Pennsylvania Commerce Bancorp

2002 Annual Report

America's Most Convenient Bank®

Pennsylvania Commerce Bancorp, Inc.
Selected Financial Data

(dollars in thousands except per share data)	**2002**	2001	2000	1999	1998
	Year Ended December 31				
Balance Sheet Data:					
Total assets	**$786,598**	$609,890	$ 480,086	$ 378,913	$ 319,323
Loans held for sale	**10,514**	7,661	5,329	5,301	5,641
Loans receivable (gross)	**368,881**	342,674	290,252	216,105	167,121
Securities available for sale	**205,436**	104,722	90,633	82,552	95,439
Securities held to maturity	**97,625**	103,349	33,812	29,039	11,493
Federal funds sold	**44,500**	4,300	22,800	0	11,900
Deposits	**726,955**	561,738	446,583	348,546	297,737
Long-term debt and other borrowed money	**0**	0	0	8,300	0
Trust preferred securities	**13,000**	13,000	5,000	0	0
Stockholders' equity	**42,812**	32,593	26,668	20,378	20,445
Income Statement:					
Net interest income	**$ 27,701**	$ 22,054	$ 17,477	$ 14,676	$ 11,276
Provision for loan losses	**1,435**	1,469	1,050	762	542
Noninterest income	**7,707**	6,607	5,362	4,558	4,061
Noninterest operating expenses	**25,428**	20,512	16,189	13,756	11,471
Income before income taxes	**8,545**	6,680	5,600	4,716	3,324
Net income	**5,674**	4,448	3,714	3,103	2,218
Per Common Share Data:					
Net income: *Basic*	**$ 2.71**	$ 2.24	$ 1.90	$ 1.59	$ 1.13
Diluted	**2.48**	2.04	1.78	1.49	1.05
Book value	**19.73**	15.97	13.29	10.16	10.25
Selected Performance Ratios:					
Return on average assets	**0.82 %**	0.82 %	0.88 %	0.89 %	0.80 %
Return on average stockholders' equity	**14.86**	14.85	16.59	15.18	11.50
Net interest margin	**4.29**	4.40	4.49	4.59	4.49
Selected Liquidity and Capital Ratios:					
Average loans to average deposits	**56.91 %**	63.25 %	65.12 %	60.24 %	60.26 %
Average stockholders' equity to average total assets	**5.44**	5.54	5.29	5.86	6.94
Risk-based capital: *Tier 1*	**11.16**	10.22	9.90	9.91	10.83
Total	**12.22**	11.78	11.04	11.12	12.02
Leverage ratio	**7.00**	7.33	6.92	6.28	6.50
Asset Quality:					
Net charge-offs to average loans outstanding	**0.23 %**	0.21 %	0.06 %	0.08 %	0.01 %
Non-performing loans to total year-end loans	**0.45**	0.26	0.29	0.32	0.16
Non-performing assets to total year-end assets	**0.23**	0.15	0.18	0.18	0.09
Allowance for loan losses to total year-end loans	**1.40**	1.33	1.29	1.31	1.34
Allowance for loan losses to non-performing loans	**321.83**	518.72	448.02	415.35	808.70

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Letter to Shareholders

Gary L. Nalbandian
Chairman of the Board, President and CEO

Dear Shareholders, Customers & Friends:

"America's Most Convenient Bank" has had an exciting and successful 17th year serving our Customers throughout Central Pennsylvania. Our unique retail strategy — one based on providing the best banking experience possible for our Customers — continues to produce exceptional results.

The Commerce brand — "America's Most Convenient Bank" — defines everything we do:

- Offering seven-day branch banking
- Providing the best possible retail experience
- Removing stupid rules
- Ensuring it takes one person to say "yes" to a Customer request, and two people to say "no"
- Building banking relationships

Our employees ensure the brand remains strong and vibrant. Our WOW! culture — where the Customer always comes first — continually is reinforced at all levels throughout Commerce.

We continue to broaden and expand the scope of our management training program to keep pace with our rapid growth. At the same time, we have added new store managers and strengthened our employee base in every area, including government banking, loan processing, lending, operations and retail delivery.

As a member of the Commerce Bancorp (NYSE Symbol: CBH) network, headquartered in Cherry Hill, New Jersey, we are able to capitalize on the technical, operational and marketing/ branding support of one of the nation's most dynamic financial services companies to enhance our own capabilities as a local bank.

The Directors, management and staff of Pennsylvania Commerce Bancorp, Inc. are pleased to report on our financial results for 2002.

Another Year of Record Earnings

In a year of economic turmoil, Commerce once again reported record earnings and increased deposits, assets and loans.

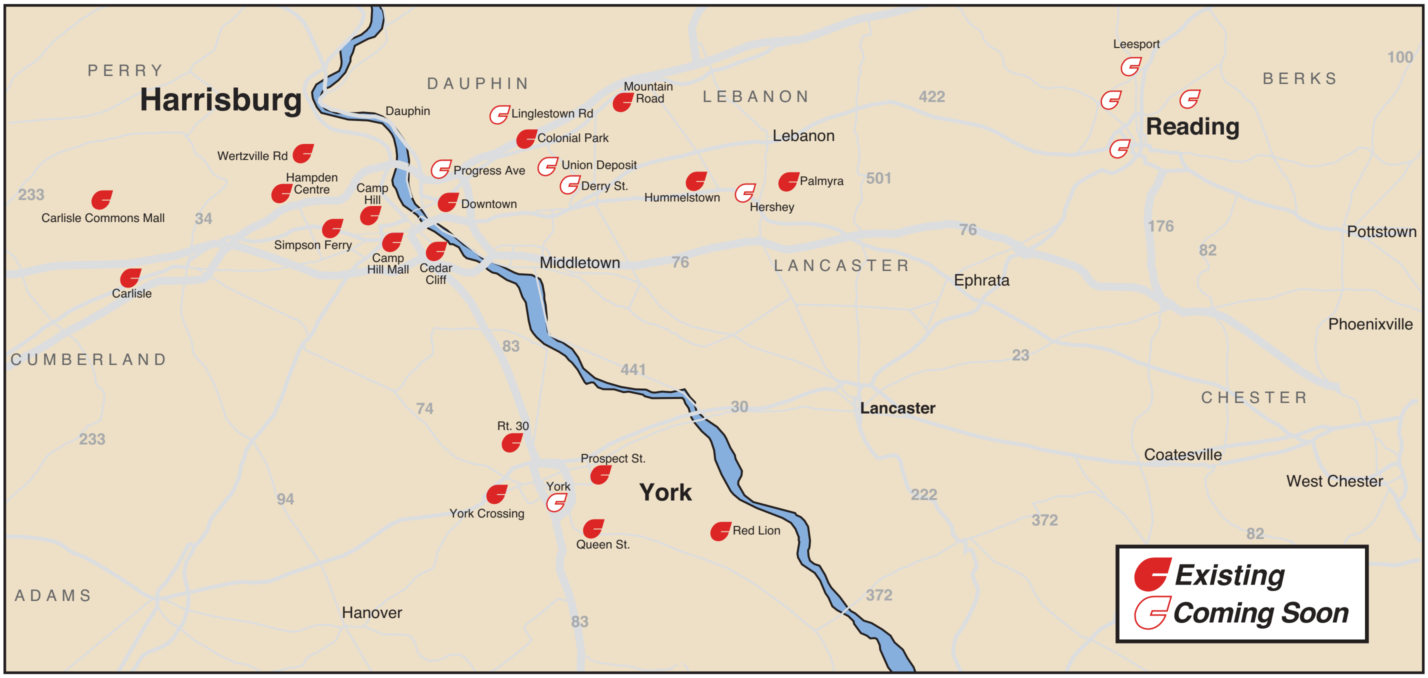
Our combination of strong deposit growth with a low cost of funds provides increased profitability, while we continue to make substantial investments in new locations, technology and staff.

Through our aggressive expansion plan, our assets have grown almost $200 million since the end of 2001 — and currently are at nearly $800 million. The development of the Reading Region and opening additional stores throughout Berks County will enable us to reach our goal of $2 billion in total assets by 2006.

We would like to share some of the financial highlights for the year 2002 with you:

4th Quarter Financial Highlights

Total Assets	$ 787 Million	+29%
Total Deposits	727 Million	+29%
Total (Net) Loans	364 Million	+ 8%
Total Revenues	9.6 Million	+25%
Total Expenses	6.9 Million	+29%
Net Income	1.6 Million	+23%
Net Income Per Share	$ .69	+15%



- Assets increased by 29%, to $787 million.
- Deposits rose by $165 million — representing a 29% increase over 2001.
- Loans increased 8%, or $26 million, to a total of $364 million.
- Revenues were up 24%, reaching $35.4 million.
- Net income grew by 28%, to $5.7 million.
- Net income per share on a diluted basis was $2.48 — a 22% increase.
- Stockholder equity rose to $42.8 million, an increase of $10.2 million or 31%.

In early June 2002, we opened our first store in downtown Harrisburg at 101 N. Second Street with a two-day celebration. The downtown Harrisburg store reached profitability in only three months, and doubled our predicted estimates for its first six months of operations. In August, we opened another high profile store at 32nd Street and Trindle Road — in front of the Camp Hill Mall — which also has exceeded our expectations.

And, just as the year came to a close, we opened our 18th store — and our second in Carlisle — at the Carlisle Commons Mall at 20 Noble Boulevard.

Honoring the Model

For the sixth straight year, the *Central Penn Business Journal* named Commerce Bank to its list of the Top 50 Fastest Growing Companies. Commerce is the only company to be recognized by the publication for six consecutive years.

The Patriot-News also ranked Commerce Bank among its Top 50 Business & Industry Companies. These are the top 50 companies that either are headquartered in central Pennsylvania or have a significant presence in the region.

And, for the third consecutive year, Commerce Bank was voted "Simply the Best" Bank in the Harrisburg area, by a *Harrisburg Magazine* Readers' Poll.

Highlighting the Technology

We continue to invest in cutting edge technology to enhance our model and bring our Customers the best possible products and services — whenever, wherever and in whatever way they may want them.

In the first quarter of 2002, we announced our new CheckView service. With CheckView, cancelled checks are presented via convenient CheckView statements. The new state-of-the-art system captures images of the checks and prints the front of them on 8.5" x 11" paper. CheckView also is available online, using Commerce Online Banking at *www.commercepc.com*.

In the last quarter of the year, we implemented a new version of our

Website — substantially upgrading its capabilities. We added new calculators, a section that addresses frequently asked questions, more powerful search capabilities, and upgraded the "look" and user-friendliness of the site.

By second quarter 2003, we will have upgraded our Online Banking program — introducing exciting new developments that incorporate state-of-the-art technology that includes running balances, faster and easier navigation, compatibility with Quicken® and Microsoft® Money, and 128-bit encryption — the most secure Internet technology available.

Expanding the Commerce Vision

Planned growth will be our greatest opportunity for the next year. We currently have five stores in development — in key locations — that we hope will help us dominate the individual markets within our footprint.

Our plan includes opening three stores in Dauphin County — on the east side of Harrisburg. There are three other sites in the municipal approval stage in the Harrisburg Region. Additionally, there are two sites in the contract finalization stage in the York Region — one is downtown and will be modeled after the store in downtown Harrisburg.

Within the next year, we will be making our market entry into the Reading Region, with two stores in prime locations. We have three additional sites in various stages of planning, approval or negotiation.

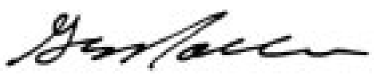
Looking to the Future

The future continues to shine brightly. Pennsylvania Commerce Bancorp continues its superior performance. From an investment standpoint, there are a number of factors that ensure Commerce remains an excellent investment:

- Consistent same-store deposit growth
- Outstanding performance
- Loan growth
- History of low loan loss ratios
- Significant brand recognition

Commerce continues to break the rules in banking — whether it's the commitment and dedication to providing superior service, offering the best online banking system available, or providing seven-day branch banking. Our philosophy remains the same: provide our Customers with the best possible banking experience.

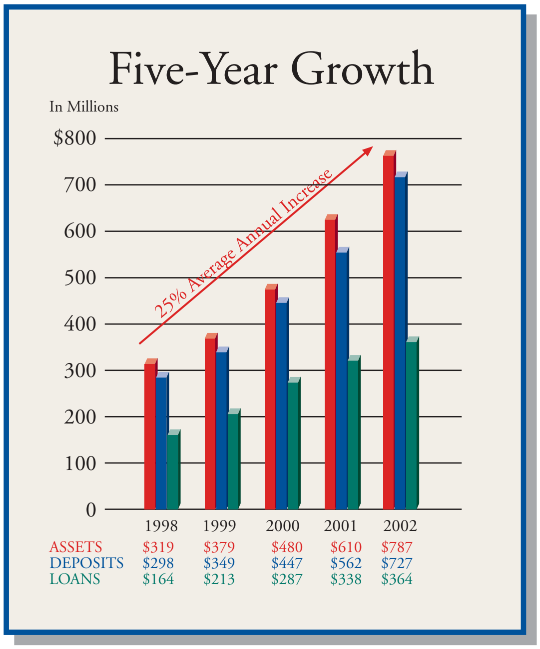
We would like to thank our employees, directors, shareholders, and especially our Customers for their ongoing support, and we look forward to working with all of you as we continue to expand in Central Pennsylvania.

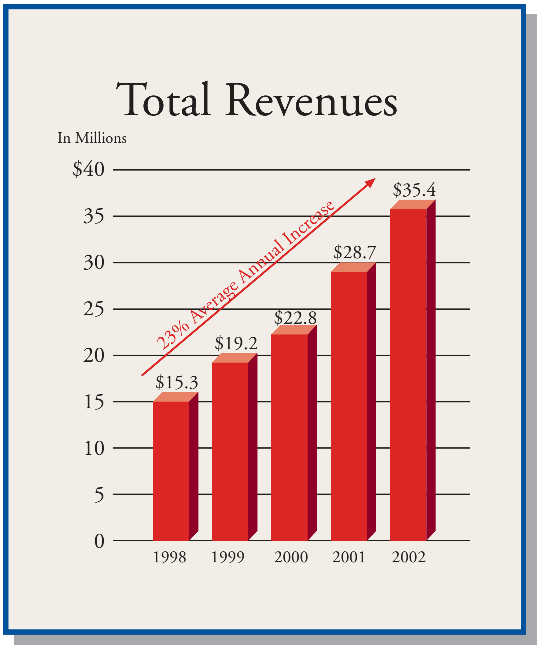


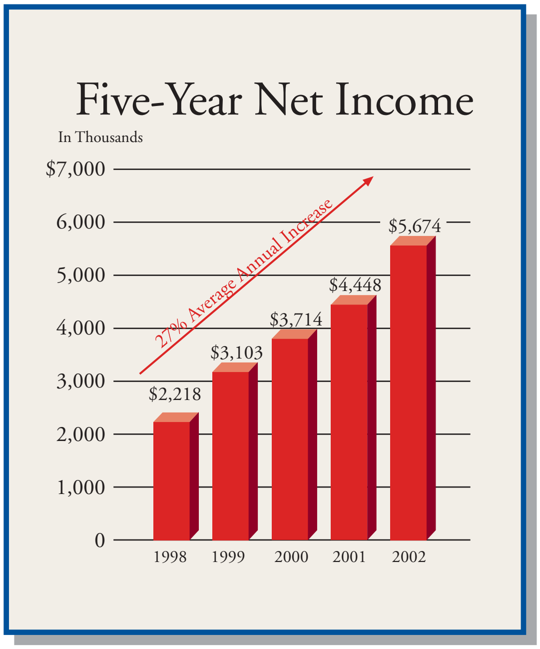
Gary L. Nalbandian
Chairman of the Board, President and CEO

March 17, 2003

Earnings Charts







Pennsylvania Commerce Bancorp

Retail Banking

David Skerpon,
Chief Retail Officer

Clockwise from top left: Retail Market Managers Leslie Meck, Vicky LaCour, Dorothy Krick and Cheryl Thoman

Providing the Best Retail Experience

Providing Customers with the best possible retail banking experience — turning them from Customers into "fans" — is the mainstay of Commerce Bank's model. The Commerce culture recognizes the value of delivering a great retail experience throughout every phase of our organization.

Employees who embrace the Commerce culture are the most important factor in Commerce Bank's success. Employees are empowered and encouraged at every level to do whatever it takes to exceed the expectations of their Customers. Employees are even rewarded for identifying "stupid rules" that keep them from "*WOWing*" their Customers.

The Commerce commitment to delivering extraordinary service goes well beyond the average in today's banking environment.

Our goal is to ensure that Commerce Customers can do their banking whenever, wherever and in whatever way they choose. This strategy has made Commerce "America's Most Convenient Bank."

Generating Growth

The Commerce Bank model continues to be a successful strategy. Commerce continued its growth during 2002:

- Commerce store deposits — comparable to same store sales in the retail industry — grew by 19%.
- Core deposits grew by 31%, to $687 million.
- Average store size increased to $44 million.

Hallmark Products and Services

Commerce Bank's hallmark products and services include:

- Seven-day branch banking
- Free personal checking
- The Commerce Bank Check Card
- 24-hour bank-by-phone service at 1-800-YES-2003
- America's Best Online Banking at *commercepc.com*
- Free Penny Arcade coin counting machines

The Commerce Bank Check Card, a multifunction debit/ATM card, provides Customers with another means of accessing their accounts. Check Card holders can use automated teller machines nationwide, and make purchases wherever Visa® is accepted.

Commerce Customers have other convenient means of accessing their accounts 24 hours a day. Although Commerce continues to welcome Customers to our stores, we also provide some of the best remote delivery channels for people who wish to use them.

