortgage, home equity and personal loans. In addition, during 1998, the Bank formed the Sussex Bancorp Mortgage

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Company (the "Mortgage Company"). The Mortgage Company originates one to four family mortgage loans for resale into the secondary market. Currently, all loans are sold servicing released, although the Company, through the Bank, may seek to service the loans it originates in the future. Tri-State, a subsidiary of the Bank, is a full service general insurance agency, offering both commercial and personal lines of insurance.

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Service Area

The Company's service area primarily consists of the Sussex County, New Jersey market, although the Company makes loans throughout New Jersey. The Company operates its main office in Franklin, New Jersey and seven branch offices in Vernon, Montague, Sparta, Wantage, Newton, Andover and Augusta New Jersey.

Competition

The Company operates in a highly competitive environment competing for deposits and loans with commercial banks, thrifts and other financial institutions, many of which have greater financial resources than the Company. Many large financial institutions in New York City and other parts of New Jersey compete for the business of New Jersey residents located in the Company's service area. Certain of these institutions have significantly higher lending limits than the Company and provide services to their customers which the Company does not offer.

Management believes the Company is able to compete on a substantially equal basis with its competitors because it provides responsive personalized services through management's knowledge and awareness of the Company's service area, customers and business.

Employees

At December 31, 2001, the Company employed 90 full-time employees and 20 part-time employees. None of these employees is covered by a collective bargaining agreement and the Company believes that its employee relations are good.

SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under both federal and state law. These laws and regulations are intended to protect depositors, not stockholders. Insurance agencies licensed in New Jersey are regulated under state law by the New Jersey Department of Banking and Insurance. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in the applicable law or regulation may have a material effect on the business and prospects of the Company and the Bank.

BANK HOLDING COMPANY REGULATION

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General

As a bank holding company registered under the Bank Holding Company Act of 1956, as amended, (the BHCA), we are subject to the regulation and supervision of the Federal Reserve Bank (FRB). We are required to file with the FRB annual reports and other information regarding our business operations and those of our subsidiaries.

The BHCA requires, among other things, the prior approval of the FRB in any case where a bank holding company proposes to (i) acquire all or substantially all of the assets of any other bank, (ii) acquire direct or indirect ownership or control or more than 5% of the outstanding voting stock of any bank (unless it owns a majority of such bank's voting shares) or (iii) merge or consolidate with any other bank holding company. The FRB will not approve any acquisition, merger, or consolidation that would have a substantially anti-competitive effect, unless the anti-competitive impact of the proposed transaction is clearly outweighed by a greater public interest in meeting the convenience and needs of the community to be served. The FRB also considers capital adequacy and other financial and managerial resources and future prospects of the companies and the banks concerned, together with the convenience and needs of the community to be served, when reviewing acquisitions or mergers.

In addition, the BHCA was amended through the Gramm-Leach-Bliley Financial Modernization Act of 1999 (the "GLBA"). Under the terms of the GLBA, bank holding companies whose subsidiary banks meet certain capital, management and Community Reinvestment Act standards are permitted to engage in a substantially broader range of non-banking activities than is permissible for bank holding companies under the BHCA. These activities include certain insurance, securities and merchant banking activities. In addition, the GLBA amendments to the BHCA remove the requirement for advance regulatory approval for a variety of activities and acquisitions by financial holding companies. As our business is currently limited to activities permissible for a bank, we have not elected to become a financial holding company.

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There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance funds in the event the depository institution becomes in danger of default. Under a policy of the FRB with respect to bank holding company operations, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so absent such policy. The FRB also has the authority under the BHCA to require a bank holding company to terminate any activity or to relinquish control of a non-bank subsidiary upon the FRB's determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

Capital Adequacy Guidelines for Bank Holding Companies

The FRB has adopted risk-based capital guidelines for bank holding companies. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks

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and bank holding companies, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The risk-based guidelines apply on a consolidated basis to bank holding companies with consolidated assets of \$150 million or more. The minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 4% of the total capital is required to be "Tier 1", consisting of common stockholders' equity and certain preferred stock, less certain goodwill items and other intangible assets. The remainder, "Tier II Capital", may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities, and (f) qualifying subordinated debt. Total capital is the sum of Tier I and Tier II capital less reciprocal holdings of other banking organizations' capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FRB (determined on a case-by-case basis or as a matter of policy after formal rule-making).

Bank holding company assets are given risk-weights of 0%, 20%, 50% and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for performing first mortgage loans fully secured by residential property which carry a 50% risk-weighting. Most investment securities (including, primarily, general obligation claims of states or other political subdivisions of the United States) are assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weight, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S. Government, which have a 0% risk-weight. In converting off-balance sheet items, direct credit substitutes including general guarantees and standby letters of credit backing financial obligations are given 100% risk-weighting. Transaction related contingencies such as bid bonds, standby letters of credit backing non-financial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) have a 50% risk-weighting. Short term commercial letters of credit have a 20% risk-weighting and certain short-term unconditionally cancelable commitments have a 0% risk-weighting.

