

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2017

OR

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

For the transition period from \_\_\_\_ to \_\_\_\_

Commission file number 001-32964

**THE FIRST OF LONG ISLAND CORPORATION**

(Exact Name Of Registrant As Specified In Its Charter)

New York

(State or Other Jurisdiction of Incorporation or Organization)

11-2672906

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

10 Glen Head Road, Glen Head, NY

(Address of Principal Executive Offices)

11545

(Zip Code)

(516) 671-4900

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, \$.10 par value per share

The NASDAQ Stock Market

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the Corporation's voting common stock held by nonaffiliates as of June 30, 2017, the last business day of the Corporation's most recently completed second fiscal quarter, was \$663.5 million. This value was computed by reference to the price at which the stock was last sold on June 30, 2017 and excludes \$26.6 million representing the market value of common stock beneficially owned by directors and executive officers of the registrant.

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

Class

Outstanding, March 1, 2018

Common Stock, \$.10 par value

25,018,449

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held April 17, 2018 are incorporated by reference into Part III.



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## PART I

### ITEM 1. BUSINESS

#### General

The First of Long Island Corporation (“Registrant”), a one-bank holding company, was incorporated on February 7, 1984 for the purpose of providing financial services through its wholly-owned subsidiary, The First National Bank of Long Island. The consolidated entity is referred to as the "Corporation," and the Bank and its subsidiaries are collectively referred to as the "Bank."

The Bank was organized in 1927 as a national banking association under the laws of the United States of America. The Bank has two wholly owned subsidiaries: FNY Service Corp., an investment company, and The First of Long Island Agency, Inc. The Bank and FNY Service Corp. jointly own another subsidiary, The First of Long Island REIT, Inc., a real estate investment trust (“REIT”).

All of the financial operations of the Corporation are aggregated in one reportable operating segment. All revenues are attributed to and all long-lived assets are located in the United States.

The Bank’s revenues are derived principally from interest on loans and investment securities, service charges and fees on deposit accounts, income from investment management and trust services and bank-owned life insurance (“BOLI”).

The Bank did not commence, abandon or significantly change any of its lines of business during 2017.

#### Markets Served and Products Offered

The Bank serves the financial needs of privately owned and publicly held businesses, professionals, consumers, public bodies and other organizations primarily in Nassau and Suffolk Counties, Long Island, and the boroughs of New York City. The Bank’s head office is located in Glen Head, New York, and the Bank has 37 other full service branches, ten commercial banking offices and two select service banking centers. Included in these totals are five full service branches in Queens, one in Brooklyn and two commercial banking offices in Manhattan. The Bank continues to evaluate potential new branch sites on Long Island and in the boroughs of New York City.

The Bank’s loan portfolio is primarily comprised of loans to borrowers on Long Island and in the boroughs of New York City, and its real estate loans are principally secured by properties located in those areas. The Bank’s investment securities portfolio is comprised of direct obligations of the U.S. government and its agencies and highly rated obligations of states and political subdivisions. The Bank has an Investment Management Division that provides investment management, pension trust, personal trust, estate and custody services.

In addition to its loan and deposit products, the Bank offers other services to its customers including the following:

- Account Reconciliation Services
- ACH Origination
- ATM Banking and Deposit Automation
- Bank by Mail
- Bill Payment
- Cash Management Services
- Collection Services
- Controlled Disbursement Accounts
- Drive-Through Banking
- Foreign Currency Sales and Purchases
- Healthcare Remittance Automation
- Instant Issue Debit Cards
- Investment Management and Trust Services
- Lock Box Services
- Merchant Credit Card Services
- Mobile Banking
- Mobile Capture
- Mutual Funds, Annuities and Life Insurance
- Night Depository Services
- Online Banking
- Payroll Services
- Personal Money Orders
- Remote Deposit
- Safe Deposit Boxes
- Securities Transactions
- Signature Guarantee Services
- Telephone Banking
- Travelers Checks
- Wire Transfers - Domestic and International
- Withholding Tax Depository Services

#### Competition

The Bank encounters substantial competition in its banking business from numerous other financial services organizations that have offices located in the communities served by the Bank. Principal competitors are money center, large regional and community banks located within the Bank’s market area, as well as mortgage brokers, brokerage firms and credit unions. The Bank competes for loans

based on the quality of service it provides, loan structure, competitive pricing and branch locations, and competes for deposits by offering a high level of customer service, paying competitive rates and through the geographic distribution of its branch system.

## **Investment Activities**

The investment policy of the Bank, as approved by the Board Asset Liability Committee (“BALCO”) and supervised by both the BALCO and the Management Investment Committee, is intended to promote investment practices which are both safe and sound and in full compliance with applicable regulations. Investment authority will be granted and amended as is necessary by the Board of Directors or BALCO.

The Bank's investment decisions seek to optimize income while keeping both credit and interest rate risk at acceptable levels, provide for the Bank's liquidity needs and provide securities that can be pledged, as needed, to secure deposits and borrowings.