Our 24-hour bank-by-phone service at 1-800-YES-2003 enables customers to:

- Open accounts
- Check account balances
- Transfer funds
- Apply for a loan
- Speak with a Customer Service Representative around the clock, 365 days a year

America's Best Online Banking can be found at *commercepc.com*. Through Commerce Online Banking, Customers can:

- Review their deposits, loans and even credit cards

- Access up-to-the-minute account balances
- Transfer funds between Commerce Bank accounts
- Pay bills electronically
- Reorder checks
- Place stop-payment orders
- Download to Quicken® or Microsoft® Money

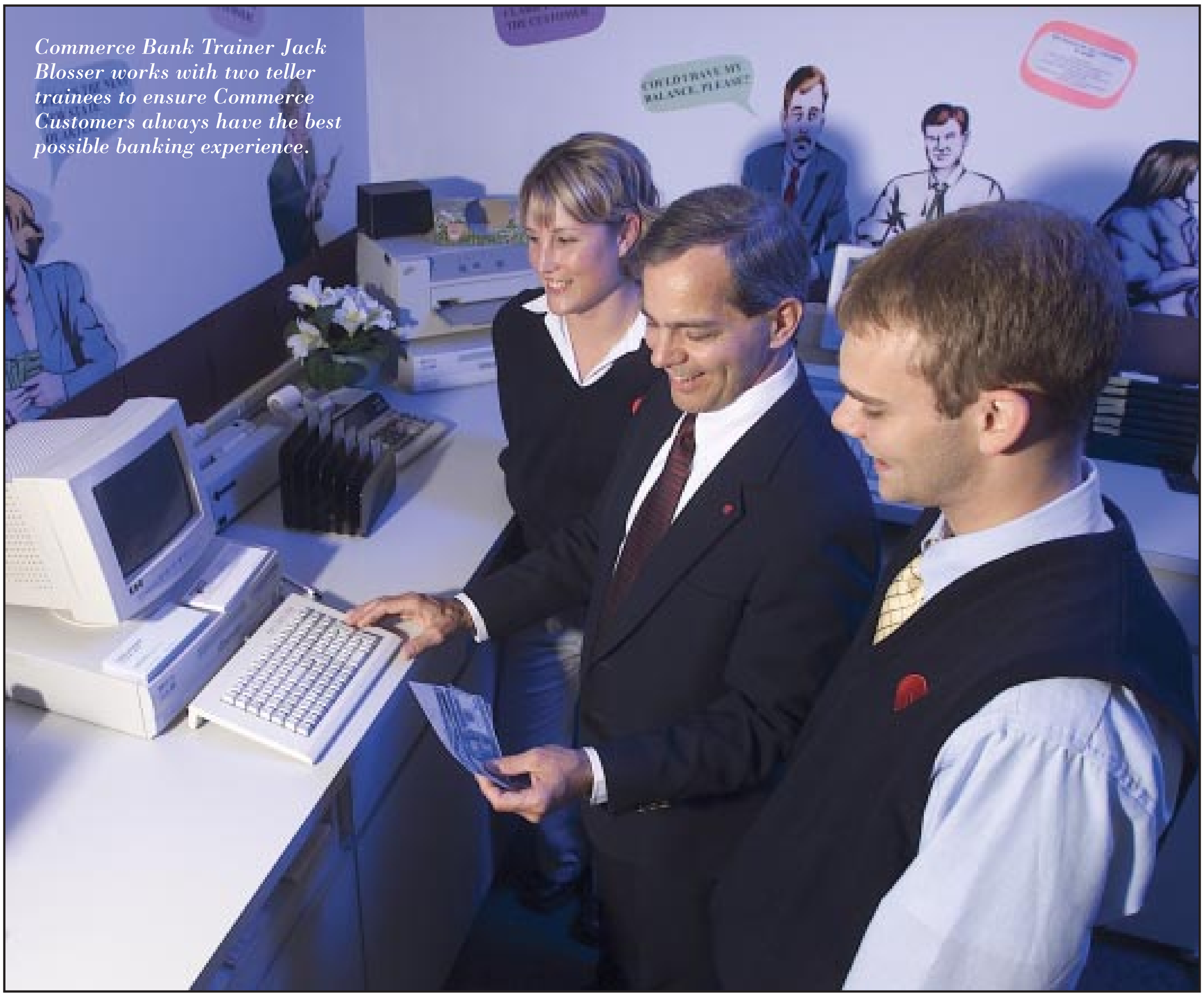
Our free coin-counting service — the Penny Arcade — remains a popular convenience for Customers and non-Customers. Conveniently located next to the Teller counter, the Penny Arcade accepts and counts loose change — without any fees!

In 2002, Commerce processed more than $6 million in change from nearly 70,000 people through its Penny Arcade machines.

Retail Loan Services

A key element of Commerce's retail banking strategy is providing knowledgeable guidance and prompt approvals to meet Customers' lending needs.

- In 2002, the residential mortgage group originated $87 million in residential mortgages.



Commerce Bank Trainer Jack Blosser works with two teller trainees to ensure Commerce Customers always have the best possible banking experience.

Retail Banking *(Continued)*

Downtown Harrisburg Store Manager Mel Wilkerson talks with Customer Joung Shin about the advantages and opportunities in using a Commerce Bank Check Card.

Commerce provides Customers with a number of mortgage products:

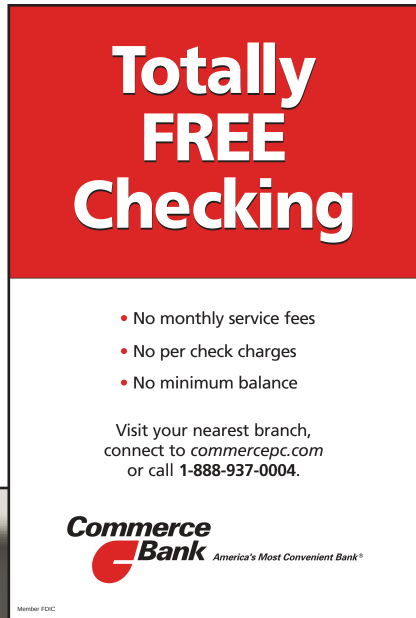
- Conventional Fixed Rate Mortgages
- Adjustable Rate Mortgages (ARM)
- Combination Mortgages
- Temporary Buydown
- FHA Mortgages
- Construction Loans

To ensure that Customers receive the best possible service, a seasoned lender takes every loan application and is well equipped to discuss all of the financing options available. Maintaining Commerce's commitment to extraordinary service, our loan officers regularly meet with Customers during the evening and on weekends to deliver our convenient lending services.

In addition to mortgage services, our retail loan products include:

- Personal Loans and Lines of Credit
- Home Equity Loans and Lines of Credit
- Auto and Manufactured Home Loans
- Education Loans

Retail Lending Customers receive competitive rates and flexible terms — and they can apply in person, online, or by telephone.



Convenience and service are the mainstay of Commerce Bank's model. Customers love the extended banking hours, online convenience and WOW! service they receive whenever, wherever and in whatever way they choose to do their banking.

The Power of "WOW!"

To the delight of Commerce Customers and employees, Harrisburg School District students from Jump Street's Gift of Music program provided a live musical performance at the Downtown Harrisburg store in mid-December.

"*WOW!* the Customer" is a service attitude…delivering unparalleled service, day in and day out.

We want all of our Customers to be passionate about doing business with us…every day. So every day, we are determined to "*WOW!* 'em!" The Power of *WOW!* turns our Customers into loyal Fans!

Extraordinary service — that's the foundation for Commerce employees. Nothing else will do for our Customers.

Each year, we receive letters from Customers — and sometimes, non-Customers — who have been "*WOWed!*" by Commerce employees' efforts. We receive letters from Fans who are impressed by our 7-day-a-week branch banking and long hours. Letters from Fans who are delighted to find we offer free coin counting through our Penny Arcade machines. And, letters from Fans who are overwhelmed by the employees who have "gone the extra mile" on their behalf.

Each year, we honor those employees who go the "extra mile" at our annual *WOW!* Awards ceremony. The annual *WOW!* Awards celebration was held at the Marriott Hotel in Harrisburg on February 25, 2002. Some 350 Commerce employees attended the Academy Awards-like event and cheered the accomplishments of nearly 40 employees who earned stock options for their tireless efforts to *WOW!* Customers every day.

SMART Principles

We work hard to maintain the Commerce *WOW!* spirit. To help us remember what Customers need and want, we follow the "SMART" Principles:

S.........Say "Yes" to Customers!

M.........Make Each Customer Feel Special!

A.........Always Keep Customer Promises!

R.........Recover! To Err Is Human, To Recover Is Divine

T.........Think Like The Customer!

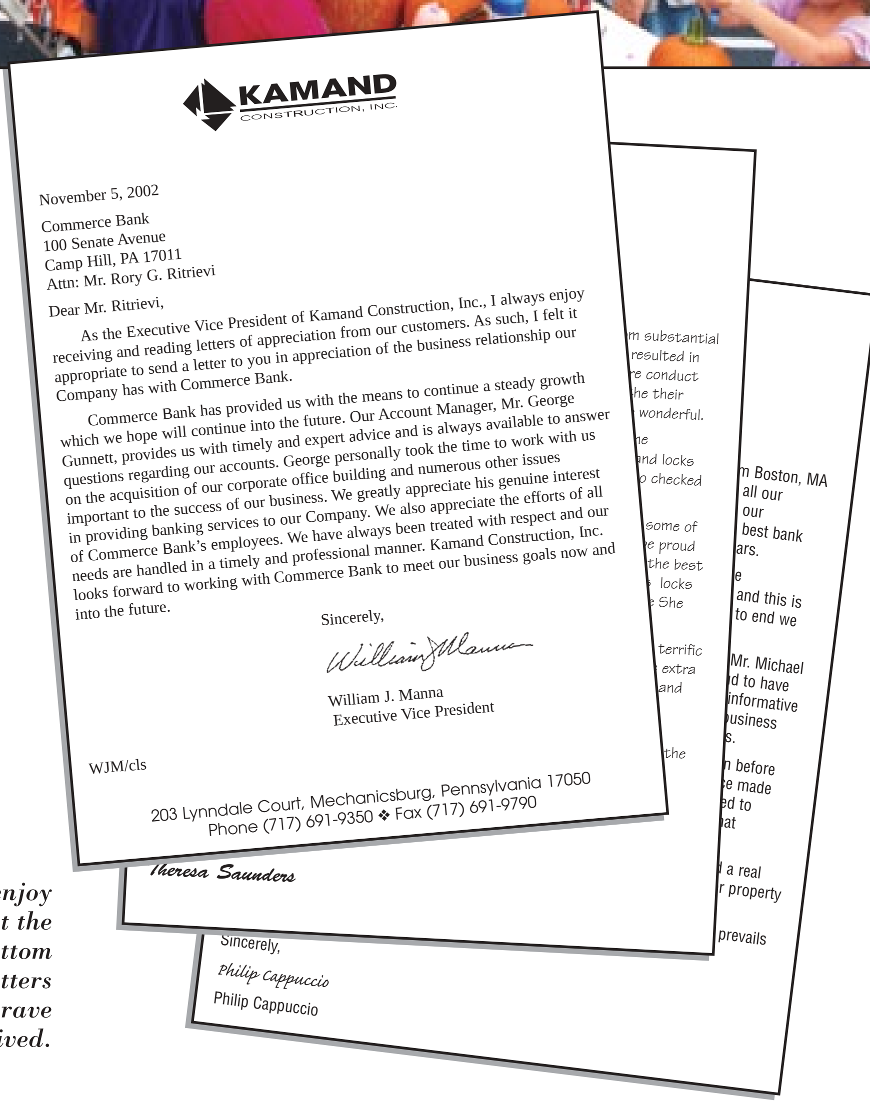
We provide our employees with a "SMART" Principles card to help remind them how to exceed our Customers' expectations every day.

Retailtainment

We think and act like retailers at Commerce. We believe in the idea of "retailtainment." We strive to create a sense of "fun" for our Customers and our employees through an array of special events, contests, and other unique activities.

Retailtainment can be local school choirs singing in our stores during the Christmas holidays, Commerce employees washing the windows of cars as they go through our drive-thru lanes, or a coloring contest for the kids.

Whatever it is, our goal is to ensure Commerce Customers leave our stores with a smile.



KAMAND CONSTRUCTION, INC.

November 5, 2002

Commerce Bank
100 Senate Avenue
Camp Hill, PA 17011
Attn: Mr. Rory G. Ritrievi

Dear Mr. Ritrievi,

As the Executive Vice President of Kamand Construction, Inc., I always enjoy receiving and reading letters of appreciation from our customers. As such, I felt it appropriate to send a letter to you in appreciation of the business relationship our Company has with Commerce Bank.

Commerce Bank has provided us with the means to continue a steady growth which we hope will continue into the future. Our Account Manager, Mr. George Gunnett, provides us with timely and expert advice and is always available to answer questions regarding our accounts. George personally took the time to work with us on the acquisition of our corporate office building and numerous other issues important to the success of our business. We greatly appreciate his genuine interest in providing banking services to our Company. We also appreciate the efforts of all of Commerce Bank's employees. We have always been treated with respect and our needs are handled in a timely and professional manner. Kamand Construction, Inc. looks forward to working with Commerce Bank to meet our business goals now and into the future.

Sincerely,

William J. Manna
Executive Vice President

WJM/cls

203 Lynndale Court, Mechanicsburg, Pennsylvania 17050
Phone (717) 691-9350 ❖ Fax (717) 691-9790

Theresa Saunders

Sincerely,
Philip Cappuccio
Philip Cappuccio

Top photo: Young Commerce Bank Fans enjoy some pumpkin painting at the Fall Festival at the Mountain Road store in Harrisburg. Bottom photo: Commerce Bank receives numerous letters from Customers and non-Customers who rave about the WOW! service they have received.

Commercial Banking

Above: Rory Ritrievi, Chief Lending Officer

Below: Eugene Draganosky, Regional Vice President, York; Lisa Laudermilch, Regional Vice President, Harrisburg

Experienced lenders are key to Commerce's success in commercial banking. Our lenders work with business and commercial Customers to ensure we develop a credit strategy that meets their needs — lines of credit, letters of credit, leases, and loans.

Commerce Customers have direct access to financial experts with authority to make prompt decisions regarding their financial needs. Locally based lenders know all of the local economic, demographic and development issues that impact our Customers and the success of their business ventures.

Our focus on providing Customers with services tailored to their needs, rather than simply selling standardized products, had a positive impact on our commercial lending business in 2002:

- The origination of $97 million in new commercial loans
- Outstanding credit quality, with non-performing assets of 0.23% of total assets

Cash Management Services

Our Cash Management services provide flexibility while ensuring the necessary control for achieving the best possible return for our Customers.

The centerpiece of the Commerce Cash Management product set — Commerce TreasuryDirect℠ — is a leading edge, "browser-based" technology. With Commerce TreasuryDirect, Customers no longer need to load or maintain banking software; all they need is an Internet browser to conduct their daily Cash Management activities.

Commerce TreasuryDirect enables Customers to "point and click" — they no longer are bound to their offices to manage their cash flow activities. The system brings together all of the routine cash management banking functions, including balance and transaction reporting, access to check images, wire transfer, ACH payment initiation and controlled disbursement reporting, among many other functions.

Commerce Bank now offers an enhanced escrow account service — Commerce EscrowDirect℠ — that simplifies bookkeeping.

Commerce EscrowDirect enables Customers to consolidate an unlimited number of individual client escrow accounts into a single, master account.

A number of money center banks offer a similar service with sub-accounting. But Commerce has added convenient, time-saving features — and a large dose of Commerce Bank's special brand of responsive customer service — to distinguish Commerce EscrowDirect. Opening an account is easy with Commerce EscrowDirect. Customers can mail or fax a deposit slip to Commerce, eliminating the need to travel to a store. Deposits also can be done electronically through the Automated Clearing House (ACH) network.

$5,110,000
Construction/
Permanent Financing

provided for

Capital Region Economic Development Corporation
(PennDOT Computer Server Facility)
1414 North Cameron Street
City of Harrisburg
Dauphin County, PA

Commerce Bank

O'Shea Lumber — which provides specialty wood products for furniture, cabinetry and woodworking — is one of Commerce Bank's customers in the York Region. Pictured from left to right are Commerce's Eugene Draganosky, York Regional Vice President; O'Shea's Shawn Covalt, Vice President; James Anton, Executive Vice President and Michael P. O'Shea, President; Commerce's Chief Lending Officer Rory Ritrievi; and O'Shea Vice President Jerry Anton.

In addition to Commerce TreasuryDirect, Cash Management products and services include:

- Direct Deposit Payroll
- Account Reconcilement
- Lock Box Service
- Time Deposits and Investment Accounts
- Interest Bearing Checking
- Merchant Card Processing
- Corporate Credit Cards

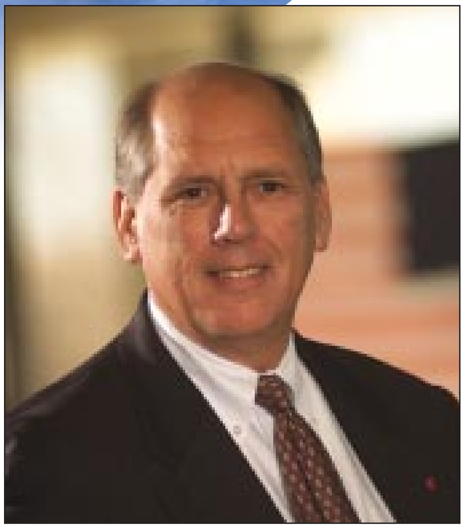
Working With Small Businesses

Commerce Bank continues to be a Preferred Lender for the Small Business Administration (SBA) in Pennsylvania. Preferred Lender status ensures Commerce can expedite the processing of SBA loan applications.

- In 2002, Commerce provided $4 million in SBA financing.

Commerce has the wherewithal to meet the needs of most businesses that may not have access to conventional funding sources.

Government Banking



Above: Thomas Bell, Government Banking Manager

Left: Ken Miller, Government Banking

Commerce Bank's Government Banking function continued to expand in 2002. We hired Thomas Bell, Government Banking Manager, in late 2002, to help accelerate our pursuit of local municipalities, school districts, and other local government entities. Bell joined Commerce with more than 20 years experience in banking. He also was the Chairman of Susquehanna Housing Initiatives from 1999 to September 2002. He continues to actively serve on the Board for the Tri-county Housing Development Corporation.