In addition to the risk-based capital guidelines, the FRB has adopted a minimum Tier I capital (leverage) ratio, under which a bank holding company must maintain a minimum level of Tier I capital to average total consolidated assets of at least 3% in the case of a bank holding company that has the highest regulatory examination rating and is not contemplating significant growth or expansion. All other bank holding companies are expected to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum.

Bank Regulation

As a New Jersey-chartered commercial bank, the Bank is subject to the regulation, supervision, and control of the Department. As an FDIC-insured institution, the Bank is subject to regulation, supervision and control of the FDIC, an agency of the federal government. The regulations of the FDIC and the Department impact virtually all activities of the Bank, including the minimum level of capital the Bank must maintain, the ability of the Bank to pay dividends, the ability of the Bank to expand through new branches or acquisitions and various other matters.

Insurance of Deposits

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The Bank's deposits are insured up to a maximum of \$100,000 per depositor under the BIF. The FDIC has

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established a risk-based insurance premium assessment system under which the FDIC has developed a matrix that sets the assessment premium for a particular institution in accordance with its capital level and overall regulatory rating by the institutions' primary federal regulatory. Under the matrix that is currently in effect, the assessment rate ranges from 0 to 27 basis points of assessed deposits. In addition to the deposit insurance premium assessment, under the deposit insurance funds act of 1996 (the "Deposit Act"), BIF insured institutions like the Bank are required to contribute to the debt service and principal repayment on bonds issued by the Federal Finance Corporation ("FICO") in the mid-1980s to fund a portion of the thrift bailout. This assessment is currently set at 1.3 basis points of assessed deposits. During the early 1990's, the Bank acquired certain Savings Association Insurance Fund ("SAIF") insured deposits from the Resolution Trust Corporation. The Bank pays FICO assessments on these deposits at the higher SAIF rate. In 2000, the assessment on these SAIF deposits totaled \$ 27,590.

Dividend Rights

Under the Banking Act, a bank may declare and pay dividends only if, after payment of the dividend, the capital stock of the bank will be unimpaired and either the bank will have a surplus of not less than 50% of its capital stock or the payment of the dividend will not reduce the bank's surplus.

ITEM 2. Description of Property

The Company conducts its business through its main office located at 399 Route 23, Franklin, New Jersey, and its seven branch offices. The following table set forth certain information regarding the Company's properties as of December 31, 2001.

LOCATION	LEASED OR OWNED	DATE OF LEASE EXPIRATION
399 Route 23 Franklin, New Jersey	Owned	N/A
7 Church Street Vernon, New Jersey	Owned	N/A
266 Clove Road Montague, New Jersey	Leased	April, 2002
96 Route 206 Augusta, New Jersey	Leased	August, 2006

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455 Route 23 Wantage, New Jersey	Owned (1)	N/A
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15 Trinity Street Newton, New Jersey	Owned	N/A
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165 Route 206 Andover, New Jersey	Owned	N/A
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100 Route 206 Augusta, New Jersey	Owned	N/A
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33 Main Street Sparta, New Jersey	Owned	N/A
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(1) The Company owns the building housing its Wantage branch. The land on which the building is located is leased pursuant to a ground lease which runs until December 31, 2020, and contains an option for the Company to extend the lease for an additional 25 year term.

ITEM 3. Legal Proceedings

The Company and the Bank are periodically parties to or otherwise involved in legal proceedings arising in the normal course of business, such as claims to enforce liens, claims involving the making and servicing of real property loans, and other issues incident to the Bank's business. Management does not believe that there is any pending or threatened proceeding against the Company of the Bank which, if determined adversely, would have a material effect on the business, financial position or results of operation of the Company or the Bank.

ITEM 4. Submission of Matters to a Vote of Security Holders

No matters were submitted for a vote of the registrant's shareholders during the Fourth Quarter of fiscal 2001.

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PART II

ITEM 5. Market for Common Equity and Related Stockholder Matters

The Common Stock trades on the American Stock Exchange, under the symbol "SBB". As of December 31, 2001, the Company had approximately 712 holders of record of the Common Stock.

The following table shows the high and low closing price, by quarter, for the common stock, as well as dividends declared, for the last two fiscal years:

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2001 ----	HIGH ----	LOW ---	DIVIDENDS DECLARED -----
4th Quarter	\$10.38	\$ 9.72	\$ 0.06
3rd Quarter	11.25	10.37	0.05
2nd Quarter	10.50	9.50	0.07
1st Quarter	10.42	10.00	0.07
2000 ----	HIGH ----	LOW ---	DIVIDENDS DECLARED -----
4th Quarter	\$9 1/2	\$8 1/2	\$.07
3rd Quarter	8 1/2	7 3/4	.06
2nd Quarter	8 3/8	7 1/4	--
1st Quarter	8 5/8	8 1/8	.06

ITEM 6. Management's Discussion and Analysis or Plan of Operation

The information required by this item is incorporated by reference from the Registrant's 2001 Annual Report to Shareholders under the caption "Management Discussion and Analysis."