The Bank's investment policy generally limits individual maturities to twenty years and estimated average lives on collateralized mortgage obligations (“CMOs”) and other mortgage-backed securities to ten years. At the time of purchase, bonds of states and political subdivisions must generally be rated AA or better, notes of states and political subdivisions must generally be rated MIG-1 (or equivalent), commercial paper must be rated A-1 or P-1, and corporate bonds must be rated AA or better. In addition, management periodically reviews the creditworthiness of all securities in the Bank's portfolio other than those issued by the U.S. government or its agencies. Any significant deterioration in the creditworthiness of an issuer is analyzed and action is taken if deemed appropriate.

At year-end 2017 and 2016, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of stockholders' equity.

At December 31, 2017, \$464.2 million of the Corporation's municipal securities were rated AA or better and \$4.1 million were non-rated bonds issued by local municipalities. The Corporation's pass-through mortgage securities portfolio at December 31, 2017 is comprised of \$4.9 million and \$66.8 million of securities issued by the Government National Mortgage Association (“GNMA”) and the Federal National Mortgage Association (“FNMA”), respectively. Each issuer's pass-through mortgage securities are backed by residential mortgages conforming to the issuer's underwriting guidelines and each issuer guarantees the timely payment of principal and interest on its securities. All of the Corporation's CMOs were issued by GNMA and such securities are backed by GNMA residential pass-through mortgage securities. GNMA guarantees the timely payment of principal and interest on its CMOs and the underlying pass-through mortgage securities. Obligations of GNMA, a U.S. government agency, represent full faith and credit obligations of the U.S. government, while obligations of FNMA, which is a U.S. government-sponsored agency, do not.

The Bank has not engaged in the purchase and sale of securities for the primary purpose of producing trading profits and its current investment policy does not allow such activity.

## **Lending Activities**

**General.** The Bank's lending is subject to written underwriting standards and loan origination procedures, as approved by the Board Loan Committee and contained in the Bank's loan policy. The loan policies allow for exceptions and set forth specific exception approval requirements. Decisions on loan applications are based on, among other things, the borrower's credit history, the financial strength of the borrower, estimates of the borrower's ability to repay the loan and the value of the collateral, if any. All real estate appraisals must meet the requirements of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”), banking agency guidance and, for those loans in excess of \$250,000, be reviewed by the Bank's independent appraisal review function.

The Bank conducts its lending activities out of its main office in Glen Head, New York and its Suffolk County regional office in Hauppauge, New York. The Bank's loan portfolio is primarily comprised of loans to small and medium-sized privately owned businesses, professionals and consumers on Long Island and in the boroughs of New York City. The Bank offers a full range of lending services including commercial and residential mortgage loans, home equity lines, commercial and industrial loans, small business credit scored loans, Small Business Administration (“SBA”) loans, construction and land development loans, consumer loans and commercial and standby letters of credit. The Bank makes both fixed and variable rate loans. Variable rate loans are primarily tied to and reprice with changes in the prime interest rate of the Bank, the prime interest rate as published in The Wall Street Journal, U.S. Treasury rates, Federal Home Loan Bank of New York advance rates and the London Interbank Offered Rate (LIBOR).

Residential mortgage loans in excess of \$1.0 million and other loans in excess of \$750,000 generally require the approval of the Management Loan Committee. Loans in excess of \$12.5 million require the additional approval of two non-management members of the Board Loan Committee, while those in excess of \$17.5 million require the approval of a majority of the Board of Directors.

**Commercial and Industrial Loans.** Commercial and industrial loans include, among other things, short-term business loans and lines of credit; term and installment loans; loans secured by marketable securities, the cash surrender value of life insurance policies, deposit accounts or general business assets; small business credit scored loans as described hereinafter; and equipment finance loans. The Bank makes commercial and industrial loans on a demand basis, short-term basis, or installment basis. Short-term business loans are generally due and payable within one year and should be self-liquidating during the normal course of the borrower's business cycle. Lines of credit are reaffirmed annually and generally require an annual cleanup period. Term and installment loans are usually due and payable within five years. Generally, it is the policy of the Bank to request personal guarantees of principal owners on loans made to privately-owned businesses.

**Small Business Credit Scored Loans.** The Bank makes small business credit scored loans and issues VISA® credit cards to businesses that generally have annual sales at the time of application of less than \$2 million. Most of these loans are in the form of revolving credit lines and, depending on the type of business, the maximum amount generally ranges from \$100,000 to \$500,000. Others are installment loans made to finance business automobiles, trucks and equipment and can be secured by the asset financed and/or deposit accounts with the Bank. Both installment loans and revolving credit commitments generally have maturities up to sixty months. Business profile reports are used in conjunction with credit reports and FICO (Fair Isaac Corporation) small business score cards for loan underwriting and decision making purposes. Credit and FICO small business risk scores enable the Bank to quickly and efficiently identify and approve loans to low-risk business applicants and decline loans to high-risk business applicants. There were \$1.0 million of small business credit scored term loans outstanding at December 31, 2017. In addition, the Bank had commitments on small business credit scored revolving lines of credit of \$42.9 million, of which \$17.7 million were drawn and funded.