We Know The Local Market

The strength of Government Banking at Commerce is the depth of knowledge our government bankers have about local markets and communities. Our financial experts bring special skills, technology and expertise to their partnerships with government entities.

In 2002, Commerce Government Banking:

- Exceeded $179 million in deposits.
- Grew Total Public Fund deposits by 81%.
- Grew its client base by 41%.

Commerce works with various government bodies throughout central Pennsylvania:

- Municipalities
- School Districts
- Municipal Airports
- Municipal Water, Sewer and Utility Authorities
- County Governments and Authorities
- Community and State Colleges and Universities
- State Governments and Authorities
- Police and Fire Services

We are committed to providing our Government Banking Customers with the best possible banking experience through the development of relationships that go beyond strategic financial support to offering information, insight and guidance.

The key to our success comes from the relationships developed by our community government bankers, increasing recognition of the Commerce Bank brand, and our physical presence in the local communities we serve.

Providing Flexible, Convenient Products

Commerce designs its products and services to offer maximum flexibility, convenience and competitive rates to meet the specific needs and requirements of local government entities. Our Government Banking service includes retail banking for Customers' employees, cash management, corporate trust services and public finance capabilities.

We provide specialized corporate trust services to various government institutions, including serving as:

- Bond Trustee
- Bond Registrar
- Paying Agent
- Custodian

We provide a full range of public finance services through Commerce Capital Markets. In addition, we have significant experience in capital financing techniques and applying them to meet the unique demands of government organizations, including:

- Short-term Financing — bond and tax anticipation notes
- Long-term Bonds — refinancing/refunding and standard bond issues, certificates of participation or lease revenue bonds
- Debt Underwriting and Financial Advisory Services

$20,425,000
General Obligation
Bonds

provided for

**Cumberland Valley
School District**

Commerce Bank

$7,000,000
General Obligation
Bonds

provided for

York Township

Commerce Bank

$4,000,000
Tax-Free
Real Estate Loans

provided for

**Susquehanna Area
Regional Airport Authority**

Commerce Bank

Commerce Bank's Government Banking Officer Audrey Hanna and West Shore Tax Bureau Executive Director Richard L. Fry stand among just some of the Bureau's completed tax forms. Commerce handles the Tax Bureau's operating and payroll accounts, invests funds, and provides automated clearinghouse (ACH) disbursements for municipalities.

Community Commitment

Commerce Bank is a committed, involved member of the communities we serve throughout central Pennsylvania. Our support goes beyond providing just financial assistance; Commerce executives and employees from throughout the Bank also are active community members and lend their experience and expertise to numerous service, charitable, business and professional organizations.

Working on Behalf of the Community

Commerce is part of the communities we serve. Our employees and Customers live and work there. Their children go to school, play baseball and grow up there. We all have a stake in ensuring the economic and cultural viability of these communities.

Throughout 2002, Commerce Bank participated in numerous activities and sponsored many organizations that emphasized community development, education and enrichment.

Commerce worked with a number of organizations on several projects related to keeping young professionals in the central Pennsylvania region, including PA Project OSCAR. This is a joint marketing project between Harrisburg Young Professionals, Pennsylvania Business and Technology Digest, Capital Region Economic Development Corporation, Technology Counsel of Central Pennsylvania, and the State of Pennsylvania, and is designed to highlight opportunities for young people in central Pennsylvania.

Commerce Bank and the Harrisburg Downtown Improvement Authority teamed up in 2002 to sponsor "Big Day in the City" — an event designed to revitalize and continue the resurgence of a vibrant center city Harrisburg. Commerce's sponsorship was particularly appropriate with the opening of its first store at Second and Walnut Streets in downtown Harrisburg. "We are proud to be a sponsor of the 'Big Day in the City' celebration," said Commerce Bank Chairman, President and CEO, Gary Nalbandian, "…we have further signaled our ongoing commitment to downtown Harrisburg." Commerce also supported the community revitalization and development efforts of the Crispus Attucks Association in York.

At left: In addition to providing $2,500 as a Prize Money Sponsor for the Harrisburg Holiday Parade, 15 Commerce Bank volunteers guided this special American Eagle balloon along the parade route. At right: In 2002, Commerce Bank once again sponsored the U.S. Marine Corps' Toys for Tots campaign. Customers could drop off new toys for needy children at all Commerce Bank stores.

Commerce Bank's Debbie Farver, Residential Mortgage Portfolio Manager, delivers Commerce Bank's donation to the PA Task Force-1 team in a unique way. The PA Task Force-1 team was the first urban search and rescue canine team to respond to the September 11th tragedy at the World Trade Center.

Students participating in Commerce Bank's financial education program, SuperSavers, are greeted by Mr. C during their visit to the York Crossing store.

Commerce Corporate Fund

The Commerce Bank Corporate Fund was created to formalize the Bank's commitment to invest in the communities it serves.

- In 2002, Commerce Bank donated in excess of $350,000 to local and regional charities and community service organizations throughout central Pennsylvania. This was more than double its contribution for the previous year.

Corporate Fund contributions support civic, social improvement, health and human services, regional economic redevelopment, artistic, cultural, and educational efforts in our communities.

Supporting education is a key issue for Commerce. In 2002, for example, Commerce made a significant commitment to the Harrisburg Public School District Foundation with a contribution of $100,000. The Commerce contribution will fund scholarships for students of the Harrisburg City Schools. Commerce also made a two-year commitment to the Harrisburg Academy for a total of $50,000. These funds will be used to assist children who otherwise could not afford to attend the Academy.

Commerce also supports health education through its relationship with the Byrnes Health Education Center in York, which uses five unique "Teaching Theaters" to reach students of all ages.

Commerce also provided support to organizations that protect and serve community members in other ways. For example, Commerce supported Delta Housing in 2002 with a contribution of $1,000 for its work with at-risk women, children and families. Commerce also gave $2,500 to the Bethesda Mission in Harrisburg in support of its efforts to serve the hungry and homeless.

Cultural activities throughout central Pennsylvania also benefited from the Commerce Corporate Fund. Commerce sponsored Yorkfest 2002, a fine arts show presented by the City of York and Main Street York, which drew approximately 20,000 people to the weekend event.

Some of the other organizations and activities which received support from the Corporate Fund in 2002 included:

- West Shore Recreation & Leisure
- Middlesex Township Fall Festival
- Special Olympics
- Carlisle Summer Fair
- Springettsbury Township Children's Carnival
- York Hospital Fete
- ACCESS Domestic Violence Center

Board of Directors

Standing (from left to right): Alan R. Hassman, Douglas S. Gelder, Michael A. Serluco, Samir J. Srouji, MD, Peter J. Ressler, James R. Adair. Seated: Howell C. Mette, Gary L. Nalbandian

Gary L. Nalbandian
Chairman, President and CEO
Pennsylvania Commerce Bancorp, Inc.
Co-owner/President
Commercial Industrial Realty Co.

James R. Adair
President/CEO
Adair Construction Services, Inc.

Douglas S. Gelder
Owner/President
DSG Development

Alan R. Hassman
Owner/Operator
Seven McDonald's
Restaurant Locations

Howell C. Mette
Senior Partner
Mette, Evans & Woodside

Peter J. Ressler *(Secretary to the Board)*
Attorney
Mette, Evans & Woodside

Michael A. Serluco
Owner
Consolidated Properties

Samir J. Srouji, MD
Owner
Plastic Surgery, P.C.

Director Emeritus
Vernon W. Hill, II
Chairman & President
Commerce Bancorp, Inc.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of the Company's consolidated balance sheets and statements of income. This section should be read in conjunction with the Company's consolidated financial statements and accompanying notes.

Application of Critical Accounting Policies

The reporting of the Company's financial condition and results of operations is impacted by the application of accounting policies by management. Certain accounting policies are particularly sensitive and require significant judgments, estimates and assumptions to be made by management in matters that are inherently uncertain. The Company's accounting policies are detailed in Note 1 to the financial statements. The audit committee to the board of directors has approved these policies.

The Company's provision for loan losses and the level of the allowance for loan losses involve significant estimates by management in evaluating the adequacy of the allowance for loan losses. The allowance for loan losses is increased by a charge to the provision for loan losses. Management's evaluation is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. While management uses available information to make such evaluations, future adjustments to the allowance and the provision for loan losses may be necessary if economic conditions or loan credit quality differ substantially from the assumptions used in making the evaluation.

As permitted by SFAS No. 123, the Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion (APB) No. 25. Under APB No. 25, no compensation expense is recognized in the income statement related to any options granted under the Company's stock option plans. The pro forma impact to net income and earnings per share that would occur if compensation expense was recognized, based on the estimated fair value of the options on the date of grant, is disclosed in the notes to the consolidated financial statements. The Company intends to continue to account for stock-based compensation in this manner unless there is more specific guidance issued by the Financial Accounting Standards Board or unless a clear consensus develops in the financial services industry on the application of accounting methods.

2002 Overview

In 2002, the Company continued its strong financial performance by posting record levels of total assets, deposits and loans. Total assets grew by $177 million, or 29%, to $787 million and total deposits increased $165 million, or 29%, to $727 million. Core deposit growth was exceptionally strong, increasing $162 million, or 31%, from $525 million to $687 million.

Net income was up 28% in 2002 to $5.7 million from $4.4 million for 2001 and total revenues increased by 24% to a record level of $35.4 million. Diluted net income per common share increased 22% to $2.48 from $2.04 per share in 2001 (after adjusting for a 5% common stock dividend declared in January 2003).

In June, the Company opened a new branch at 101 North Second Street, Harrisburg, Pennsylvania, a new branch in August at 3201 Trindle Road, Camp Hill, Pennsylvania, and another new branch in December at 20 Knoble Boulevard, Carlisle, Pennsylvania. This brings the Bank's total number of full-service branches to 18. The Company plans to construct five additional branches in 2003.

Results of Operations

Average Balances and Average Interest Rates

Table 1 on the following page sets forth balance sheet items on a daily average basis for the years ended December 31, 2002, 2001 and 2000 and presents the daily average interest rates earned on assets and the daily average interest rates paid on liabilities for such periods. During 2002, average interest-earning assets were $645.1 million, an increase of $144.0 million, or 29%, over 2001. This was the result of an increase in the average balance of investment securities of $81.5 million, an increase in the average balance of federal funds sold of $14.4 million, and an increase in the average balance of loans receivable of $48.1 million. The growth in the average balance of interest earning assets was funded primarily by an increase in the average balance of deposits (including noninterest bearing demand deposits) of $140.4 million.

The yield on total interest-earning assets decreased by 112 basis points in 2002 from 7.63% to 6.51%. The decrease resulted primarily from decreased yields in the loan and investment portfolios due to the overall level and timing of changes in general market interest rates during 2002 as compared to 2001. The Federal Reserve Board (FRB) lowered short-term market interest rates eleven times throughout 2001 and an additional 50 basis points in 2002 for a total decrease of 525 basis points (bps). As a result, the Company experienced lower yields on interest-earning assets in 2002 from 2001 as well as a lower cost of funds in 2002 versus the prior year.

TABLE 1

	Year Ended December 31,								
(dollars in thousands)	**2002**			2001			2000		
Earning Assets	**Average Balance**	**Interest**	**Average Rate**	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Securities:									
Taxable	**$246,230**	**$14,514**	**5.89%**	$165,013	$10,860	6.58%	$121,833	$ 8,025	6.59%
Tax-exempt	**1,995**	**107**	**5.36**	1,743	94	5.38	795	44	5.51
Total securities	**248,225**	**14,621**	**5.89**	166,756	10,954	6.57	122,628	8,069	6.58
Federal funds sold	**31,833**	**508**	**1.59**	17,399	641	3.68	11,707	760	6.49
Loans receivable:									
Mortgage and construction	**241,647**	**18,408**	**7.62**	212,117	18,013	8.49	178,937	15,852	8.86
Commercial loans and lines of credit	**83,971**	**5,670**	**6.75**	69,815	5,810	8.32	47,747	4,691	9.82
Consumer	**35,851**	**2,677**	**7.47**	32,305	2,709	8.39	26,640	2,293	8.61
Tax-exempt	**3,598**	**111**	**3.09**	2,711	120	4.43	1,833	109	5.94
Total loans receivable	**365,067**	**26,866**	**7.36**	316,948	26,652	8.41	255,157	22,945	8.99
Total earning assets	**$645,125**	**$41,995**	**6.51%**	$501,103	$38,247	7.63%	$389,492	$31,774	8.16%
Sources of Funds									
Interest-bearing deposits:									
Regular savings	**$197,225**	**$ 3,857**	**1.96%**	$141,350	$ 4,168	2.95%	$108,131	$ 4,219	3.90%
Interest checking	**10,590**	**125**	**1.18**	7,955	165	2.07	8,696	339	3.90
Money market	**145,851**	**1,923**	**1.32**	100,394	2,261	2.25	71,764	2,288	3.19
Time deposits	**118,899**	**5,595**	**4.71**	126,389	7,133	5.64	104,983	5,422	5.17
Public funds time	**54,165**	**1,440**	**2.66**	33,642	1,693	5.03	25,833	1,688	6.54
Total interest-bearing deposits	**526,730**	**12,940**	**2.46**	409,730	15,420	3.76	319,407	13,956	4.37
Short-term borrowings	**12**	**0**	**1.46**	330	13	3.94	696	42	5.91
Trust Capital Securities	**13,000**	**1,354**	**10.41**	7,082	760	10.73	2,708	299	11.07
Total interest-bearing liabilities	**539,742**	**14,294**	**2.65**	417,142	16,193	3.88	322,811	14,297	4.43
Noninterest-bearing funds (net)	**105,383**			83,961			66,681		
Total sources to fund earning assets	**$645,125**	**14,294**	**2.22**	$501,103	16,193	3.23	$389,492	14,297	3.67
Net interest income and margin		**$27,701**	**4.29%**		$22,054	4.40%		$17,477	4.49%
Other Balances									
Cash & due from banks	**$ 23,022**			$ 18,904			$ 14,806		
Other assets	**27,190**			20,951			18,734		
Total assets	**695,337**			540,958			423,032		
Noninterest-bearing demand deposits	**114,758**			91,352			72,413		
Other liabilities	**2,657**			2,508			5,419		
Stockholders' equity	**38,180**			29,956			22,389		

Notes: Nonaccrual loans have been included in the average loan balances. Securities include securities available for sale and securities held to maturity. Securities available for sale are carried at amortized cost for purposes of calculating the average rate received on taxable securities above. Yields on tax-exempt securities are not computed on a taxable equivalent basis.

The aggregate cost of interest-bearing liabilities decreased 123 basis points from 3.88% in 2001 to 2.65% in 2002. The average rate paid on savings deposits decreased by 99 basis points, from 2.95% in 2001 to 1.96% in 2002 and the average rate paid on interest checking accounts decreased from 2.07% in 2001 to 1.18% in 2002. For time deposits the average rate paid was 4.71%, down 93 basis points from 2001 and public funds experienced a decrease of 237 basis points in 2002 on the average rate paid. The majority of the Company's public funds are deposits of local school districts and municipalities. These deposits are repriced at maturity based upon an average of rates paid for comparable time deposits by several financial institutions in the Central Pennsylvania market.

The Company's aggregate cost of funding sources decreased 101 basis points in 2002 from 3.23% to 2.22%. This decrease resulted primarily from lower average rates paid on total interest bearing deposits as well as a $23.4 million increase in the average of noninterest-bearing demand deposits.

Net Interest Income and Net Interest Margin

Net interest income is the difference between interest income earned on assets and interest expense incurred on liabilities used to fund those assets. Interest earning assets primarily include loans and securities. Liabilities used to fund such assets include deposits and borrowed funds. Changes in net interest income and margin result from the interaction between the volume and composition of earning assets, related yields and associated funding costs.

Net interest income for 2002 increased $5.6 million, or 26%, over 2001 to $27.7 million. Interest income on earning assets totaled $42.0 million, an increase of $3.7 million, or 10%, over 2001. The majority of this increase was related to volume increases in the securities and loans receivable portfolios partially offset by lower interest rates on interest earning assets. Interest expense for 2002 decreased $1.9 million, or 12% from $16.2 million in 2001 to $14.3 million in 2002. This decrease was

TABLE 2

	2002 v. 2001 Increase (Decrease) Due to Changes in [1]			2001 v. 2000 Increase (Decrease) Due to Changes in [1]		
(in thousands)	**Volume**	**Rate**	**Total**	Volume	Rate	Total
Interest on securities:						
Taxable	**$4,793**	**$(1,139)**	**$3,654**	$ 2,847	$ (12)	$ 2,835
Tax-exempt	**13**	**0**	**13**	51	(1)	50
Federal funds sold	**231**	**(364)**	**(133)**	210	(329)	(119)
Interest on loans receivable:						
Mortgage and construction	**2,240**	**(1,845)**	**395**	2,823	(662)	2,161
Commercial	**956**	**(1,096)**	**(140)**	1,835	(716)	1,119
Consumer	**265**	**(297)**	**(32)**	475	(59)	416
Tax-exempt	**27**	**(36)**	**(9)**	39	(28)	11
Total interest income	**8,525**	**(4,777)**	**3,748**	8,280	(1,807)	6,473
Interest expense:						
Regular savings	**1,088**	**(1,399)**	**(311)**	976	(1,027)	(51)
Interest checking	**31**	**(71)**	**(40)**	(15)	(159)	(174)
Money market plus	**596**	**(934)**	**(338)**	647	(674)	(27)
Time deposits	**(363)**	**(1,175)**	**(1,538)**	1,218	493	1,711
Public funds	**544**	**(797)**	**(253)**	395	(390)	5
Short-term borrowings	**(5)**	**(8)**	**(13)**	(15)	(13)	(28)
Trust Capital Securities	**617**	**(23)**	**594**	451	9	460
Total interest expense	**2,508**	**(4,407)**	**(1,899)**	3,657	(1,761)	1,896
Net increase (decrease)	**$6,017**	**$ (370)**	**$5,647**	$4,623	$ (46)	$4,577

[1] *Changes due to both volume and rate have been allocated to volume changes.*

primarily related to the reduction in interest rates on the deposit products partially offset by the increases in the Company's average level of deposits and long-term debt.