ITEM 7. Financial Statements

The information required by this item is incorporated by reference from the Registrant's 2001 Annual Report to Shareholders under the caption "Consolidated Financial Statements."

ITEM 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

In 2001 the Registrant made the decision to change independent auditors. The Registrant has retained Arthur Andersen to serve as its independent auditors for the fiscal year ended December 31, 2001, and to replace Radics & Co., LLC, which had acted as the Company's independent auditors for the years ended December 31, 1999 and 2000. The decision to change auditors was recommended by the Registrant's Audit Committee. There have been no disagreements with Radics & Co., LLC on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure which, if not resolved to the satisfaction of Radics & Co., LLC, would have caused it to make reference to the subject matter of the disagreement in connection with their reports. The

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independent auditor's report on the consolidated financial statements for the fiscal years ended December 31, 2000 and 1999 did not contain an adverse opinion or disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or auditing principles.

ITEM 9. Directors and Executive Officers of the Registrant; Compliance with Section 16(a)

Information concerning directors and executive officers is included in the definitive Proxy Statement for the Company's 2002 Annual Meeting under the captions "ELECTION OF DIRECTORS" and information

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concerning compliance with Section 16(a) of the Exchange Act is included under the caption "COMPLIANCE WITH SECTION 16(A) OF THE SECURITIES EXCHANGE ACT OF 1934," each of which is incorporated herein by reference. It is expected that such Proxy Statement will be filed with the Securities and Exchange commission no later than April 29, 2002.

The following table sets forth certain information about each executive officer of the Company who is not also a director.

Name, Age and Position	Officer Since (1)	Principal Occupation During Past Five Years
Candace A. Leatham, 47 Senior Vice President and Treasurer	1984	Senior Vice President and Treasurer of the Bank

(1) Includes prior service as an officer of the Bank.

ITEM 10. Executive Compensation

Information concerning executive compensation is incorporated by reference from the Registrant definitive Proxy Statement for the Company's 2002 Annual Meeting under the captions "ANNUAL EXECUTIVE COMPENSATION AND ALL OTHER COMPENSATION" and "COMPENSATION OF DIRECTORS". It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2002.

ITEM 11. Security Ownership of Certain Beneficial Owners and Management

Information concerning security ownership of certain beneficial owners and management is included in the definitive Proxy statement for the Company's 2002 Annual Meeting under the caption "SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT", which is incorporated herein by reference. It is expected that such Proxy statement will be filed with the Securities and Exchange commission no later than April 29, 2002.

ITEM 12. Certain Relationships and Related Transactions

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Information concerning certain relationships and related transactions is included in the definitive Proxy Statement for the Company's 2002 Annual Meeting under the caption "INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS", which is incorporated herein by reference. It is expected that such Proxy Statement will be filed with the Securities and Exchange commission no later than April 29, 2002.

ITEM 13. Exhibits, List and Reports on Form 8-K

(a) Exhibits

Exhibit

Number Description of Exhibits

2 Stock Purchase Agreement, dated as of September 28, 2001 (1)

3(i) Certificate of Incorporation of the Company (2)

3(ii) Bylaws of the Company(2)

10(i) 1995 Incentive Stock Option Plan(2)

10(ii) 1995 Stock Option Plan for Non-Employee Directors(2)

10(iii)1988 Non-Qualified Stock Option(2)

10(iv) Employment Agreement with Donald Kovach (2)

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10(v) Employment Agreement of George Lista (1)

10(vi) Employment Agreement of George Harper (1)

13 Annual Report to Shareholders for the year ended December 31,2001

21 Subsidiaries of the Registrant

23(i) Consent of Arthur Andersen LLP

23(ii) Consent of Radics & Co., LLP

99 Letter Pursuant to Temporary Note 3T.

(1) Incorporated by reference from Exhibits 2, 10(a) and 10(b) of the Registrant's Current Report on Form 8-K filed October 4, 2001.

(2) Incorporated by reference from Exhibits 5(B)(1) to 5(B)(27) from the Company's Registration Statement on form 8-B, Registration No. 1-12569.

(b) Reports on form 8-K

Date Filed

Item

October 4, 2001

Item 5 - Announcing the acquisition of Tri-State Insurance Agency, Inc.

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October 25, 2001

Item 5 - Announcing the third quarter results.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

SUSSEX BANCORP

By: /s/ Donald L. Kovach

Donald L. Kovach
Chairman of the Board and
Chief Executive Officer

Dated: March 20, 2002

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

NAME	TITLE	DATE
/s/_Donald L. Kovach ----- Donald L. Kovach	Chairman of the Board and Chief Executive Officer	March 20,2002
/s/_Candace A. Leatham ----- Candace A. Leatham	Treasurer (Principal Financial Officer and Principal Accounting Officer)	March 20,2002
/s/_Irvin Ackerson ----- Irvin Ackerson	Director	March 20,2002
/s/_William E. Kulsar ----- William E. Kulsar	Secretary and Director	March 20,2002
/s/_Joel D. Marvil ----- Joel D. Marvil	Director	March 20,2002