**Real Estate Mortgage Loans and Home Equity Lines.** The Bank makes residential and commercial mortgage loans and establishes home equity lines of credit. Applicants for residential mortgage loans and home equity lines will be considered for approval provided they have satisfactory credit history and collateral and the Bank believes that there is sufficient monthly income to service both the loan or line applied for and existing debt. Applicants for commercial mortgage loans will be considered for approval provided they, as well as any guarantors, have satisfactory credit history and can demonstrate, through financial statements and otherwise, the ability to repay. Commercial and residential mortgage loans are made with terms not in excess of thirty years and are generally maintained in the Bank's portfolio. The residential mortgage loans made by the Bank in recent years consist of both fixed rate loans with terms ranging from 10 to 30 years and variable rate loans that reprice in five, seven or ten years and then every year thereafter. Commercial mortgage loans generally reprice within five years and home equity lines generally mature within ten years. Depending on the type of property, the Bank will generally not lend more than 75% of appraised value on residential mortgage, home equity and commercial mortgage loans. The lending limitations with regard to appraised value are more stringent for loans on co-ops and condominiums.

In processing requests for commercial mortgage loans, the Bank generally requires an environmental assessment to identify the possibility of environmental contamination. The extent of the assessment procedures varies from property to property and is based on factors such as the use and location of the subject property and whether or not the property has a suspected environmental risk based on current or past use.

**Construction Loans.** From time to time, the Bank makes loans to finance the construction of both residential and commercial properties. The maturity of such loans is generally eighteen months or less and advances are made as the construction progresses. The advances can require the submission of bills by the contractor, verification by a Bank-approved inspector that the work has been performed, and title insurance updates to ensure that no intervening liens have been placed. Variable rate construction and land development loans are included in Commercial Mortgages on the Consolidated Balance Sheet and amounted to \$8.5 million at December 31, 2017.

**Consumer Loans and Lines.** The Bank makes auto loans, home improvement loans and other consumer loans, establishes revolving overdraft lines of credit and issues VISA® credit cards. Consumer loans are generally made on an installment basis over terms not in excess of five years. In reviewing loans and lines for approval, the Bank considers, among other things, the borrower's ability to repay, stability of employment and residence, and past credit history.

## **Sources of Funds**

The Corporation's primary sources of cash are deposits, maturities and amortization of loans and investment securities, operations, borrowings and funds received under the Dividend Reinvestment and Stock Purchase Plan ("DRIP"). The Corporation uses cash from these and other sources to fund loan growth, purchase investment securities, repay borrowings, expand and improve its physical facilities, pay cash dividends and for general operating purposes.

The Bank offers checking and interest-bearing deposit products. In addition to business and small business checking, the Bank has a variety of personal checking products that differ in minimum balance requirements, monthly maintenance fees, and per check charges, if any. The interest-bearing deposit products, which have a wide range of interest rates and terms, consist of checking

accounts, which include negotiable order of withdrawal (“NOW”) accounts and IOLA, escrow service accounts, rent security accounts, a variety of personal and nonpersonal money market accounts, a variety of personal and nonpersonal savings products, time deposits, holiday club accounts, and a variety of individual retirement accounts.

The Bank relies primarily on its branch network, customer service, calling programs, lending relationships, referral sources, competitive pricing and advertising to attract and retain local deposits. The flow of deposits is influenced by general economic conditions, changes in interest rates and competition.

## **Employees**

As of December 31, 2017, the Bank had 333 full-time equivalent employees and considers employee relations to be good. Employees of the Bank are not represented by a collective bargaining unit.

## **Supervision and Regulation**

**General.** The banking industry is highly regulated. Statutory and regulatory controls are designed primarily for the protection of depositors and the banking system, and not for the purpose of protecting shareholders. The following discussion is not intended to be a complete list of all the activities regulated by banking laws or of the impact of such laws and regulations on the Corporation and the Bank. Changes in applicable laws or regulations, and in their interpretation and application by regulatory agencies, cannot be predicted, but may have a material effect on our business and results of operations.

As a registered bank holding company, the Corporation is regulated under the Bank Holding Company Act of 1956, as amended (“BHC Act”), and subject to inspection, examination and supervision by the Federal Reserve Board. In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks, performing servicing activities for subsidiaries, and engaging in activities that the Federal Reserve has determined, by order or regulation, are so closely related to banking as to be a proper incident thereto under the BHC Act. The Corporation is also subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the Securities and Exchange Commission (“SEC”). Our common stock is listed on the Capital Market tier of the NASDAQ Stock Market (“NASDAQ”) under the symbol “FLIC” and is subject to NASDAQ rules for listed companies.

As a national bank, the Bank is subject to regulation and examination by the Office of the Comptroller of the Currency (“OCC”) and the Federal Deposit Insurance Corporation (“FDIC”). Insured banks, such as the Bank, are subject to extensive regulation of many aspects of their businesses. These regulations relate to, among other things: (i) the nature and amount of loans that may be made by the Bank and the rates of interest that may be charged; (ii) types and amounts of other investments; (iii) branching; (iv) anti-money laundering; (v) permissible activities; (vi) reserve requirements; and (vii) dealings with officers, directors and affiliates.