Changes in net interest income are frequently measured by two statistics: net interest rate spread and net interest margin. Net interest rate spread is the difference between the average rate earned on interest-earning assets and the average rate incurred on interest-bearing liabilities. Net interest margin represents the difference between interest income, including net loan fees earned, and interest expense, reflected as a percentage of average earning assets. The Company's net interest rate spread increased to 3.86% in 2002 from 3.75% in 2001 and the net interest margin decreased 11 basis points from 4.40% to 4.29%.

Table 2 demonstrates the relative impact on net interest income of changes in the volume of earning assets and interest-bearing liabilities and changes in rates earned and paid by the Company on such assets and liabilities. For purposes of this table, nonaccrual loans have been included in the average loan balances.

Noninterest Income

Noninterest income for 2002 increased by $1.1 million, or 17%, over 2001 to $7.7 million. The increase was due primarily to increased "core" other operating income attributable to service charges and fees associated with servicing a higher volume of deposit and loan accounts. Included in total noninterest income were gains of $493,000 in 2002 and $354,000 in 2001 on the sale of residential and student loans. Also included in noninterest income were net securities gains of $0 for 2002 and $52,000 for 2001.

Noninterest Expenses

Noninterest expenses totaled $25.4 million for 2002, an increase of $4.9 million, or 24%, over 2001. Staffing levels, occupancy, furniture and equipment, and related expenses increased as a result of opening three full service branches in 2002. A comparison of noninterest expense for certain categories for 2002 and 2001 is presented below.

Salary expenses and employee benefits, which represent the largest component of noninterest expenses, increased by $3.0 million, or 32%, in 2002 over 2001. This increase was consistent with an increase in the level of full-time equivalent employees from 334 at December 31, 2001 to 424 at year-end 2002. The increased level of expenses includes the impact of salary and benefit costs associated with the additional staff for the three new branch offices opened in June, August and December 2002, respectively.

Occupancy expenses totaled $2.4 million in 2002, an increase of $270,000, or 13%, over 2001 while furniture and equipment expenses increased by $121,000, or 9%, to $1.5 million. The full year impact of the two branch offices opened in 2001 along with three additional branches opened in 2002, contributed to the increases in occupancy and furniture and equipment expenses in 2002 over 2001.

Advertising and marketing expenses were $2.2 million for 2002, an increase of $459,000, or 27%, over 2001. The increase was primarily the result of increased advertising efforts in each of the Company's markets. The Company's markets include Lebanon, Dauphin, Cumberland, and York Counties. With expansion into the Berk's County area in 2003, the Company will continue to see increases in advertising and marketing expenses. The Company will continue to have multiple markets in which to advertise its products.

Data processing expenses increased by $577,000, or 44%, in 2002 over 2001. The primary increase was due to costs associated with processing additional transactions as a result of growth in the number of accounts serviced. Another contributing factor was the Company outsourced the proof, check clearing, and customer statement and processing functions in 2002. As a result, the Company experienced greater costs in the data processing area but achieved offsetting savings in postage, stationery and supplies and correspondent bank charges.

Postage and supplies expenses of $862,000 were $16,000, or 2%, higher than the prior year. The increase in postage and supplies expenses was attributed to the growth in the number of account statements mailed to customers offset by reduced postage rates incurred as a direct result of converting to imaged customer statements.

Audits, regulatory fees, and assessments for 2002 increased by $83,000, or 21%, from 2001. This was primarily due to the increase in the yearly assessments by the Office of the Comptroller of the Currency for examinations and the Federal Deposit Insurance Corporation for deposit insurance coverage. Both assessment calculations, which are based on deposit size, continue to increase as the Company's deposit balances grow.

Other noninterest expenses totaled $3.6 million for 2002, compared to $3.2 million for 2001. The increase included increased loan expenses of $83,000, increased legal expenses of $100,000, increased business development expenses of $88,000 and increased provisions for non-credit-related losses of $72,000.

The Company's current strategic plan calls for the construction of five additional new branch offices in 2003. The costs associated with these planned offices will continue to result in higher levels of staff, facilities, and related expenses in 2003 and in future periods.

One key measure used to monitor progress in controlling overhead expenses is the ratio of net noninterest expenses to average assets. Net noninterest expenses equal noninterest expenses (excluding other real estate expenses) less noninterest income (exclusive of non-recurring gains). This ratio equaled 2.55% for 2002, compared to 2.60% for 2001. Another productivity measure is the operating efficiency ratio. This ratio expresses the relationship of noninterest expenses (excluding other real estate expenses) to net interest income plus noninterest income (excluding non-recurring gains). For 2002 and 2001, the operating efficiency ratio was 71.9%.

Provision for Income Taxes

The provision for income taxes was $2.9 million for 2002, compared to $2.2 million for 2001. The effective tax rate, which is the ratio of income tax expense to income before taxes, was 33.6% in 2002 and 33.4% in 2001. Reference should be made to Note 11 of the *Notes to Consolidated Financial Statements* for an additional analysis of the provision for income taxes for 2002 and 2001.

In accordance with Statement of Financial Accounting Standard No. 109 (SFAS No. 109), "Accounting for Income Taxes", income taxes are accounted for under the liability method. Under the liability method, deferred tax assets and liabilities are recognized for future tax consequences attributable to temporary differences between the financial statement and tax bases of existing assets and liabilities.

At December 31, 2002, deferred tax assets amounted to $1.8 million and deferred tax liabilities amounted to $1.4 million. Deferred tax assets are realizable primarily through carryback of existing deductible temporary differences to recover taxes paid in prior years, and through future reversal of existing taxable temporary differences. Management currently anticipates future earnings will be adequate to utilize the net deferred tax assets.

Net Income and Net Income Per Share

Net income for 2002 rose to a record $5.7 million, an increase of $1.3 million, or 28%, over the $4.4 million recorded in 2001. This increase was due to an increase in net interest income of $5.6 million, an increase in noninterest income of $1.1 million, a decrease in the provision for loan losses of $34,000, partially offset by an increase in noninterest expenses of $4.9 million and an increase of $639,000 in the provision for income taxes.

Basic earnings per common share, after adjusting for a 5% common stock dividend declared in January 2003, increased by 21% to $2.71 per share, compared to $2.24 in 2001. Diluted earnings per common share were $2.48 for 2002 and $2.04 for 2001 after adjusting for the 5% common stock dividend declared in January 2003. Reference should be made to Note 13 in the *Notes to Consolidated Financial Statements* for an analysis of earnings per share.

Return on Average Assets and Average Equity

Return on average assets (ROA) measures the Company's net income in relation to its total average assets. The Company's ROA for 2002 and 2001 was 0.82%.

For purposes of calculating ROA, average assets have been adjusted to exclude the effect of net unrealized gains (losses) on securities available for sale.

Return on average equity (ROE) indicates how effectively the Company can generate net income on the capital invested by its stockholders. ROE is calculated by dividing net income by average stockholders' equity. For purposes of calculating ROE, average stockholders' equity includes the effect of unrealized gains (losses), net of income taxes, on securities available for sale. Reference should be made to Note 3 in the *Notes to Consolidated Financial Statements* for an analysis of securities available for sale. The Company's ROE for 2002 was 14.86%, compared to 14.85% for 2001.

Results of Operations

2001 versus 2000

Net income for 2001 rose to a record $4.4 million, an increase of $734,000, or 20%, over the $3.7 million recorded in 2000.

Diluted earnings per common share increased by 14% to $2.04 for 2001 over $1.78 for 2000 after adjusting for the 5% common stock dividend declared in January 2002 and 2003.

Net interest income for 2001 increased $4.6 million, or 26%, over 2000 to $22.1 million. Interest income on earning assets totaled $38.2 million, an increase of $6.5 million, or 20%, over 2000. Interest expense for 2001 increased by $1.9 million, or 13%, to $16.2 million from $14.3 million.

The Company's net interest rate spread increased to 3.75% in 2001 from 3.73% in 2000 and the net interest margin decreased 9 basis points from 4.49% to 4.40%.

Noninterest income for 2001 increased by $1.2 million, or 23%, over 2000 to $6.6 million. Included in total noninterest income were gains of $354,000 in 2001 and $370,000 in 2000 on the sale of residential, student, and Small Business Administration loans.

Noninterest expenses totaled $20.5 million for 2001, an increase of $4.3 million, or 27%, over 2000. Staffing levels, occupancy, furniture and equipment, and related expenses increased as a result of opening two full service branches in Spring and Fall 2001.

Salary expenses and employee benefits, which represent the largest component of noninterest expenses, increased by $2.0 million, or 27%, in 2001 over 2000. This increase was consistent with an increase in the level of full-time equivalent employees from 266 at December 31, 2000 to 334 at year-end 2001.

Occupancy expenses totaled $2.1 million in 2001, an increase of $351,000, or 20%, over 2000 while furniture and equipment expenses increased by $310,000, or 28%, to $1.4 million.

Advertising and marketing expenses were $1.7 million for 2001, an increase of $271,000, or 19%, over 2000. Data processing expenses increased by $349,000, or 36%, in 2001 over 2000. Postage and supplies expenses of $846,000 were $187,000, or 28%, higher than the prior year.

Audits, regulatory fees, and assessments for 2001 increased by $53,000, or 15%, from 2000. Other noninterest expenses totaled $3.2 million for 2001, compared to $2.4 million for 2000.

Financial Condition

Securities

Securities are purchased and sold as part of the overall asset and liability management function at Pennsylvania Commerce Bancorp, Inc. The classification of all securities is determined at the time of purchase. Securities expected to be held for an indefinite period of time are classified as securities available for sale and are carried at fair value. Decisions by management to purchase or sell these securities are based on an assessment of financial and economic conditions, including changes in prepayment risks and interest rates, liquidity needs, capital adequacy, collateral requirements for pledging, alternative asset and liability management strategies, tax considerations, and regulatory requirements.

Securities are classified as held to maturity if, at the time of purchase, management has both the intent and ability to hold the securities until maturity. Securities held to maturity are carried at amortized cost. Sales of securities in this portfolio should only occur in unusual and rare situations where significant unforeseeable changes in circumstances may cause a change in intent. Examples of such instances would include deterioration in the issuer's creditworthiness that is evidently supportable and significant or a change in tax law that eliminates or reduces the tax-exempt status of interest (but not the revision of marginal tax rates applicable to interest income). Held to maturity securities cannot be sold based upon any of the decisions used to sell securities available for sale as listed above. Reference should be made to Note 3 in the *Notes to Consolidated Financial Statements* for further analysis of the Company's securities portfolio.

The Company's investment securities portfolio consists primarily of U.S. Government agency and mortgage-backed obligations. These securities have very little, if any, credit risk because

Table 3

December 31, 2002 *(dollars in thousands)*	Due Under 1 Year Amount/Yield		Due 1–5 Years Amount/Yield		Due 5–10 Years Amount/Yield		Due Over 10 Years Amount/Yield		Total Amount/Yield	
Available for Sale										
U.S. Government										
Agency obligations	—	—	—	—	$ 1,997	5.82%	$ 10,310	6.48%	$ 12,307	6.37%
Mortgage-backed obligations	—	—	$ 647	7.64%	11,903	3.90	172,243	4.46	184,793	4.43
Corporate debt securities	—	—	—	—	—	—	6,033	7.76	6,033	7.76
Total available for sale	$ —	—%	$ 647	7.64%	$13,900	4.17%	$188,586	4.68%	$203,133	4.65%
Held to Maturity										
U.S. Government										
Agency obligations	—	—	$ 999	6.30%	—	—	$ 9,006	6.92%	$10,005	6.86%
Municipal obligations	—	—	—	—	—	—	1,996	5.37	1,996	5.37
Mortgage-backed obligations	—	—	1,799	7.20	$ 4,833	5.11%	57,277	5.98	63,909	5.95
Corporate debt securities	—	—	2,008	6.35	11,100	6.68	8,607	7.51	21,715	6.97
Total held to maturity	$ —	—%	$4,806	6.66%	$15,933	6.19%	$76,886	6.30%	$97,625	6.26%

Note: Securities available for sale are carried at amortized cost in the table above for purposes of calculating the weighted average yield received on such securities.

they are either backed by the full faith and credit of the U.S. Government or their principal and interest payments are guaranteed by an agency of the U.S. Government or are AAA rated. These investment securities carry fixed rate coupons that do not change over the life of the securities. Since most securities are purchased at premiums or discounts, their yield and average life will change depending on any change in the estimated rate of prepayments. The Company amortizes premiums and accretes discounts over the estimated average life of the securities. Changes in the estimated average life of the securities portfolio will lengthen or shorten the period in which the premium or discount must be amortized or accreted, thus affecting the Company's securities yields.

At December 31, 2002, the weighted average life of the Company's securities portfolio was 2.5 years compared to 6.7 years at December 31, 2001. The weighted average life of the portfolio is calculated by estimating the average rate of repayment of the underlying collateral of the security. Mortgage-backed obligations historically experience repayment rates in excess of the scheduled repayments, causing a shorter weighted average life of the security. The Company's securities portfolio contained no "high-risk" securities or derivatives as of December 31, 2002 or 2001.

Securities available for sale increased by $97.7 million in 2002 (excluding the effect of unrealized gains or losses) primarily as a result of purchases of $176.9 million, offset by principal repayments and maturities of $78.5 million. The securities available for sale portfolio is comprised of U.S. Government Agency securities, mortgage-backed securities, AAA Whole Loan CMO securities, and corporate debt securities. At December 31, 2002, the unrealized gains on securities available for sale included in stockholders' equity totaled $1.5 million, net of tax, compared to unrealized losses of $111,000, net of tax, at December 31, 2001. The weighted average anticipated maturity of the securities available for sale portfolio was 2.3 years at December 31, 2002, with a weighted average yield of 4.65%.

During 2002, securities held to maturity decreased by $5.7 million as a result of purchases of $29.1 million offset by principal repayments of $34.7 million. The securities held in this portfolio include U.S. Government Agency securities, tax-exempt municipal bonds, AAA Whole Loan CMO securities, corporate debt securities and mortgage-backed securities. The weighted average anticipated maturity of the securities held to maturity portfolio was 3.2 years at December 31, 2002, with a weighted average yield of 6.26%.

The contractual maturity distribution and weighted average yield of the Company's available for sale and held to maturity portfolios at December 31, 2002 are summarized in Table 3. Weighted average yield is calculated by dividing income within each maturity range by the outstanding amount of the related investment and has not been tax affected on tax-exempt obligations.

Loan Portfolio

The table below summarizes the composition of the loan portfolio of the Company by type as of December 31, for each of the years 1998 through 2002.

The Company manages risk associated with its loan portfolio through diversification, underwriting policies and procedures that are reviewed and updated on at least an annual basis, and ongoing loan monitoring efforts. The commercial real estate portfolio includes owner-occupied (owner occupies greater than 50% of the property), other commercial real estate and construction loans. Owner-occupied and other commercial real estate loans generally have five-year call provisions and personal guarantees of the principals involved. Construction loans are primarily used for single-family residential properties. Financing is provided against firm agreements of sale, with speculative construction normally limited to one or two samples per project.

Table 4

	December 31,				
(in thousands)	**2002**	2001	2000	1999	1998
Commercial real estate, construction and land development loans	**$175,993**	$175,832	$158,707	$120,008	$ 81,949
Residential real estate mortgage loans	**66,190**	48,415	41,314	34,681	31,694
Tax-exempt loans	**5,629**	2,676	2,786	342	395
Commercial, industrial and other business loans	**49,226**	42,399	31,490	21,228	19,614
Consumer loans	**34,598**	36,551	30,691	22,764	20,868
Lines of credit	**37,245**	36,801	25,264	17,082	12,601
Total loans	**$368,881**	$342,674	$290,252	$216,105	$167,121

The commercial loan portfolio is comprised primarily of loans to small businesses in the Southern Central Pennsylvania market area. Business assets, personal guarantees, and/or personal assets of the borrower generally secure these loans. The consumer loan portfolio is comprised primarily of loans secured by first and second mortgage liens on residential real estate. The Company's loan portfolio is generally nonhomogeneous in that the loans have different interest rates, repayment options, maturities, collateral requirements, etc.

During 2002, total gross loans increased by $29.1 million from $350.3 million at December 31, 2001, to $379.4 million at December 31, 2002, including $10.5 million of loans held for sale on December 31, 2002 and $7.7 million of loans held for sale on December 31, 2001. The loans held for sale represent student loans and certain residential loans that management intends to sell and reinvest in higher yielding loans and securities. The increase in loans receivable in 2002 was primarily in residential and commercial business. Loans receivable represented 51% of total deposits and 47% of total assets at December 31, 2002, excluding the loans held for sale, compared to 61% and 56%, respectively, at December 31, 2001.

The maturity ranges of the loan portfolio and the amounts of loans with predetermined interest rates and floating interest rates in each maturity range, as of December 31, 2002, are presented in the following table.

Concentrations of Credit Risk

The largest portion of loans, 39%, on the Company's balance sheet is for commercial real estate related loans. The Company's commercial real estate loan portfolio is principally to borrowers throughout Cumberland, Dauphin, Lebanon, and York counties of Pennsylvania where it has full-service branch locations. Commercial real estate, construction, and land development loans aggregated $176.0 million at December 31, 2002, compared to $175.8 million at December 31, 2001. Commercial real estate loans are collateralized by the related project (principally office building, multi-family residential, land development, and other properties) and the Company generally requires loan-to-value ratios of no greater than 80%. Collateral requirements on such loans are determined on a case-by-case basis based on managements' credit evaluations of the respective borrowers.

Non-Performing Loans and Assets

Total non-performing assets (non-performing loans and foreclosed real estate) at December 31, 2002, were $1.8 million, or 0.23%, of total assets as compared to $888,000, or 0.15%, of total assets at December 31, 2001. Foreclosed real estate totaled $118,000 as of December 31, 2002, and $12,000 as of December 31, 2001. Total non-performing loans (non-accrual loans and restructured loans) at December 31, 2002 were $1.7 million compared to

Table 5

	December 31, 2002			
(in thousands)	Due Under One Year	Due 1–5 Years	Due Over Five Years	Total
Real estate:				
Commercial mortgage	$ 9,331	$39,949	$ 95,679	$144,959
Construction and land development	18,873	7,492	4,669	31,034
Residential mortgage	3,767	9,767	52,656	66,190
Tax-exempt	418	3,239	1,972	5,629
	32,389	60,447	154,976	247,812
Commercial	23,309	19,195	6,722	49,226
Consumer	11,173	13,156	10,269	34,598
Lines of credit	37,245	0	0	37,245
Total loans	$104,116	$92,798	$171,967	$368,881
Interest rates:				
Predetermined	$ 32,546	$75,252	$158,500	$266,298
Floating	71,570	17,546	13,467	102,583
Total loans	$104,116	$92,798	$171,967	$368,881

$876,000 a year ago. Total delinquent loans (those loans 30 days or more delinquent) as a percentage of total loans were 0.68% at December 31, 2002, compared to 0.34% at December 31, 2001. The Company generally places a loan on nonaccrual status and ceases accruing interest when loan payment performance is deemed unsatisfactory and the loan is past due 90 days or more, unless the loan is both well-secured and in the process of collection. At December 31, 2002, loans past due 90 days and still accruing interest amounted to $55,000 compared to $0 at December 31, 2001.

Foreclosed real estate totaled $118,000 as of December 31, 2002 as compared to $12,000 as of December 31, 2001. These properties have been written down to the lower of cost or fair value less disposition costs. The Company obtains updated appraisals on non-performing loans secured by real estate. In those instances where appraisals reflect reduced collateral values, an evaluation of the borrower's overall financial condition is made to determine the need for possible write-downs or appropriate additions to the allowance for loan losses.

The following table summarizes information regarding non-performing loans and non-performing assets as of December 31, 1998 through 2002.

Allowance for Loan Losses

The allowance for loan losses is a reserve established through charges to expense in the form of a provision for loan losses and reduced by loan charge-offs net of recoveries. Charge-offs occur when loans are deemed to be uncollectible. Management has established an allowance for loan losses that they believe is adequate for estimated inherent losses in the current loan portfolio. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risks on a timely basis so that an appropriate allowance can be maintained. Based on an evaluation of the loan portfolio, management presents a quarterly review of the allowance for loan losses to the Board of Directors, indicating any changes in the allowance since the last review and any recommendations as to adjustments in the allowance. In making the evaluation, management considers the results of recent regulatory examinations, which typically include a review of the allowance for loan losses as an important part of the examination process.

In establishing the allowance, management evaluates individual large classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. An allowance for the remainder of the loan portfolio is also determined based on historical loss experience within the components of the portfolio. These allocations may be modified if current condi-

Table 6

	December 31,				
(dollars in thousands)	**2002**	2001	2000	1999	1998
Nonaccrual loans:					
Commercial	**$ 958**	$127	$300	$119	$227
Consumer	**42**	116	162	244	23
Real estate: Construction	**0**	0	0	0	0
Mortgage	**599**	633	371	321	25
Total nonaccrual loans	**1,599**	876	833	684	275
Loans past due 90 days or more and still accruing	**55**	0	0	20	1
Restructured loans	**0**	0	0	0	0
Total non-performing loans	**1,654**	876	833	704	276
Foreclosed real estate	**118**	12	42	12	11
Total non-performing assets	**$1,772**	$888	$875	$716	$287
Non-performing loans to total loans	**0.45%**	0.26%	0.29%	0.32%	0.16%
Non-performing assets to total assets	**0.23%**	0.15%	0.18%	0.18%	0.09%
Interest income received on nonaccrual loans	**$ 79**	$ 33	$ 52	$ 38	$ 5
Interest income that would have been recorded under the original terms of the loans	**$193**	$ 89	$ 96	$ 66	$ 22

tions indicate that loan losses may differ from historical experience, based on factors and changes in portfolio mix and volume.

In addition, an unallocated portion of the allowance is established for losses inherent in the loan portfolio, which have not been identified by the more quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in the Company's historical loss experience. Those factors include changes in levels and trends of charge-offs, delinquencies and nonaccrual loans, trends in volume and term loans, changes in underwriting standards and practices, portfolio mix, tenure of the loan officers and management, changes in credit concentrations, and national and local economic trends and conditions.

While the allowance for loan losses is maintained at a level believed to be adequate by management for estimated losses in the loan portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. Changes in these estimates may impact the provisions charged to expense in future periods.

The Company recorded provisions of $1.4 million to the allowance for loan losses for 2002 compared to $1.5 million for 2001. During 2002, net charge-offs amounted to $833,000, or 0.23%, of average loans outstanding for the year, compared to $657,000, or 0.21%, of average loans outstanding for 2001. The allowance for loan losses increased as a percentage of loans receivable from 1.33% of total loans outstanding at December 31, 2001, to 1.40% of total loans outstanding and provided coverage of 311% of non-performing loans.

The table below presents, for the years 1998 through 2002, information regarding the Company's provision and allowance for loan losses.

Table 7

	Year Ended December 31,				
(dollars in thousands)	**2002**	2001	2000	1999	1998
Balance at beginning of year	**$4,544**	$3,732	$2,841	$2,232	$1,699
Provisions charged to operating expenses	**1,435**	1,469	1,050	762	542
	5,979	5,201	3,891	2,994	2,241
Recoveries of loans previously charged-off:					
Commercial	**93**	3	6	8	4
Consumer	**2**	21	8	4	3
Real estate	**21**	0	0	1	0
Total recoveries	**116**	24	14	13	7
Loans charged-off:					
Commercial	**(561)**	(475)	(1)	(150)	(2)
Consumer	**(70)**	(85)	(95)	(10)	(14)
Real estate	**(318)**	(121)	(77)	(6)	(0)
Total charged-off	**(949)**	(681)	(173)	(166)	(16)
Net charge-offs	**(833)**	(657)	(159)	(153)	(9)
Balance at end of year	**$5,146**	$4,544	$3,732	$2,841	$2,232
Net charge-offs to average loans outstanding	**0.23%**	0.21%	0.06%	0.08%	0.01%
Allowance for loan losses to year-end loans	**1.40%**	1.33%	1.29%	1.31%	1.34%

Allocation of the Allowance for Loan Losses

The following table details the allocation of the allowance for loan losses to the various categories. The allocation is made for analytical purposes and it is not necessarily indicative of the categories in which future credit losses may occur. The total allowance is available to absorb losses from any segment of loans.

Table 8

	Allowance for Loan Losses at December 31,									
	2002		2001		2000		1999		1998	
(dollars in thousands)	**Amount**	**% Gross Loans**	Amount	% Gross Loans	Amount	% Gross Loans	Amount	% Gross Loans	Amount	% Gross Loans
Commercial loans and lines of credit	**$2,428**	**23.45%**	$ 986	23.20%	$ 178	19.20%	$ 155	17.73%	$ 400	19.28%
Consumer	**452**	**9.38**	157	10.67	143	10.57	224	10.53	150	12.49
Real estate, construction and land development:										
Commercial	**1,698**	**47.84**	3,240	50.38	3,286	54.61	2,335	55.69	1,582	49.27
Residential	**568**	**19.33**	161	15.75	125	15.62	127	16.05	100	18.96
Total	**$5,146**	**100.00%**	$4,544	100.00%	$3,732	100.00%	$2,841	100.00%	$2,232	100.00%

Deposits

Total deposits at December 31, 2002, were $727.0 million, up $165.3 million, or 29%, over total deposits of $561.7 million at December 31, 2001. The Company remains a deposit-driven financial institution with emphasis on core deposit accumulation and retention as a basis for sound growth and profitability. The Company regards core deposits as all deposits other than public certificates of deposits. Deposits in the various core categories, increased $162.1 million, or 31%, in 2002 over 2001. Total deposits averaged $641.5 million for 2002, an increase of $140.4 million, or 28%, over the 2001 average of $501.1 million. The average balance on noninterest-bearing demand deposits increased in 2002 by $23.4 million, or 26%, compared to the prior year. The average balance of interest bearing demand accounts (money market and interest checking accounts) for 2002 increased by $48.1 million, or 44%, over the average balance for the prior year. The average total balance of all savings accounts was $197.2 million, a $55.9 million, or 40%, increase over the average balance for 2001. The average balance of all time deposits in 2002 was $173.1 million, an increase of $13.0 million, or 8%, over the average balance for 2001. For 2002, the cost of total deposits was 2.02% as compared to 3.08% in 2001.

The Company believes that its record of sustaining core deposit growth is reflective of the Company's retail approach to banking which emphasizes a combination of free checking accounts, convenient branch locations, extended hours of operation, quality service, and active marketing.

The average balances and weighted average rates paid on deposits for 2002, 2001 and 2000 are presented below.

Table 9

	Year Ended December 31,					
(dollars in thousands)	**2002 Average Balance/Rate**		2001 Average Balance/Rate		2000 Average Balance/Rate	
Demand deposits:						
Noninterest-bearing	**$114,758**		$ 91,352		$ 72,413	
Interest-bearing (money market and checking)	**156,441**	**1.30%**	108,349	2.24%	80,460	3.26%
Savings	**197,225**	**1.96**	141,350	2.95	108,131	3.90
Time	**173,064**	**4.06**	160,031	5.52	130,816	5.44
Total deposits	**$641,488**		$501,082		$391,820	

The remaining maturity for certificates of deposit of $100,000 or more as of December 31, 2002, 2001 and 2000 is presented in Table 10.

Table 10

(in thousands)	2002	2001	2000
3 months or less	**$31,591**	$32,092	$41,554
3 to 6 months	**20,462**	17,493	4,771
6 to 12 months	**16,390**	9,028	7,541
Over 12 months	**11,427**	16,292	13,515
Total	**$79,870**	$74,905	$67,381

Interest Rate Sensitivity

The management of interest rate sensitivity seeks to avoid fluctuating net interest margins and to provide consistent net interest income through periods of changing interest rates.

The Company's risk of loss arising from adverse changes in the fair value of financial instruments, or market risk, is composed primarily of interest rate risk. The primary objective of the Company's asset/liability management activities is to maximize net interest income while maintaining acceptable levels of interest rate risk. The Company's Asset/Liability Committee (ALCO) is responsible for establishing policies to limit exposure to interest rate risk, and to ensure procedures are established to monitor compliance with those policies. The Company's Board of Directors reviews the guidelines established by ALCO.

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. Historically, the most common method of estimating interest rate risk was to measure the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at specific points in time ("GAP"), typically one year. Under this method, a company is considered liability sensitive when the amount of its interest-bearing liabilities exceeds the amount of its interest-earning assets within the one-year horizon. However, assets and liabilities with similar repricing characteristics may not reprice at the same time or to the same degree. As a result, the Company's GAP does not necessarily predict the impact of changes in general levels of interest rates on net interest income. Table 11 shows the GAP position for the Company as of December 31, 2002.

Table 11

	December 31, 2002					
(in thousands)	1 – 90 Days	91 – 180 Days	181 – 365 Days	1 – 5 Years	Beyond 5 Years	Total
Interest earning assets:						
Loans receivable	$119,955	$ 5,551	$11,978	$ 75,071	$164,383	$376,938
Securities	49,520	39,704	54,693	96,064	57,705	297,686
Federal funds sold	44,500	0	0	0	0	44,500
Total interest earning assets	213,975	45,255	66,671	171,135	222,088	719,124
Interest-bearing liabilities:						
Transaction accounts	129,679	0	0	0	301,650	431,329
Time deposits	49,620	33,101	45,337	40,369	0	168,427
Trust capital securities	0	0	0	0	13,000	13,000
Total interest-bearing liabilities	179,299	33,101	45,337	40,369	314,650	612,756
Period GAP	34,676	12,154	21,334	130,766	(92,562)	$106,368
Cumulative GAP	$ 34,676	$46,830	$68,164	$198,930	$106,368	

Notes: Nonaccrual loans, deferred fees on loans and overdrafts have been excluded in the loans receivable balances. Securities are reported at par for purposes of this table.

Management believes the simulation of net interest income in different interest rate environments provides a more meaningful measure of interest rate risk. Income simulation analysis captures not only the potential of all assets and liabilities to mature or reprice, but also the probability that they will do so. Income simulation also attends to the relative interest rate sensitivities of these items, and projects their behavior over an extended period of time. Finally, income simulation permits management to assess the probable effects on the balance sheet not only of changes in interest rates, but also of proposed strategies for responding to them.

The Company's income simulation model analyzes interest rate sensitivity by projecting net income over the next 24 months in a flat rate scenario versus net income in alternative interest rate scenarios. Management continually reviews and refines its interest rate risk management process in response to the changing economic climate. Currently, the Company's model projects a 200 basis point increase and a 100 basis point decrease during the next year, with rates remaining constant in the second year.

Historically, the Company's Asset/Liability Committee (ALCO) policy has established that income sensitivity will be considered acceptable if overall net income volatility in a plus 200 or minus 200 basis point scenario is within 15% of net income in a flat rate scenario in the first year and 30% using a two year planning window. At December 31, 2002, the Company projected its interest rate risk using a plus 200 and minus 100 basis point scenario. During 2002 and 2001 combined, the Federal Reserve lowered short-term interest rates by 525 basis points, pushing the Federal Funds rate down to 1.25% at year-end 2002, the lowest level in over 50 years. The Company's ALCO believed it was a better measure of current risk assuming a minus 100 point scenario, as a minus 200 basis point reduction would be unlikely given that current short-term market interest rates are already below 2.00%. At December 31, 2002, the Company's income simulation model indicates net income would decrease 0.5%, or $39,000, and 5.2%, or $1.0 million, in the first year and over a two-year time frame, respectively, if rates decreased 100 basis points as compared to an increase of 4.1% and 5.5%, respectively, at December 31, 2001. The model projects that net income would increase by 5.4%, or $414,000, and 16.8%, or $3.3 million, in the first year and over a two-year time frame, respectively, if rates increased as described above, as compared to an increase of 0.5% and 5.3%, respectively, at December 31, 2001. All of these forecasts are within an acceptable level of interest rate risk per the policies established by ALCO. The market value of equity model reflects certain estimates and assumptions regarding the impact on the market value of the Company's assets and liabilities given an immediate 200 basis point change in interest rates. One of the key assumptions is the market value assigned to the Company's core deposits, or the core deposit premium. The Company has completed and updated comprehensive core deposit studies in order to assign its own core deposit premiums as permitted by regulation. The studies have consistently confirmed management's assertion that the Company's core deposits have stable balances over long periods of time, and are generally insensitive to changes in interest rates. Thus, these core deposit balances provide an internal hedge to market fluctuations in the Company's fixed rate assets. Management believes the core deposit premiums produced by its market value of equity model at December 31, 2002 provide an accurate assessment of the Company's interest rate risk.

Management also monitors interest rate risk by utilizing a market value of equity model. The model assesses the impact of a change in interest rates on the market value of all the Company's assets and liabilities, as well as any off balance sheet items. The model calculates the market value of the Company's assets and liabilities in excess of book value in the current rate scenario, and then compares the excess of market value over book value given an immediate 200 basis point increase in rates and a 100 basis point decrease in rates. The Company's ALCO policy indicates that the level of interest rate risk is unacceptable if the immediate change would result in the loss of 60% or more of the excess of market value over book value in the current rate scenario. At December 31, 2002, the market value of equity indicates an acceptable level of interest rate risk.

Liquidity

Liquidity management involves the Company's ability to generate cash or otherwise obtain funds at reasonable rates to support asset growth and reduce assets to meet deposit withdrawals, to maintain reserve requirements, and to otherwise operate the Company on an ongoing basis. Liquidity sources from asset categories are provided primarily by cash, federal funds sold, and the cash flow from the amortizing securities and loan portfolios. The primary source of liquidity from liability categories is the generation of additional core deposit balances. As previously mentioned, total core deposits increased by $162.1 million, or 31%, in 2002.

Additionally, the Company has established secondary sources of liquidity consisting of federal funds lines of credit, repurchase agreements, and borrowing capacity at the Federal Home Loan Bank, which can be drawn upon if needed. As of December 31, 2002, the total potential liquidity for the Company through these secondary sources was $231 million. In view of the primary and secondary sources as previously mentioned, management believes the Company is capable of meeting its anticipated liquidity needs.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

The following table represents the Company's on-and–off balance sheet aggregate contractual obligations to make future payments as of December 31, 2002:

Table 12

	December 31, 2002				
(in thousands)	1 Year or Less	Over 1 to 3 Years	Over 3 to 5 Years	Over 5 Years	Total
Time Deposits	$128,058	$24,038	$16,331	$ 0	$168,427
Trust Capital Securities	0	0	0	13,000	13,000
Operating Leases	1,195	2,039	1,619	6,164	11,017
Total	$129,253	$26,077	$17,950	$19,164	$192,444

In addition, the Company, in the conduct of ordinary business operations routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contract. Management is not aware of any additional commitments or contingent liabilities, which may have a material adverse impact on the liquidity or capital resources of the Company.

The Company is also party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit.

Short-Term Borrowings

Short-term borrowings, or other borrowed money, which consists of securities sold under agreement to repurchase and federal funds purchased, were used occasionally in 2002 and 2001 to meet short-term liquidity needs. For 2002, other borrowed money averaged $12,000 as compared to $330,000 in 2001. The average rate paid on the Company's short-term borrowings was 1.46% during 2002 and 3.94% in 2001. Short-term borrowings totaled $0 at December 31, 2002 and 2001.

Long-Term Debt

Long-term debt consists of Trust Capital Securities through Commerce Harrisburg Capital Trust I and Commerce Harrisburg Capital Trust II, Delaware business trust subsidiaries of the Company. At December 31, 2002, all of the Capital Trust Securities qualified as Tier I capital for regulatory capital purposes. Proceeds of the trust capital securities are for general corporate purposes, including additional capitalization of the Company's wholly-owned banking subsidiary. Reference should be made to Note 10 in the Notes to the consolidated Financial Statements for further analysis of the Company's long-term debt. Long-term debt totaled $13.0 million at December 31, 2002 and 2001.