The Dodd-Frank Act made extensive changes in the regulation of depository institutions and their holding companies. For example, the Dodd-Frank Act created a new Consumer Financial Protection Bureau (“CFPB”) as an independent bureau of the Federal Reserve Board. The CFPB has assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations, a function previously assigned to principal federal banking regulators, and has authority to impose new requirements. However, institutions of less than \$10 billion in assets, such as the Bank, continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the enforcement authority of, their primary federal regulator, although the CFPB has limited back-up authority to examine such institutions.

**Bank Holding Company Regulation.** The BHC Act requires the prior approval of the Federal Reserve Board for the acquisition by a bank holding company of 5% or more of the voting stock or substantially all of the assets of any bank or bank holding company. Also, under the BHC Act, bank holding companies are prohibited, with certain exceptions, from engaging in, or from acquiring 5% or more of the voting stock of any company engaging in activities other than (i) banking or managing or controlling banks, (ii) furnishing services to or performing services for their subsidiaries or (iii) activities that the Federal Reserve Board has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Bank holding companies that meet certain criteria specified by the Federal Reserve may elect to be regulated as a “financial holding company” and thereby engage in a broader array of financial activities including insurance and investment banking.

**Payment of Dividends.** A large source of the Corporation’s liquidity is dividends from the Bank. Prior approval of the OCC is required if the total of all dividends declared by a national bank in any calendar year would exceed the sum of the bank’s net profits for that year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. Under the foregoing dividend restrictions, and while maintaining its “well-capitalized” status and absent affirmative governmental approvals, during 2018 the Bank could declare dividends to the Corporation of approximately \$52.7 million plus any 2018 net profits retained to the date of the dividend declaration.



In addition, the Corporation and the Bank are subject to other regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimum capital levels. The Federal Reserve Board is authorized to determine under certain circumstances relating to the financial condition of a bank holding company or a bank that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. Federal Reserve guidance sets forth the supervisory expectation that bank holding companies will inform and consult with Federal Reserve staff in advance of declaring a dividend that exceeds earnings for the quarter and should inform the Federal Reserve and should eliminate, defer or significantly reduce dividends if (i) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends, (ii) the prospective rate of earnings retention is not consistent with the bank holding company's capital needs and overall current and prospective financial condition, or (iii) the bank holding company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios.

**Transactions with Affiliates.** Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. Regulations promulgated by the Federal Reserve Board limit the types and amounts of these transactions (including loans due and extensions of credit from their U.S. bank subsidiaries) that may take place and generally require those transactions to be on an arm's-length basis. In general, these regulations require that any "covered transactions" between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company be limited to 10% of the bank subsidiary's capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, loans and extensions of credit to affiliates generally are required to be secured by eligible collateral in specified amounts.

**Source of Strength Doctrine.** Federal Reserve policy has historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, the Corporation is expected to commit resources to support the Bank, including at times when the Corporation may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to depositors and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

**Capital Requirements.** As a bank holding company, the Corporation is subject to consolidated regulatory capital requirements administered by the Federal Reserve. The Bank is subject to similar capital requirements administered by the OCC.

The Corporation and the Bank implemented the Basel III regulatory capital standards ("Basel III") issued by the Federal Reserve Board and the OCC. Under the Basel III capital requirements, the Corporation and the Bank are required to maintain minimum ratios of capital to assets of 4.00% for Tier 1 capital to average assets, 4.50% for Common equity tier 1 capital to risk weighted assets, 6.00% for Tier 1 capital to risk weighted assets and 8.00% for Total capital to risk weighted assets. Common equity tier 1 capital, Tier 1 capital, Total capital, risk weighted assets and average assets are defined in the Basel III rules. Failure to meet the minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on the financial statements of the Corporation and Bank. The Corporation and the Bank exceeded the Basel III minimum capital adequacy requirements at December 31, 2017.

Basel III also phases-in a capital conservation buffer from 2016 through 2019. The capital conservation buffer must be maintained in order for a banking organization to avoid being subject to limitations on capital distributions, including dividend payments, and discretionary bonus payments to executive officers. The capital ratio phase-in schedule, including the capital conservation buffer, for banks with \$250 billion or less in total assets is as follows:

	2015	2016	2017	2018	2019
Minimum leverage measure (%).....	4.0	4.0	4.0	4.0	4.0
Minimum common equity tier 1 risk-based capital ("RBC") (%).....	4.5	4.5	4.5	4.5	4.5
Capital conservation buffer (%).....	N/A	.625	1.25	1.875	2.5
Minimum common equity tier 1 RBC with capital conservation buffer (%).....	4.5	5.125	5.75	6.375	7.0
Minimum tier 1 RBC (%).....	6.0	6.0	6.0	6.0	6.0
Minimum tier 1 RBC with capital conservation buffer (%).....	6.0	6.625	7.25	7.875	8.5
Minimum total RBC (%).....	8.0	8.0	8.0	8.0	8.0
Minimum total RBC with capital conservation buffer (%).....	8.0	8.625	9.25	9.875	10.5