Stockholders' Equity and Capital Adequacy

At December 31, 2002, stockholders' equity totaled $42.8 million, up $10.2 million, or 31%, over stockholders' equity at December 31, 2001. This increase was due to the Company's net income for the year, shares issued under stock purchase and stock option plans, and unrealized appreciation on securities available for sale. Stockholders' equity as a percent of total assets was 5.44% at December 31, 2002, compared to 5.34% at December 31, 2001.

Risk-based capital provides the basis for which all banks are evaluated in terms of capital adequacy. The risk-based capital standards require all banks to have Tier 1 capital of at least 4% and total capital, including Tier 1 capital, of at least 8% of risk-adjusted assets. Tier 1 capital includes common stockholders' equity and qualifying perpetual preferred stock together with related surpluses and retained earnings. Total capital may be comprised of total Tier 1 capital plus limited life preferred stock, qualifying debt instruments, and the allowance for loan losses.

Table 13 provides a comparison of the Bank's risk-based capital ratios and leverage ratios to the minimum regulatory requirements for the periods indicated.

At December 31, 2002, the consolidated capital levels of the Company and of the subsidiary bank (Commerce) met the definition of a "well capitalized" institution, i.e., a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 6%, and a total risk-based capital ratio exceeding 10%.

Table 13

	Actual December 31, 2002	2001	For Capital Adequacy Purposes	To Be Well-Capitalized Under Prompt Corrective Action Provisions
Tier 1 Capital	**11.11%**	10.67%	4.00%	6.00%
Total Capital	**12.17**	11.73	8.00	10.00
Leverage ratio (to average assets)	**6.97**	7.65	4.00	5.00

The Company's common stock is listed for trading on the NASDAQ Small Cap Market under the symbol COBH. The Company offers a Dividend Reinvestment and Stock Purchase Plan by which dividends on the Company's Common Stock and optional cash payments of up to $5,000 per quarter (subject to change) may be invested in Common Stock at a 3% discount (subject to change) to the market price and without payment of brokerage commissions.

Forward-Looking Statements

The Company may from time to time make written or oral "forward-looking statements," including statements contained in the Company's filings with the Securities and Exchange Commission (including this Annual Report and Form 10-K and the exhibits hereto and thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to the Company's beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond the Company's control). The words "may", "could", "should", "would", "believe", "anticipate", "estimate", "expect", "intend", "plan" and similar expressions are intended to identify forward-looking statements. The following factors, among others, could cause the Company's financial performance to differ materially from that expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies, including interest rate policies of the Board of Governors of the Federal Reserve System (the "FRB"); inflation; interest rate, market and monetary fluctuations; the timely development of competitive new products and services by the Company and the acceptance of such products and services by customers; the willingness of customers to substitute competitors' products and services for the Company's products and services and vice versa; the impact of changes in financial services' laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; future acquisitions; the expense savings and revenue enhancements from acquisitions being less than expected; the growth and profitability of the Company's noninterest or fee income being less than expected; unanticipated regulatory or judicial proceedings; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on behalf of the Company.

Impact of Inflation and Changing Prices

Interest rates have a more significant impact on the Company's performance than do the effects of general levels of inflation, since most of the Company's assets and liabilities are monetary in nature. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services as measured by the Consumer Price Index. The liquidity and maturity structure of the Company's assets and liabilities are critical to the maintenance of acceptable performance levels.

Consolidated Balance Sheets

(in thousands, except share amounts)	December 31, 2002	2001
Assets		
Cash and due from banks	**$ 30,950**	$ 21,555
Federal funds sold	**44,500**	4,300
Cash and cash equivalents	**75,450**	25,855
Securities, available for sale at fair value	**205,436**	104,722
Securities, held to maturity at cost (fair value 2002: $101,036; 2001: $102,427)	**97,625**	103,349
Loans, held for sale	**10,514**	7,661
Loans receivable, net of allowance for loan losses (allowance 2002: $5,146; 2001: $4,544)	**363,735**	338,130
Restricted investments in bank stock	**2,045**	2,593
Premises and equipment, net	**26,409**	21,587
Accrued interest receivable	**3,675**	3,542
Other assets	**1,709**	2,451
Total assets	**$786,598**	$609,890

	2002	2001
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	**$127,199**	$105,171
Interest-bearing	**599,756**	456,567
Total deposits	**726,955**	561,738
Accrued interest payable	**832**	837
Other liabilities	**2,999**	1,722
Trust capital securities	**13,000**	13,000
Total liabilities	**743,786**	577,297
Stockholders' Equity:		
Preferred stock – Series A noncumulative; $10.00 par value; 1,000,000 shares authorized; 40,000 shares issued and outstanding	**400**	400
Common stock – $1.00 par value; 10,000,000 shares authorized; (issued and outstanding 2002: 2,117,089; 2001: 1,881,960)	**2,117**	1,882
Surplus	**31,909**	25,263
Retained earnings	**6,866**	5,159
Accumulated other comprehensive income (loss)	**1,520**	(111)
Total stockholders' equity	**42,812**	32,593
Total liabilities and stockholders' equity	**$786,598**	$609,890

See accompanying notes

Consolidated Statements of Income

(in thousands, except per share amounts)	Year Ended December 31, **2002**	2001	2000
Interest Income			
Loans receivable, including fees:			
Taxable	**$26,755**	$26,532	$22,836
Tax-exempt	**111**	120	109
Securities:			
Taxable	**14,514**	10,860	8,025
Tax-exempt	**107**	94	44
Federal funds sold	**508**	641	760
Total interest income	**41,995**	38,247	31,774
Interest Expense			
Deposits	**12,940**	15,420	13,956
Other	**0**	13	42
Trust capital securities	**1,354**	760	299
Total interest expense	**14,294**	16,193	14,297
Net interest income	**27,701**	22,054	17,477
Provision for loan losses	**1,435**	1,469	1,050
Net interest income after provision for loan losses	**26,266**	20,585	16,427
Noninterest Income			
Service charges and other fees	**6,766**	5,660	4,564
Other	**448**	541	428
Gain on sales of securities available for sale	**0**	52	0
Gain on sales of loans	**493**	354	370
Total noninterest income	**7,707**	6,607	5,362
Noninterest Expenses			
Salaries and employee benefits	**12,491**	9,486	7,485
Occupancy	**2,403**	2,133	1,782
Furniture and equipment	**1,523**	1,402	1,092
Advertising and marketing	**2,181**	1,722	1,451
Data processing	**1,890**	1,313	964
Postage and supplies	**862**	846	659
Audits, regulatory fees and assessments	**484**	401	348
Other	**3,594**	3,209	2,408
Total noninterest expenses	**25,428**	20,512	16,189
Income before income taxes	**8,545**	6,680	5,600
Provision for income taxes	**2,871**	2,232	1,886
Net income	**$ 5,674**	$ 4,448	$ 3,714
Net Income per Common Share			
Basic	**$2.71**	$2.24	$1.90
Diluted	**2.48**	2.04	1.78

See accompanying notes

Consolidated Statements of Stockholders' Equity

(dollars in thousands)	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
December 31, 1999	**$400**	**$1,644**	**$18,196**	**$3,137**	**$(2,999)**	**$20,378**
Comprehensive income:						
Net income	–	–	–	3,714	–	3,714
Change in unrealized gains (losses) on securities, net of reclassification adjustment	–	–	–	–	2,323	2,323
Total comprehensive income						6,037
Dividends declared on preferred stock	–	–	–	(80)	–	(80)
Common stock of 12,693 shares issued under stock option plans	–	13	71	–	–	84
Income tax benefit of stock options exercised	–	–	30	–	–	30
Common stock of 240 shares issued under employee stock purchase plan	–	–	6	–	–	6
Proceeds from issuance of 8,890 shares of common stock in connection with dividend reinvestment and stock purchase plan	–	9	210	–	–	219
5% common stock dividend and cash paid in lieu of fractional shares (82,909 shares issued)	–	83	2,348	(2,437)	–	(6)
December 31, 2000	**$400**	**$1,749**	**$20,861**	**$4,334**	**$ (676)**	**$26,668**
Comprehensive income:						
Net income	–	–	–	4,448	–	4,448
Change in unrealized gains (losses) on securities, net of reclassification adjustment	–	–	–	–	565	565
Total comprehensive income						5,013
Dividends declared on preferred stock	–	–	–	(80)	–	(80)
Common stock of 23,231 shares issued under stock option plans	–	24	193	–	–	217
Income tax benefit of stock options exercised	–	–	78	–	–	78
Common stock of 290 shares issued under employee stock purchase plan	–	–	9	–	–	9
Proceeds from issuance of 20,016 shares of common stock in connection with dividend reinvestment and stock purchase plan	–	20	678	–	–	698
5% common stock dividend and cash paid in lieu of fractional shares (89,378 shares issued)	–	89	3,444	(3,543)	–	(10)
December 31, 2001	**$400**	**$1,882**	**$25,263**	**$5,159**	**$ (111)**	**$32,593**
Comprehensive income:						
Net income	–	–	–	5,674	–	5,674
Change in unrealized gains (losses) on securities, net of reclassification adjustment	–	–	–	–	1,631	1,631
Total comprehensive income						7,305
Dividends declared on preferred stock	–	–	–	(80)	–	(80)
Common stock of 112,379 shares issued under stock option plans	–	113	1,625	–	–	1,738
Income tax benefit of stock options exercised	–	–	378	–	–	378
Common stock of 440 shares issued under employee stock purchase plan	–	–	19	–	–	19
Proceeds from issuance of 21,733 shares of common stock in connection with dividend reinvestment and stock purchase plan	–	22	846	–	–	868
5% common stock dividend and cash paid in lieu of fractional shares (100,577 shares issued)	–	100	3,778	(3,887)	–	(9)
December 31, 2002	**$400**	**$2,117**	**$31,909**	**$6,866**	**$ 1,520**	**$42,812**

See accompanying notes

Consolidated Statements of Cash Flows

(in thousands)	Year Ended December 31, 2002	2001	2000
Operating Activities			
Net income	**$ 5,674**	$ 4,448	$ 3,714
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	**1,435**	1,469	1,050
Provision for depreciation and amortization	**1,484**	1,403	1,202
Deferred income taxes	**68**	(251)	(281)
Amortization of securities premiums and accretion of discounts, net	**926**	219	193
Gains on sale of securities available for sale	**0**	(52)	0
Proceeds from sales of loans	**67,794**	48,887	19,813
Loans originated for sale	**(70,154)**	(50,944)	(19,705)
Gains on sales of loans	**(493)**	(354)	(370)
Stock granted under stock purchase plan	**19**	9	6
(Increase) decrease in accrued interest receivable and other assets	**74**	(742)	(1,345)
Increase in accrued interest payable and other liabilities	**1,272**	724	143
Net cash provided by operating activities	**8,099**	4,816	4,420
Investing Activities			
Securities held to maturity:			
Proceeds from principal repayments and maturities	**34,681**	18,589	2,608
Purchases	**(29,121)**	(88,112)	(7,398)
Securities available for sale:			
Proceeds from principal repayments and maturities	**77,946**	43,922	7,501
Proceeds from sales	**0**	7,497	0
Purchases	**(176,945)**	(64,833)	(12,268)
(Purchase) redemption of restricted investments in bank stock	**548**	(305)	(158)
Proceeds from sales of loans receivable	**0**	3,255	6,449
Net increase in loans receivable	**(27,040)**	(56,254)	(80,521)
Proceeds from sale of premises and equipment	**0**	0	743
Purchases of premises and equipment	**(6,306)**	(6,353)	(4,174)
Net cash used by investing activities	**(126,237)**	(142,594)	(87,218)
Financing Activities			
Net increase in demand, interest checking, money market, and savings deposits	**159,992**	102,383	68,145
Net increase in time deposits	**5,225**	12,772	29,892
Net decrease in other borrowed money	**0**	0	(8,300)
Proceeds from issuance of trust capital securities	**0**	8,000	5,000
Proceeds from common stock options exercised	**1,738**	217	84
Proceeds from common stock purchase and dividend reinvestment plan	**868**	698	219
Cash dividends on preferred stock and cash in lieu of fractional shares	**(90)**	(86)	(83)
Net cash provided by financing activities	**167,733**	123,984	94,957
Increase (decrease) in cash and cash equivalents	**49,595**	(13,794)	12,159
Cash and cash equivalents at beginning of year	**25,855**	39,649	27,490
Cash and cash equivalents at year-end	**$ 75,450**	$ 25,855	$ 39,649

See accompanying notes.

1. Significant Accounting Policies

Nature of Operations and Basis of Presentation

The consolidated financial statements include the accounts of Pennsylvania Commerce Bancorp, Inc. (the Company) and its wholly-owned subsidiaries Commerce Bank/Harrisburg, N.A. (Commerce or Bank), Commerce Harrisburg Capital Trust I and Commerce Harrisburg Capital Trust II. All material intercompany transactions have been eliminated. The Holding Company was formed July 1, 1999 and is subject to regulation of the Federal Reserve Bank.

The Company is a one-bank holding company headquartered in Camp Hill, Pennsylvania and provides full banking services through its subsidiary Commerce Bank. Commerce operates under a national bank charter and provides full banking services. As a national bank, Commerce is subject to regulation of the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. The area served by the Bank is principally South Central Pennsylvania.

Estimates

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. These principles require management to make estimates and assumptions that affect reported amounts of assets and liabilities and require disclosure of contingent assets and liabilities. In the opinion of management, all adjustments considered necessary for fair presentation have been included and are of a normal, recurring nature. Actual results could differ from those estimates.

Securities

Securities classified as held to maturity are those debt securities that the Company has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs, or general economic conditions. These securities are carried at cost adjusted for amortization of premium and accretion of discount, computed by the interest method over the estimated average life of the securities.

Securities classified as available for sale are those debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported in other comprehensive income, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the estimated average life of the securities.

Management determines the appropriate classification of debt securities at the time of purchase and re-evaluates such designation as of each balance sheet date.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees and costs are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the loan.

The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Allowance for Loan Losses

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures.

Loans Held for Sale

Loans held for sale are comprised of residential loans and student loans that the Company originates with the intention of selling in the future. These loans are carried at the lower of cost or estimated fair value.

Restricted Investments in Bank Stock

Restricted investments in bank stock include stock in the Federal Home Loan Bank (FHLB) and Federal Reserve Bank. Federal law requires a member institution of the FHLB system to hold stock of its district FHLB according to a predetermined formula. The stock is carried at cost.

Advertising Costs

The Company follows the policy of charging the costs of advertising to expense as incurred.

Income Taxes

Deferred income taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted through the provision for income taxes for the effects of changes in tax laws and rates on the date of enactment.

Bank Premises and Equipment

Bank premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is charged to operations over the estimated useful lives of the respective assets. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Depreciation and amortization are determined on the straight-line method.

Per Share Data

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options, and are determined using the treasury stock method. Per share amounts have been adjusted to give retroactive effect to stock dividends declared through January 31, 2003.

Off Balance Sheet Financial Instruments

In the ordinary course of business, the Company has entered into off balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded on the balance sheet when they become payable by the borrower to the Company.

Cash Flow Information

For purposes of the statements of cash flows, the Company considers cash and due from banks and federal funds sold as cash and cash equivalents. Generally, federal funds are purchased and sold for one-day periods. Cash paid during the years ended December 31, 2002, 2001, and 2000 for interest was $14.3 million, $16.2 million, and $14.0 million, respectively. Income taxes paid totaled $2.6 million, $2.4 million, and $2.2 million in 2002, 2001, and 2000, respectively.

Recently Issued FASB Statements

In July of 2001, the Financial Accounting Standards Board issued Statement No. 143, "*Accounting for Asset Retirement Obligations*", which addresses the financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. This Statement became effective for the Company on January 1, 2003.

In July 2002, the Financial Accounting Standards Board issued Statement No. 146, *"Accounting for Costs Associated with Exit or Disposal Activities"*, which nullifies EITF Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This statement delays recognition of these costs until liabilities are incurred, rather than the date of commitment to the plan, and requires fair value measurement. It does not impact the recognition of liabilities incurred in connection with a business combination or the disposal of long-lived assets. The provisions of this statement are effective for exit or disposal activities after December 31, 2002.

In October 2002, the Financial Accounting Standards Board issued Statement No. 147, *"Acquisitions of Certain Financial Institutions."* This statement provides guidance on accounting for the acquisition of a financial institution, including the acquisition of part of a financial institution. The statement defines criteria for determining whether the acquired financial institution meets the conditions for a "business combination". If the acquisition meets the conditions of a "business combination", the specialized accounting guidance under Statement No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions" will not apply after September 30, 2002 and the amount of any unidentifiable intangible asset will be classified to goodwill upon adoption of Statement No.147. The transition provisions were effective on October 1, 2002.

Adoption of these statements did not have or is not expected to have a material impact on the Company's financial condition or results of operations.

Segment Reporting

Commerce acts as an independent community financial services provider, and offers traditional banking and related financial services to individual, business and government customers. Through its branches, the Company offers a full array of commercial and retail financial services.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial and retail operations of the Company. As such, discrete financial information is not available and segment reporting would not be meaningful.

2. Restrictions on Cash and Due From Bank Accounts

The Bank is required to maintain average reserve balances with the Federal Reserve Bank. The average amount of those reserve balances maintained for 2002 and 2001 was approximately $4.3 million and $2.3 million, respectively.

3. Securities

The amortized cost and fair value of securities are summarized in the following tables.