**Prompt Corrective Action Regulations.** The Federal Deposit Insurance Act, as amended (“FDIA”), requires among other things, the federal banking agencies to take “prompt corrective action” with respect to banks that do not meet minimum capital requirements. The FDIA sets forth the following five capital tiers for purposes of implementing the prompt corrective action (“PCA”) regulations: “well-capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” The PCA thresholds established by Basel III for each of the capital tiers is as follows:

	Total RBC Measure (%)	Tier 1 RBC Measure (%)	Common Equity Tier 1 RBC Measure (%)	Leverage Measure (%)
Well capitalized.....	≥ 10	≥ 8	≥ 6.5	≥ 5
Adequately capitalized .....	≥ 8	≥ 6	≥ 4.5	≥ 4
Undercapitalized .....	< 8	< 6	< 4.5	< 4
Significantly undercapitalized.....	< 6	< 4	< 3	< 3
Critically undercapitalized .....		Tangible equity to total assets ≤ 2		

The Bank was well capitalized under the Basel III PCA thresholds at December 31, 2017.

**Deposit Insurance.** The FDIC imposes an assessment on financial institutions for deposit insurance. The assessment is based on the risk category of the institution as assigned by the FDIC, the institution’s average total assets and average tangible equity. The FDIC periodically adjusts the deposit insurance assessment rates, which may raise or lower the cost to an institution of maintaining FDIC insurance coverage.

The FDIC may terminate the insurance of an institution’s deposits upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. Management is not aware of any practice, condition or violation that might lead to termination of the Bank’s deposit insurance.

**Safety and Soundness Standards.** The FDIA requires the federal bank regulatory agencies to prescribe standards, through regulations or guidelines, relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. Guidelines adopted by the federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal stockholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying one or more of the safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the PCA provisions of the FDIA. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

**Community Reinvestment Act and Fair Lending Laws.** The Community Reinvestment Act of 1977 (“CRA”) requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low and moderate income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. Banking regulators take into account CRA ratings when considering approval of proposed acquisition transactions. The Bank received a “Satisfactory” CRA rating on its most recent Federal examination. The Bank and the Corporation are firmly committed to the practice of fair lending and maintaining strict adherence to all federal and state fair lending laws which prohibit discriminatory lending practices.

**Federal Home Loan Bank System.** The Bank is a member of the Federal Home Loan Bank System (“FHLB System”), which consists of 11 regional Federal Home Loan Banks (each a “FHLB”). The FHLB System provides a central credit facility primarily for member banks. As a member of the FHLB of New York, the Bank is required to acquire and hold shares of capital stock in the FHLB in an amount equal to 4.5% of its borrowings from the FHLB (transaction-based stock) plus .15% of the total principal amount at the beginning of the year of the Bank’s unpaid residential real estate loans, commercial real estate loans, home equity loans, CMOs, and other similar obligations (membership stock). At December 31, 2017, the Bank was in compliance with the FHLB’s capital stock ownership requirement.

**Financial Privacy.** Federal regulations require the Bank to disclose its privacy policy, including identifying with whom it shares “nonpublic personal information,” to its customers at the time the customer establishes a relationship with the Bank and annually thereafter. In addition, we are required to provide our customers with the ability to “opt-out” of having the Bank share their nonpublic personal information with nonaffiliated third parties before we can disclose that information, subject to certain exceptions.

The federal banking agencies adopted guidelines establishing standards for safeguarding our customer information. The guidelines describe the agencies’ expectation that regulated entities create, implement and maintain an information security program, which would include administrative, technical and physical safeguards appropriate to the size and complexity and the nature and scope of our activities. The standards set forth in the guidelines are intended to ensure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of customer records, and protect against unauthorized access to records or information that could result in substantial harm or inconvenience to customers. Additionally, the guidance states that banks, such as the Bank, should develop and implement a response program to address security breaches involving customer information, including customer notification procedures. The Bank has developed such a program.

**Anti-Money Laundering and the USA PATRIOT Act.** A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 (“Patriot Act”) substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The United States Treasury Department has issued and, in some cases, proposed a number of regulations that apply various requirements of the Patriot Act to financial institutions such as the Bank. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Certain of those regulations impose specific due diligence requirements on financial institutions that maintain correspondent or private banking relationships with non-U.S. financial institutions or persons. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences for the institution. The Bank and the Corporation are firmly committed to maintaining strong policies, procedures and controls to ensure compliance with anti-money laundering laws and regulations and to combat money laundering and terrorist financing.

**Legislative Initiatives and Regulatory Reform.** From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to change substantially the financial institution regulatory system. Such legislation could change banking statutes and the operating environment in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions and other financial institutions. The Corporation cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on our financial condition or results of operations. A change in statutes, regulations or regulatory policies applicable to the Corporation could have a material effect on our business.

## **Availability of Reports**

The Bank maintains a website at [www.fnbli.com](http://www.fnbli.com). The Corporation’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed with or furnished to the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through the Bank’s website as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. To access these reports go to the homepage of the Bank’s website and click on “Investor Relations,” then click on “SEC Filings,” and then click on “Corporate SEC Filings.” This will bring you to a listing of the Corporation’s reports maintained on the SEC’s EDGAR website. You can then click on any report to view its contents. Information on our website shall not be considered a part of this annual report on Form 10-K.

You may also read and copy any document we file with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, DC 20549. You should call 1-800-SEC-0330 for more information on the Public Reference Room. Our SEC filings are also available on the SEC’s website at [www.sec.gov](http://www.sec.gov).

## **ITEM 1A. RISK FACTORS**

The Corporation is exposed to a variety of risks, some of which are inherent in the banking business. The more significant of these are addressed by the Corporation’s written policies and procedures. While management is responsible for identifying, assessing and managing risk, the Board of Directors is responsible for risk oversight. The Board fulfills its risk oversight responsibilities largely through its committees. The following provides information regarding risk factors faced by the Corporation. Additional risks and uncertainties not currently known to the Corporation, or that the Corporation currently deems to be immaterial, could also have a material impact on the Corporation’s business, financial condition, or results of operations.

**The inability to realize the full carrying value of the Bank's investment securities, loans and bank-owned life insurance could negatively impact our financial condition and results of operations.**

For investment securities, loans and bank-owned life insurance, there is always the risk that the Bank will be unable to realize their full carrying value. Credit risk in the Bank's securities and bank-owned life insurance portfolios has been addressed by adopting board committee approved investment and bank-owned life insurance policies that, among other things, limit terms, types and amounts of holdings and specify minimum required credit ratings. Allowable investments include direct obligations of the U.S. government and its agencies, highly rated obligations of states and political subdivisions, highly rated corporate obligations and bank-owned life insurance policies issued by highly rated insurance carriers. At the time of purchase, bonds of states and political subdivisions must generally be rated AA or better, notes of states and political subdivisions must generally be rated MIG-1 (or equivalent), commercial paper must be rated A-1 or P-1, and corporate bonds must be rated AA or better. Bank-owned life insurance may only be purchased from insurance carriers rated A or better. For carriers rated AA or better, cash surrender value is limited to 15% of Tier 1 capital, and for those carriers rated below AA, the limitation is 10% of Tier 1 capital. The cash surrender value of policies with all carriers, plus corporate bond holdings of such carriers, cannot exceed 25% of Tier 1 capital. Management periodically reviews the creditworthiness of all securities in the Bank's portfolio other than those issued by the U.S. government or its agencies and all bank-owned life insurance carriers. Any significant deterioration in the creditworthiness of an issuer or carrier will be analyzed and action taken if deemed appropriate.

Credit risk in the Bank's loan portfolio has been addressed by adopting a board committee approved loan policy and by maintaining independent loan and appraisal review functions and an independent credit department. The loan policy contains what the Corporation believes to be prudent underwriting guidelines, which include, among other things, specific loan approval requirements, maximum loan terms, loan to appraised value and debt service coverage limits for mortgage loans, credit score minimums, guarantor support and environmental study requirements.

The credit risk within the Bank's loan portfolio primarily stems from factors such as changes in the borrower's financial condition, credit concentrations, changes in collateral values, economic conditions and environmental contamination. The Bank's commercial loans, including those secured by mortgages, are primarily made to small and medium-sized businesses. Such loans sometimes involve a higher degree of risk than those to larger companies because such businesses may have shorter operating histories, higher debt-to-equity ratios and may lack sophistication in internal record keeping and financial and operational controls. In addition, most of the Bank's loans are made to businesses and consumers on Long Island and in the boroughs of New York City, and a large percentage of these loans are mortgage loans secured by properties located in those areas. At December 31, 2017, residential mortgage loans, including home equity lines of credit, amounted to approximately \$1.6 billion and comprised approximately 58% of loans secured by real estate. The primary source of repayment for residential mortgage loans is cash flows from individual borrowers and co-borrowers. Also, at December 31, 2017, multifamily loans amounted to approximately \$683 million and comprised approximately 57% of the Bank's total commercial mortgage portfolio and approximately 24% of the Bank's total loans secured by real estate. The primary source of repayment for multifamily loans is cash flows from the underlying properties, a substantial portion of which are rent stabilized or rent controlled. Such cash flows for both residential mortgage and multifamily loans are dependent on the strength of the local economy.

Environmental impairment of properties securing mortgage loans is always a risk. However, at the present time, the Bank is not aware of any existing loans in the portfolio where there is environmental pollution originating on or near the mortgaged properties that would materially affect the value of the portfolio.