	December 31, 2002			
(in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available for Sale				
U.S. Government Agency securities	**$ 12,307**	**$ 204**	**$ 0**	**$ 12,511**
Mortgage-backed securities	**184,793**	**2,203**	**(526)**	**186,470**
Corporate debt securities	**6,033**	**422**	**0**	**6,455**
Total	**$203,133**	**$2,829**	**$(526)**	**$205,436**
Held to Maturity				
U.S. Government Agency securities	**$ 10,005**	**$ 525**	**$ 0**	**$ 10,530**
Municipal securities	**1,996**	**79**	**0**	**2,075**
Mortgage-backed securities	**63,909**	**2,284**	**(8)**	**66,185**
Corporate debt securities	**21,715**	**795**	**(264)**	**22,246**
Total	**$ 97,625**	**$3,683**	**$(272)**	**$101,036**

	December 31, 2001			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
U.S. Treasury securities	$ 1,001	$ 8	$ 0	$ 1,009
U.S. Government Agency securities	17,487	134	(4)	17,617
Mortgage-backed securities	77,269	203	(468)	77,004
Corporate debt securities	9,133	39	(80)	9,092
Total	$104,890	$384	$ (552)	$104,722
Held to Maturity				
U.S. Government Agency securities	$ 5,987	$ 73	$ (33)	$ 6,027
Municipal securities	1,994	43	(15)	2,022
Mortgage-backed securities	73,611	172	(789)	72,994
Corporate debt securities	21,757	95	(468)	21,384
Total	$103,349	$383	$(1,305)	$102,427

The amortized cost and fair value of debt securities at December 31, 2002 by contractual maturity are shown in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations.

	Held to Maturity		Available for Sale	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	**$ 0**	**$ 0**	**$ 0**	**$ 0**
Due after one year through five years	**3,007**	**3,139**	**0**	**0**
Due after five years through ten years	**11,100**	**11,316**	**1,997**	**2,060**
Due after ten years	**19,609**	**20,396**	**16,343**	**16,906**
	33,716	**34,851**	**18,340**	**18,966**
Mortgage-backed securities	**63,909**	**66,185**	**184,793**	**186,470**
Total	**$97,625**	**$101,036**	**$203,133**	**$205,436**

There were no sales of securities available for sale in 2002. Gross gains of $53,000 and gross losses of $1,000 were realized on sales of securities available for sale in 2001. There were no sales of securities available for sale in 2000.

At December 31, 2002 and 2001, securities with a fair value of $200.1 million and $117.7 million respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

4. Loans Receivable and Allowance for Loan Losses

A summary of loans receivable is as follows:

	December 31,	
(in thousands)	**2002**	2001
Real Estate:		
Commercial Mortgage	**$144,959**	$142,969
Construction and land development	**31,034**	32,863
Residential Mortgage	**66,190**	48,415
Tax-Exempt	**5,629**	2,676
Commercial Business	**49,226**	42,399
Consumer	**34,598**	36,551
Lines of Credit	**37,245**	36,801
	368,881	342,674
Less: Allowance for Loan Losses	**5,146**	4,544
Net Loans Receivable	**$363,735**	$338,130

The following is a summary of the transactions in the allowance for loan losses.

	Year Ended December 31,		
(in thousands)	**2002**	2001	2000
Balance at beginning of year	**$4,544**	$3,732	$2,841
Provision charged to expense	**1,435**	1,469	1,050
Recoveries	**116**	24	14
Loans charged off	**(949)**	(681)	(173)
Balance at end of year	**$5,146**	$4,544	$3,732

At December 31, 2002 and 2001, the recorded investment in loans considered to be impaired under FASB Statement No.114 "Accounting by Creditors for Impairment of a Loan" totaled $1.5 million and $531,000, respectively, all of which are included in nonperforming loans. As of December 31, 2002, impaired loans have a related allowance for loan losses of $90,000. As of December 31, 2001, no impaired loans required an allowance for loan losses. Impaired loans averaged approximately $1.5 million, $531,000, and $267,000 during 2002, 2001, and 2000, respectively. Actual interest income recorded on these loans amounted to $79,000, $33,000, and $52,000 during 2002, 2001 and 2000, respectively.

At December 31, 2002 and 2001, the recorded investment in nonaccrual loans was $1.6 million and $876,000, respectively. The recorded investment in past due loans greater than 90 days and still accruing was $55,000 and $0 at December 31, 2002 and 2001, respectively.

Certain directors and executive officers of the Company, including their associates and companies, have loans with the Bank. Such loans were made in the ordinary course of business at the Bank's normal credit terms including interest rate and collateralization, and do not represent more than a normal risk of collection. Total loans to these persons and companies amounted to approximately $8.5 million and $9.0 million at December 31, 2002 and 2001, respectively. During 2002, $5.4 million of new loans were made and repayments totaled $5.9 million.

5. Loan Commitments and Standby Letters of Credit

Loan commitments are made to accommodate the financial needs of Commerce's customers. Standby letters of credit commit the Bank to make payments on behalf of customers when certain specified future events occur. They primarily are issued to facilitate the customers' normal course of business transactions. Historically, almost all of the Bank's standby letters of credit expire unfunded.

Both types of lending arrangements have credit risk essentially the same as that involved in extending loans to customers and are subject to the Bank's normal credit policies. Letter of credit commitments are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

The Bank's maximum exposure to credit loss for loan commitments (unfunded loans and unused lines of credit, including home equity lines of credit) and standby letters of credit outstanding were as follows:

	December 31,	
(in thousands)	**2002**	2001
Commitments to grant loans	**$ 1,628**	$ 8,913
Unfunded commitments of existing loans	**68,105**	65,302
Standby letters of credit	**7,265**	7,640
Total	**$76,998**	$81,855

6. Concentrations of Credit Risk

The Company's loan portfolio is principally to borrowers throughout Cumberland, Dauphin, York, and Lebanon counties of Pennsylvania where it has full-service branch locations. Commercial real estate loans and loan commitments for commercial real estate projects aggregated $193 million at December 31, 2002.

Commercial real estate loans are collateralized by the related project (principally office buildings, multifamily residential, land development, and other properties) and the Company generally requires loan-to-value ratios of no greater than 80%. Collateral requirements on such loans are determined on a case-by-case basis based on management's credit evaluations of the respective borrowers.

7. Bank Premises, Equipment and Leases

A summary of premises and equipment is as follows:

	December 31,	
(in thousands)	**2002**	2001
Land	**$ 4,211**	$ 4,211
Buildings	**19,941**	15,732
Leasehold improvements	**1,919**	1,772
Furniture, fixtures, and equipment	**8,956**	7,529
	35,027	29,244
Less accumulated depreciation and amortization	**8,618**	7,657
	$26,409	$21,587

Land, buildings, and equipment are leased under noncancelable operating lease agreements that expire at various dates through 2022. Total rental expense for operating leases in 2002, 2001, and 2000 was $1,084,000, $908,000, and $739,000, respectively. At December 31, 2002, future minimum lease payments for noncancelable operating leases are payable as follows:

(in thousands)	
2003	$1,195
2004	1,139
2005	900
2006	804
2007	815
Thereafter	6,164
Total minimum lease payments	$11,017

8. Deposits

The composition of deposits is as follows:

	December 31,	
(in thousands)	**2002**	2001
Demand	**$127,199**	$105,171
Interest checking and money market	**214,293**	126,851
Savings	**217,036**	166,514
Time certificates $100,000 or more	**79,870**	74,905
Other time certificates	**88,557**	88,297
	$726,955	$561,738

At December 31, 2002, the scheduled maturities of time deposits are as follows:

(in thousands)	
2003	$128,058
2004	15,407
2005	8,631
2006	5,361
2007	10,970
	$168,427

9. Other Borrowed Money

The Bank has a line of credit commitment from the Federal Home Loan Bank (FHLB) for borrowings up to $170 million. No amounts were outstanding on this line as of December 31, 2002 and 2001. Certain qualifying assets of the Bank collateralize the line. In addition, the Bank has a line of credit of $5.5 million and availability under two repurchase agreements to borrow up to $55.0 million, all of which were available as of December 31, 2002.

10. Long-term Debt

On June 15, 2000, the Company issued $5,000,000 of 11% Trust Capital Securities to Commerce Bancorp, Inc. through Commerce Harrisburg Capital Trust I (the Trust), a Delaware business trust subsidiary. The Trust Capital Securities evidence a preferred ownership interest in the Trust, of which the Company owns 100% of the common equity. The proceeds from the issuance of the Trust Capital Securities were invested in substantially similar Junior Subordinated Debt of the Company. The Company unconditionally guarantees the Trust Capital Securities. Interest on the debt is payable quarterly in arrears on March 31, June 30, September 30, and December 31 of each year. The Trust Capital Securities are scheduled to mature on June 15, 2030. The Trust Capital Securities may be redeemed in whole or in part at the option of the Company on or after June 15, 2010 at 105.50% of the principal plus accrued interest, if any. The redemption price declines by 0.55% on June 15 of each year from 2011 through 2020 at which time the securities may be redeemed at 100% of the principal plus accrued interest, if any, to the date fixed for redemption, subject to certain conditions. All $5,000,000 of the Trust Capital Securities qualified as Tier 1 capital for regulatory capital purposes.

On September 28, 2001, the Company issued $8,000,000 of 10% Trust Capital Securities to Commerce Bancorp, Inc. through Commerce Harrisburg Capital Trust II (the Trust II), a Delaware business trust subsidiary. The issuance of the Trust Capital Securities has similar properties as the Trust I. The Trust Capital Securities evidence a preferred ownership interest in the Trust II of which the Company owns 100% of the common equity. The proceeds from the issuance of the Trust Capital Securities were invested in substantially similar Junior Subordinated Debt of the Company. The Company unconditionally guarantees the Trust Capital Securities. Interest on the debt is payable quarterly with similar terms as in the Trust I. The Trust Capital Securities are scheduled to mature on September 28, 2031. The Trust Capital Securities may be redeemed in whole or in part at the option of the Company on or after September 28, 2011 at 105.00% of the principal plus accrued interest, if any. The redemption price declines by 0.50% on September 28 of each year from 2012 through 2021 at which time the securities may be redeemed at 100% of the principal plus accrued interest, if any, to the date fixed for redemption, subject to certain conditions. All $8,000,000 of the Trust Capital Securities qualified as Tier 1 capital for regulatory capital purposes.

11. Income Taxes

A reconciliation of the provision for income taxes and the amount that would have been provided at statutory rates is as follows:

	Year Ended December 31,		
(in thousands)	**2002**	2001	2000
Provision at statutory rate on pre-tax income	**$2,905**	$2,271	$1,904
Tax-exempt income on loans and investments	**(74)**	(73)	(52)
Other	**40**	34	34
	$2,871	$2,232	$1,886

The components of income tax expense are as follows:

	Year Ended December 31,		
(in thousands)	**2002**	2001	2000
Current	**$2,803**	$2,483	$2,167
Deferred	**68**	(251)	(281)
	$2,871	$2,232	$1,886

The components of the net deferred tax assets were as follows:

	December 31,	
(in thousands)	**2002**	2001
Deferred tax assets:		
Allowance for loan losses	**$1,749**	$1,545
Unrealized losses on securities	**0**	57
Other	**41**	18
Total deferred tax assets	**1,790**	1,620
Deferred tax liabilities:		
Unrealized gains on securities	**(783)**	0
Premises and equipment	**(583)**	(296)
Prepaid expenses	**(83)**	(75)
Total deferred tax liabilities	**(1,449)**	(371)
Net deferred tax assets	**$ 341**	$1,249

Income taxes of $0, $18,000 and $0 were recognized on net securities gains in 2002, 2001, and 2000 respectively.

12. Stockholders' Equity

At December 31, 2002, Commerce Bancorp, Inc. owned 40,000 shares of the Company's Series A $10 par value noncumulative nonvoting preferred stock and warrants that entitle the holder to purchase 136,825 shares (adjusted for common stock dividends) of the Company's common stock, exercisable at $7.30 per share (adjusted for common stock dividends), in the event of a "change in control" (as defined in the Warrant Agreement). Such warrants are fully transferable and expire on October 7, 2008. None of these warrants were exercised during 2002 or 2001. The preferred stock is redeemable at the option of the Company at the price of $25 per share plus any unpaid dividends. Dividends on the preferred stock are payable quarterly at a rate of $2 per share per annum (see Note 15).

The Company has implemented a dividend reinvestment and stock purchase plan. Holders of common stock may participate in the plan in which reinvested dividends and voluntary cash payments of up to $5,000 per quarter (subject to change) may be reinvested in additional common shares at a 3% discount (subject to change) from the current market price. Employees who have been continuously employed for at least one year are also eligible to participate in the plan under the same terms as listed above for shareholders. A total of 22,173 and 20,306 common shares were issued pursuant to this plan in 2002 and 2001, respectively. At December 31, 2002, the Company had reserved approximately 447,000 common shares to be issued in connection with the plan.

On January 30, 2002, the Board of Directors declared a 5% common stock dividend payable on February 25, 2002, to stockholders of record on February 11, 2002.

On January 24, 2003, the Board of Directors declared a 5% common stock dividend payable on February 24, 2003, to stockholders of record on February 7, 2003.

All common stock and per share data included in these financial statements have been restated for these stock dividends.

13. Earnings per Share (continued)

All options outstanding were included in the computation of diluted EPS for the year ended December 31, 2002, because the options' exercise price was lower than the average market price of the common shares.

Options to purchase 87,375 shares of common stock at $32.66 were outstanding during 2001. They were not included in the computation of diluted EPS for the year ended December 31, 2001, because the options' exercise price was greater than the average market price of the common shares.

Options to purchase 43,788 shares of common stock at $22.38, options to purchase 49,060 shares at $22.53, options to purchase 76,259 shares at $25.49, options to purchase 10,262 shares at $21.27, and options to purchase 10,262 shares of common stock at $24.29 were outstanding during 2000. They were not included in the computation of diluted EPS for the year ended December 31, 2000, because the options' exercise price was greater than the average market price of the common shares.

13. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share.

	For the Year Ended December 31,								
(in thousands except per share amounts)	**2002**			2001			2000		
	Income	**Shares**	**Per Share Amount**	Income	Shares	Per Share Amount	Income	Shares	Per Share Amount
Basic earnings per share:									
Net income	**$5,674**			$4,448			$3,714		
Preferred stock dividends	**(80)**			(80)			(80)		
Income available to common stockholders	**5,594**	**2,063**	**$2.71**	4,368	1,946	$2.24	3,634	1,914	$1.90
Effect of dilutive securities:									
Stock options		**189**			194			130	
Diluted earnings per share:									
Income available to common stockholders plus assumed conversions	**$5,594**	**2,252**	**$2.48**	$4,368	2,140	$2.04	$3,634	2,044	$1.78

14. Stock Option Plans

The 1996 Employee Stock Option Plan covers 502,256 authorized shares of common stock reserved for issuance upon exercise of options granted or available for grant to officers and key employees and will expire on December 31, 2005. The Plan provides that the option price of qualified incentive stock options will be fixed by the Board of Directors, but will not be less than 100% of the fair market value of the stock at the date of grant. In addition, the Plan provides that the option price of nonqualified stock options (NQSO's) also will be fixed by the Board of Directors, however for NQSO's the option price may be less than 100% of the fair market value of the stock at the date of grant. Options granted are exercisable one year after the date of grant, subject to certain vesting provisions, and expire ten years after the date of grant.

In 2000, the Company's shareholders approved the adoption of the 2001 Directors' Stock Option Plan. The Plan commenced January 1, 2001 and replaced the 1990 Directors' Stock Option Plan, which expired December 31, 2000. The Plan covers 115,762 authorized shares of common stock reserved for issuance upon exercise of options granted or available for grant to directors and will expire on December 31, 2010. Under the Company's Directors' Stock Option Plan, each Director of the Company who is not regularly employed on a salaried basis by the Company shall be entitled to an option to acquire 1,710 shares of the Company's common stock during each year in which the Director serves on the Board. The Plan provides that the option price will be fixed by the Board of Directors, but will not be less than 100% of the fair market value of the stock on the date of the grant. Options granted are exercisable from the earlier of (1) one year after the date of the option grant, or (2) the date of a change in control of the Bank.

The Company has adopted the disclosure-only provisions of Standards of Financial Accounting Standards (SFAS) No. 123 "Accounting for Stock-Based Compensation." Accordingly, no compensation costs have been recognized for options granted in 2002, 2001, and 2000.

For purposes of pro-forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro-forma information is presented in the following table.

	Year Ended December 31,		
(in thousands)	**2002**	2001	2000
Net income:			
As reported	**$5,674**	$4,448	$3,714
Total stock-based compensation cost, net of tax, that would have been included in the determination of net income if the fair value based method had been applied to all awards	**(1,434)**	(952)	(608)
Pro-forma	**$4,240**	$3,496	$3,106
Reported earnings per share:			
Basic	**$2.71**	$2.24	$1.90
Diluted	**2.48**	2.04	1.78
Pro-forma earnings per share:			
Basic	**$2.02**	$1.75	$1.58
Diluted	**1.85**	1.59	1.48

The fair value of each option grant is estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for 2002, 2001, and 2000 respectively: risk-free interest rates of 4.7%, 4.8% and 5.7%; volatility factors of the expected market price of the Company's common stock of .33, .28, and .48; weighted-average expected life of the options of 10 years; and no cash dividends.

Had compensation costs for stock options granted in 2002, 2001 and 2000 been determined based on the fair value at the grant dates for awards under the plan consistent with the provisions of SFAS No. 123, the Company's net income and earnings per share for the years ended December 31, 2002, 2001 and 2000 would have been reduced to the proforma amounts indicated.

Stock options transactions under the Plans were as follows:

	Year Ended December 31,					
	2002		2001		2000	
	Options	**Weighted Avg. Exercise Price**	Options	Weighted Avg. Exercise Price	Options	Weighted Avg. Exercise Price
Outstanding at beginning of year	**550,225**	**$18.73**	482,925	$15.57	424,176	$13.62
Granted	**13,862**	**36.42**	99,621	31.82	88,258	24.09
Exercised	**(118,078)**	**14.73**	(25,265)	8.52	(14,811)	5.63
Forfeited	**(24,587)**	**30.59**	(7,056)	24.03	(14,698)	20.45
Outstanding at end of year	**421,422**	**$19.75**	550,225	$18.73	482,925	$15.57
Exercisable at December 31	**374,379**	**$18.33**				
Options available for grant at December 31	**270,112**					
Weighted-average fair value of options granted during the year		**$18.84**		$18.53		$14.38

Exercise prices for options outstanding as of December 31, 2002 are presented in the following table.