**Uncertainty, changes in accounting rules and regulatory principals and other factors could result in a need to increase the Bank's Allowance for Loan Losses and adversely impact our financial condition and results of operations.**

The Bank maintains an allowance for loan losses in an amount believed to be adequate to absorb probable incurred losses in its loan portfolio. The maintenance of the allowance for loan losses is governed by a board committee approved allowance for loan and lease losses policy. In arriving at the allowance for loan losses, an impairment analysis is performed on each loan where it is probable that the borrower will not be able to make all required principal and interest payments according to contractual terms. In addition, incurred losses for all other loans in the Bank's portfolio are determined on a pooled basis taking into account, among other things, historical loss experience, delinquencies, economic conditions, changes in value of underlying collateral, trends in nature and volume of loans, concentrations of credit, changes in lending policies and procedures, experience, ability and depth of lending staff, changes in quality of the loan review function, environmental risks and loan risk ratings. Because estimating the allowance for loan losses is highly subjective in nature and involves a variety of estimates and assumptions that are inherently uncertain, there is the risk that management's estimate may not accurately capture probable incurred losses in the loan portfolio. The Bank's allowance may need to be increased based on, among other things, additional information that comes to light after the estimate is made, changes in circumstances or a recommendation by bank regulators based on their review of the Bank's loan portfolio. The impact of one or more of these factors on the Bank's allowance could result in the need for a significant increase in the Bank's provision for loan losses and have a material adverse impact on the Bank's financial condition and results of operations.

In addition, the Financial Accounting Standards Board has adopted an Accounting Standards Update (“ASU”) 2016-13, that will be effective for reporting periods beginning after December 15, 2019. This standard changes the accounting methodology used to determine the allowance for loan losses from an incurred loss model to a current expected credit loss (“CECL”) model. The CECL model will require the Bank to maintain at each periodic reporting date an allowance for loan losses in an amount that is equal to its estimate of expected lifetime credit losses on the loans in its portfolio. Utilization of the CECL model may require the Bank to increase its allowance for loan losses and will increase the types and amount of data the Bank will need to collect and consider in determining an appropriate level for its allowance for loan losses.

**Changes in interest rates, the shape of the yield curve and a sustained period of low interest rates could negatively impact our earnings.**

The Bank’s results of operations are subject to risk resulting from interest rate fluctuations and having assets and liabilities that have different maturity, repricing and prepayment/withdrawal characteristics. The Bank defines interest rate risk as the risk that the Bank’s net interest income and/or economic value of equity (“EVE”) will change when interest rates change. The Bank has addressed interest rate risk by adopting a board committee approved interest rate risk policy which sets forth quantitative risk limits and calls for monitoring and controlling interest rate risk through a variety of techniques including the use of interest rate sensitivity models and traditional repricing gap analysis. Management utilizes a consultant with expertise in bank asset liability management to aid them in these efforts.

A sustained period of low interest rates and a flattening of the yield curve over the past several years have resulted in continued pressure on our net interest margin. The historic low interest rate environment appears to be ending as the Federal Reserve Bank (“FRB”) has slowly changed from an accommodative monetary policy to a tightening of monetary policy. The FRB has increased the federal funds target rate 100 basis points since December 2016 and has stated that it plans to increase rates an additional three times in 2018 if economic growth continues to expand and the unemployment rate remains at historic lows.

Increases in the federal funds target rate have already begun to exert upward pressure on non-maturity deposit liability rates and the cost of overnight borrowings. Should short-term rates continue to increase and a further flattening of the yield curve were to occur, the Bank’s loans and investment securities could reprice slower than its interest-bearing liabilities, which would have a negative effect on net interest income. However, over a longer period of time, the effect on the Bank’s earnings should be positive primarily because with the passage of time the yield curve should steepen and more loans and investment securities would reprice at the higher rates and there would be no offsetting increase in interest expense for those interest-earning assets funded by noninterest-bearing checking deposits and capital.

When interest rates decline, borrowers tend to refinance higher rate loans at lower rates and prepayments on mortgage loans and mortgage-backed securities are elevated. Under those circumstances, the Bank may not be able to reinvest the resulting cash flows in new interest-earning assets with rates as favorable as those on the prepaid loans or investment securities. In addition, subject to the floors contained in many of the Bank’s loan agreements, the Bank’s loans at variable interest rates may adjust to lower rates at their reset dates. While lower rates could reduce the Bank’s cost of funds on non-maturity deposits, certificates of deposits and FHLB advances, the cost savings would be somewhat constrained as overall funding rates have not increased significantly from the decade-long historic low interest rate environment and a significant portion of the Bank’s funding comes from noninterest-bearing checking deposits and capital.

**The Bank may not have sufficient funds or funding sources to meet liquidity demands.**

Liquidity risk is the risk that the Bank will not have sufficient funds to accommodate loan growth, meet deposit outflows or make contractual payments on borrowing arrangements. The Bank has addressed liquidity risk by adopting a board committee approved liquidity policy and liquidity contingency plan that set forth quantitative risk limits and a protocol for responding to liquidity stress conditions should they arise. The Bank encounters significant competition in its market area from branches of larger banks, various community banks, credit unions and other financial services organizations. This, in addition to consumer confidence in the equity markets, could cause deposit outflows, and such outflows could be significant.