	As of December 31, 2002				
	Options Outstanding	Weighted Avg. Exercise Price	Weighted Avg. Contractual Life	Options Exercisable	Weighted Avg. Exercise Price
Options with exercise prices ranging from $4.39 to $15.00	155,490	$ 9.01	3.1 Years	155,490	$ 9.01
Options with exercise prices ranging from $15.01 to $25.00	124,930	21.48	6.1 Years	121,465	21.55
Options with exercise prices ranging from $25.01 to $37.86	141,002	30.05	8.7 Years	97,424	29.18
Total options outstanding with exercise prices ranging from $4.39 to $37.86	421,422	$19.75	5.8 Years	374,379	$18.33

15. Regulatory Matters

Regulatory authorities restrict the amount of cash dividends the Bank can declare without prior regulatory approval. Presently, the Bank cannot declare a cash dividend in excess of its accumulated retained earnings.

The Company and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2002, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2002, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table on the next page. There are no conditions or events since that notification that management believes have changed the Bank's category.

The following table presents the risk-based and leverage capital amounts and ratios at December 31, 2002 and 2001 for the Company and the Bank.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Company						
As of December 31, 2002						
Risked based capital ratios:						
Total capital	**$59,438**	**12.22%**	**≥ $38,907**	**≥ 8.0%**	**N/A**	**N/A**
Tier 1 capital	**54,292**	**11.16**	**≥ 19,454**	**≥ 4.0**	**N/A**	**N/A**
Leverage ratio	**54,292**	**7.00**	**≥ 31,012**	**≥ 4.0**	**N/A**	**N/A**
Bank						
As of December 31, 2002						
Risked based capital ratios:						
Total capital	**$59,160**	**12.17%**	**≥ $38,897**	**≥ 8.0%**	**≥ $48,622**	**≥ 10.0%**
Tier 1 capital	**54,014**	**11.11**	**≥ 19,449**	**≥ 4.0**	**≥ 29,173**	**≥ 6.0**
Leverage ratio	**54,014**	**6.97**	**≥ 30,988**	**≥ 4.0**	**≥ 38,735**	**≥ 5.0**
Company						
As of December 31, 2001						
Risked based capital ratios:						
Total capital	$50,248	11.78%	≥ $34,124	≥ 8.0%	N/A	N/A
Tier 1 capital	43,606	10.22	≥ 17,062	≥ 4.0	N/A	N/A
Leverage ratio	43,606	7.33	≥ 23,796	≥ 4.0	N/A	N/A
Bank						
As of December 31, 2001						
Risked based capital ratios:						
Total capital	$50,045	11.73%	≥ $34,130	≥ 8.0%	≥ $42,663	≥ 10.0%
Tier 1 capital	45,501	10.67	≥ 17,065	≥ 4.0	≥ 25,598	≥ 6.0
Leverage ratio	45,501	7.65	≥ 23,786	≥ 4.0	≥ 29,733	≥ 5.0

16. Employee Benefit Plan

The Company has established a 401(k) Retirement Savings Plan for all of its employees who meet eligibility requirements. Employees may contribute up to 15% of their salary to the Plan. The Company will provide a discretionary matching contribution for up to 6% of each employee's salary. For 2002, 2001, and 2000, the Company's matching contribution was established at 25% of the employees' salary deferral. The amount charged to expense was $98,000, $84,000, and $42,000 in 2002, 2001, and 2000, respectively.

17. Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income are components of comprehensive income.

The only other comprehensive income item that the Company presently has is unrealized gains (losses) on securities available for sale.

	Year Ended December 31,		
(in thousands)	**2002**	2001	2000
Unrealized holding gains (losses) arising during the year	**$2,471**	$ 908	$3,520
Less reclassification adjustment for gains included in net income	**0**	52	0
Net unrealized gains	**2,471**	856	3,520
Tax (expense)	**(840)**	(291)	(1,197)
Net of tax amount	**$1,631**	$ 565	$2,323

18. Commitments and Contingencies

The Company has entered into an agreement to purchase the land at 3951 Union Deposit Road, Harrisburg, Dauphin County, Pennsylvania. The Company plans to construct a full-service branch on this property to be opened in late Spring 2003.

The Company has entered into an agreement to purchase the land at 15 Lorane Road in conjunction with the purchase of 5140 Perkiomen Avenue, Reading, Berks County, Pennsylvania. The Company plans to construct a full-service branch on these properties to be opened in Summer 2003.

In addition, the Company is also subject to certain routine legal proceedings and claims arising in the ordinary course of business. It is management's opinion that the ultimate resolution of these claims will not have a material adverse effect on the Company's financial position and results of operations.

19. Related Party Transactions

Commerce Bancorp, Inc. (an 8.2% shareholder of common stock and 100% shareholder of Series A preferred stock of the Company), through a subsidiary (Commerce Bank, N.A., a national bank located in Cherry Hill, New Jersey), provides various services to the Company. These services include maintenance to the branch LAN network, proof and encoding services, deposit account statement rendering, MAC/VISA card processing, data processing, and advertising support. Insurance premiums and commissions, which are paid to a subsidiary of Commerce Bancorp, Inc., are included in the total amount paid. The Company paid approximately $1.3 million, $622,000, and $414,000 for services provided by Commerce Bancorp, Inc. during 2002, 2001, and 2000, respectively. The Company routinely sells loan participations to Commerce Bank, N.A. and at December 31, 2002 and 2001, approximately $8.6 million and $12.4 million, respectively, of these participations were outstanding. A director emeritus of the Company is Chairman of the Board of Commerce Bank, N.A. The Company obtained interior design services for $108,000, $114,000, and $76,000 in 2002, 2001, and 2000, respectively, from a business owned by the spouse of the director emeritus. Additionally, the business received additional revenues for project management of approximately $159,000, $101,000, and $54,000 in 2002, 2001, and 2000, respectively, on furniture and facility purchases made directly by the Company. The Company leases land for one of its branches from a limited partnership in which the director emeritus is a 20% limited partner. Total payments on the land lease for 2002, 2001, and 2000 were $58,000, $56,000, and $50,000, respectively.

A federal funds line of credit was established with Commerce Bank N.A. in the amount of $5.5 million, which could be drawn upon if needed. The balance at December 31, 2002 and 2001 on this line was $0.

A law firm in which a director of the Company is a partner received professional fees totaling $290,000, $258,000, and $137,000 during 2002, 2001, and 2000, respectively.

The Company leases land for a billboard owned by the Company from a director. Payments on the land lease totaled $25,000, $24,000, and $24,000 for 2002, 2001, and 2000, respectively.

The Company paid commissions for real estate services to a company owned by the Chairman of the Board of the Company of $0, $74,000, and $48,000 in 2002, 2001, and 2000, respectively.

20. Fair Value of Financial Instruments

FASB Statement No. 107, "Disclosures about Fair Value of Financial Instruments" (FAS 107), requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practical to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year ends, and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The Company, in estimating its fair value disclosures for financial instruments, used the following methods and assumptions:

Cash and cash equivalents

The carrying amounts reported approximate those assets' fair value.

Securities

Fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans Receivable

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans receivable were estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loans with significant collectibility concerns were fair valued on a loan–by-loan basis utilizing a discounted cash flow method or the fair market value of the underlying collateral.

Restricted Investments in Bank Stock

The carrying amounts reported approximate those assets' fair value.

Accrued Interest Receivable and Payable

The carrying amount of accrued interest receivable and payable approximate their fair values.

Deposit Liabilities

The fair values disclosed for demand deposits (e.g., interest-bearing and noninterest-bearing checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates of deposit to a schedule of aggregated expected monthly maturities on time deposits.

Long-term Debt

The fair values for long-term debt were estimated using the interest rate currently available from the related party that holds the existing debt.

Off-balance Sheet Instruments

Fair values for the Company's off-balance sheet instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

The carrying amounts and fair values of the Company's financial instruments as of December 31 are presented in the following table.

	2002		2001	
(in thousands)	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	**$ 75,450**	**$ 75,450**	$ 25,855	$ 25,855
Securities	**303,061**	**306,472**	208,071	207,149
Loans, net (including loans held for sale)	**374,249**	**393,618**	345,791	346,968
Restricted invetments in bank stock	**2,045**	**2,045**	2,593	2,593
Accrued interest receivable	**3,675**	**3,675**	3,542	3,542
Financial liabilities:				
Deposits	**$726,955**	**$726,070**	$561,738	$562,626
Long-term debt	**13,000**	**15,231**	13,000	14,573
Accrued interest payable	**832**	**832**	837	837
Off-balance sheet instruments:				
Standby letters of credit	**$ 0**	**$ 0**	$ 0	$ 0
Commitments to extend credit	**0**	**0**	0	0

21. Quarterly Financial Data (unaudited)

The following represents summarized unaudited quarterly financial data of the Company which in the opinion of management, reflects adjustments (comprising only normal recurring accruals) necessary for fair presentation (in thousands, except per share amounts):

	Three Months Ended			
	December 31	**September 30**	**June 30**	**March 31**
2002				
Interest income	**$10,992**	**$10,788**	**$10,342**	**$9,873**
Interest expense	**3,505**	**3,615**	**3,599**	**3,575**
Net interest income	**7,487**	**7,173**	**6,743**	**6,298**
Provision for loan losses	**345**	**375**	**280**	**435**
Net securities gains	**0**	**0**	**0**	**0**
Provision for income taxes	**799**	**741**	**682**	**649**
Net income	**1,570**	**1,467**	**1,347**	**1,290**
Net income per share:				
Basic	**$0.73**	**$0.69**	**$0.65**	**$0.64**
Diluted	**0.69**	**0.63**	**0.58**	**0.57**
2001				
Interest income	$ 9,902	$ 9,713	$ 9,489	$9,143
Interest expense	3,859	3,978	4,049	4,307
Net interest income	6,043	5,735	5,440	4,836
Provision for loan losses	464	405	315	285
Net securities gains	0	0	0	52
Provision for income taxes	646	592	533	461
Net income	1,276	1,181	1,068	923
Net income per share:				
Basic	$0.65	$0.60	$0.53	$0.46
Diluted	0.59	0.53	0.49	0.43

22. Condensed Financial Statements of Parent Company

Balance Sheets

(in thousands)	December 31, **2002**	2001
ASSETS		
Cash	**$ 252**	$ 148
Investment in subsidiaries:		
Banking subsidiary	**55,534**	45,400
Non-banking subsidiaries	**600**	600
Other assets	**128**	117
Total Assets	**$56,514**	$46,265
LIABILITIES		
Long-term debt	**$13,000**	$13,000
Other liabilities	**702**	672
Total liabilities	**13,702**	13,672
STOCKHOLDERS' EQUITY		
Preferred stock	**400**	400
Common stock	**2,117**	1,882
Surplus	**31,909**	25,263
Retained earnings	**6,866**	5,159
Accumulated other comprehensive loss	**1,520**	(111)
Total stockholders' equity	**42,812**	32,593
Total Liabilities & Stockholders' Equity	**$56,514**	$46,265

Statements of Income

(in thousands)	Year Ended December 31, **2002**	2001	2000
Income:			
Dividends from bank subsidiary	**$1,226**	$ 794	$ 393
Interest income	**62**	32	12
	1,288	826	405
Expenses:			
Interest expense	**1,416**	793	312
Other	**258**	213	187
	1,674	1,006	499
Loss before income (taxes) benefit and equity in undistributed net income of subsidiaries	**(386)**	(180)	(94)
Income (taxes) benefit	**548**	331	165
	162	151	71
Equity in undistributed net income of bank subsidiary	**5,512**	4,297	3,643
Net income	**$5,674**	$4,448	$3,714

Statements of Cash Flows

(in thousands)	Year Ended December 31, 2002	2001	2000
Operating Activities:			
Net Income	**$ 5,674**	$ 4,448	$ 3,714
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of financing costs	**6**	10	5
Increase in other liabilities	**30**	385	287
Equity in undistributed net income of bank subsidiary	**(5,512)**	(4,297)	(3,643)
Net cash provided by operating activities	**198**	546	363
Investing Activities:			
Investment in bank subsidiary	**(2,610)**	(8,786)	(5,303)
Investment in nonbank subsidiaries	**0**	(400)	(200)
Net cash (used) by investing activities	**(2,610)**	(9,186)	(5,503)
Financing Activities:			
Proceeds from common stock options exercised	**1,738**	217	84
Proceeds from issuance of long term debt	**0**	8,000	5,000
Proceeds from issuance of common stock under stock purchase plan	**868**	698	219
Costs of issuing long term debt	**0**	(53)	(68)
Cash dividends on preferred stock and cash in lieu of fractional shares	**(90)**	(86)	(83)
Net cash provided by financing activities	**2,516**	8,776	5,152
Increase in cash and cash equivalents	**104**	136	12
Cash and cash equivalents at beginning of the year	**148**	12	0
Cash and cash equivalents at end of year	**$ 252**	$ 148	$ 12

Independent Auditor's Report

To the Board of Directors
Pennsylvania Commerce Bancorp, Inc.
Camp Hill, Pennsylvania

We have audited the accompanying consolidated balance sheets of Pennsylvania Commerce Bancorp, Inc. and its subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pennsylvania Commerce Bancorp, Inc. and its subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Harrisburg, Pennsylvania
January 31, 2003

Corporate Information

Headquarters

Pennsylvania Commerce Bancorp, Inc.
100 Senate Avenue
Camp Hill, PA 17011

Annual Shareholders' Meeting

Pennsylvania Commerce Bancorp, Inc.'s annual shareholders' meeting will be held on Friday, May 16, 2003 at 9:00 am at the following location:

Radisson Penn Harris Hotel
1150 Camp Hill Bypass
Camp Hill, PA 17011

Contacts

Analysts, portfolio managers, and others seeking financial information about Pennsylvania Commerce Bancorp, Inc. should contact:

Mark A. Zody
Chief Financial Officer
at (717) 975-5630

News media representatives and others seeking general corporate information should contact:

Gary L. Nalbandian, Chairman/CEO
at (717) 975-5630

Shareholders seeking assistance with stock records should contact:

Sherry Richart
Shareholder Relations
at (717) 972-2879

Dividend Reinvestment and Stock Purchase Plan

Pennsylvania Commerce Bancorp, Inc. offers its shareholders a convenient plan to increase their investment in the Company. Through the Dividend Reinvestment and Stock Purchase Plan, holders of common stock may have their dividends and voluntary cash payments of up to $5,000 per quarter (subject to change) reinvested in additional common shares at a 3% discount (subject to change) from the market price and without brokerage fees, commissions, or service charges. Shareholders not enrolled in this plan, as well as brokers and custodians who hold stock for clients, may receive a plan prospectus and enrollment card by contacting Sherry Richart at (717) 972-2879.

Annual Report and Form 10-K

Additional copies of Pennsylvania Commerce Bancorp, Inc.'s Annual Report and Form 10-K are available without charge by writing:

Pennsylvania Commerce Bancorp, Inc.
Shareholder Relations
100 Senate Avenue
Camp Hill, PA 17011

NASDAQ Symbol

Shares of Pennsylvania Commerce Bancorp, Inc. common stock are traded nationally under the symbol **COBH** in the Over-The-Counter Small Cap Market and are listed in NASDAQ Quotations.

Common Stock Prices

The following table sets forth the prices for which common stock has traded during the last two (2) fiscal years on the NASDAQ Small Cap Market. The prices per share have been adjusted to reflect common stock dividends of 5% with record dates of February 7, 2003 and February 11, 2002. As of December 31, 2002, there were approximately 600 holders of record of the Company's common stock.

	Sales Price	
Quarter Ended:	High	Low
March 31, 2002	$ 40.00	$ 33.79
June 30, 2002	51.43	39.33
September 30, 2002	46.00	35.48
December 31, 2002	42.02	32.99
March 31, 2001	$ 33.67	$ 24.83
June 30, 2001	33.67	29.52
September 30, 2001	32.42	29.80
December 31, 2001	34.92	30.83

Transfer and Dividend Paying Agent/Registrar

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016-3572

Cumberland County

Camp Hill
100 Senate Avenue
Camp Hill, PA 17011
717/972-2875

Camp Hill Mall
32nd Street & Trindle Road
Camp Hill, PA 17011
717/920-5740

Carlisle
65 Ashland Avenue
Carlisle, PA 17013
717/240-2665

Carlisle Commons
20 Noble Boulevard
Carlisle, PA 17013
717/249-6650

Cedar Cliff
1120 Carlisle Road
Camp Hill, PA 17011
717/909-3200

Hampden Centre
4860 Carlisle Pike
Mechanicsburg, PA 17055
717/975-7546

Simpson Ferry
5032 Simpson Ferry Road
Mechanicsburg, PA 17055
717/766-6800

Wertzville Road
742 Wertzville Road
Enola, PA 17025
717/909-6700

Dauphin County

Colonial Park
4700 Jonestown Road
Harrisburg, PA 17109
717/540-7676

Downtown Harrisburg
101 North Second Street
Harrisburg, PA 17101
717/760-5210

Hummelstown
600 Walton Avenue
Hummelstown, PA 17036
717/566-4400

Mountain Road
6071 Allentown Boulevard
Harrisburg, PA 17112
717/540-7605

Coming Soon:

Derry Street
Derry Street & East Park Drive
Harrisburg, PA

Progress Avenue
Progress Avenue & Kohn Road
Harrisburg, PA

Union Deposit Road
3951 Union Deposit Road
Harrisburg, PA

Lebanon County

Palmyra Branch
903 East Main Street
Palmyra, PA 17078
717/832-0800

York County

Prospect Street
1098 Haines Road
York, PA 17402
717/840-9257

Queen Street
2160 South Queen Street
York, PA 17402
717/747-0700

Route 30
55 Arsenal Road
York, PA 17404
717/852-9292

Red Lion
3109 Cape Horn Road
Red Lion, PA 17356
717/718-1188

York Crossing
2100 York Crossing Drive
York, PA 17404
717/767-7700

Berks County

Coming Soon:

5th Street Highway
Reading, PA

Route 422 East
Route 422 & Lorane Road
Reading, PA

Pennsylvania Commerce Bancorp