The Bank has both internal and external sources of liquidity that can be used to fund loan growth and accommodate deposit outflows. The Bank’s primary internal sources of liquidity are overnight investments, maturities and monthly payments on its investment securities and loan portfolios, operations and investment securities designated as available-for-sale.

The Bank is a member of the FRB of New York and the FHLB of New York, and has a federal funds line with a commercial bank. In addition to customer deposits, the Bank’s primary external sources of liquidity are secured borrowings from the FHLB of New York and FRB of New York. In addition, the Bank can purchase overnight federal funds under its existing line. However, the Bank’s FRB of New York membership, FHLB of New York membership and federal funds line do not represent legal commitments to extend credit to the Bank. The amount that the Bank can potentially borrow is currently dependent on, among other things, the

amount of unencumbered eligible securities and loans that the Bank can use as collateral and the collateral margins required by the lenders.

**A decline in the Corporation's market capitalization could negatively impact the price, trading volume and liquidity of our common stock.**

The Corporation's market capitalization on December 31, 2017 was approximately \$703 million, exceeding the \$500 million market capitalization which may make the Corporation's common stock more attractive to certain investors. In addition, the Corporation's common stock is included in the Russell 3000 and Russell 2000 Indexes, which are reconstituted annually. Upon reconstitution in May 2017, the average market capitalization of companies in the Russell 2000 Index was \$2.0 billion, the median market capitalization was \$784 million, the capitalization of the largest company in the index was \$3.4 billion and the capitalization of the smallest company in the index was \$144 million. The Corporation believes that a market capitalization in excess of \$500 million and inclusion in the Russell indexes have positively impacted the price, trading volume and liquidity of its common stock. Conversely, if the Corporation's market capitalization falls below the minimum necessary to be included in the indexes at any future reconstitution date, the opposite could occur.

**Changes in national and local economic conditions could negatively impact our financial condition and results of operations.**

Although the economy has improved, national and local economic conditions could deteriorate. This poses risks to both the Corporation's business and the banking industry as a whole. Specific risks include reduced loan demand from quality borrowers; increased competition for loans; increased loan loss provisions resulting from deterioration in loan quality; reduced net interest income and net interest margin caused by a sustained period of low interest rates; interest rate volatility; price competition for deposits due to liquidity concerns or otherwise; volatile equity markets; and higher cost to attract capital to support growth.

In addition to the significant risks posed by economic conditions, the Corporation could experience deposit outflows as national and local economic conditions improve and investors pursue alternative investment opportunities.

**The Bank's internal controls and those of its third-party service providers may be ineffective or circumvented, resulting in significant financial loss, adverse action by governmental bodies and damaged reputation.**

The Corporation relies on its system of internal controls and the internal controls of its third-party service providers ("TPSPs") to ensure that transactions are captured, recorded, processed and reported properly; confidential customer information is safeguarded; and fraud by employees and persons outside the Corporation is detected and prevented. The Corporation's internal controls and/or those of its TPSPs may prove to be ineffective or employees of the Corporation and/or its TPSPs may fail to comply with or override the controls, either of which could result in significant financial loss to the Corporation, adverse action by bank regulatory authorities or the SEC and damage to the Corporation's reputation.

**The Bank's inability to keep pace with technological advances could negatively impact our business, financial condition and results of operations.**

The delivery of financial products and services has increasingly become technology-driven. The Bank's ability to competitively meet the needs of its customers in a cost-efficient manner is dependent on its ability to keep pace with technological advances and to invest in new technology as it becomes available. The ability to keep pace with technological change is important, and failure to do so could have a material adverse impact on the Corporation's business, financial condition and results of operations.

**System failures, interruptions and security breaches could negatively impact our customers, reputation, and results of operations.**

The Bank outsources most of its data processing to TPSPs. If TPSPs encounter difficulties, or if the Bank has difficulty communicating with them, the Bank's ability to adequately process and account for customer transactions could be affected, and the Bank's business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through TPSPs. The Bank's website and online banking products have been the target of cyber attacks in the past. While the Bank and its TPSPs believe they have successfully blocked attempts to infiltrate the Bank's systems, there is always the possibility that successful attacks have not yet been identified and that future attacks may not be blocked. A significant cybersecurity incident may be determined to be material insider information and would prohibit corporate insiders from trading in Company stock until appropriate public disclosures are made.

The Board Audit Committee has oversight responsibility for cybersecurity risk, which it administers through periodic meetings with management and the approval of information technology and cybersecurity policies. In this regard, board committee approved policies address information security, IT vulnerability assessment, cybersecurity incident response and electronic communications. These policies are intended to prevent, detect and respond to cybersecurity incidents. In addition, these policies prevent or limit the impact of systems failures, interruptions and security breaches and rely on commonly used security and processing systems to provide the security and authentication necessary for the processing of data. The Bank makes use of logon and user access controls, multifactor and out of band authentication, transaction limits, firewalls, antivirus software, intrusion protection monitoring, vulnerability scans and independent penetration testing. The Bank also ensures employee awareness of cybersecurity trends. System failures or interruptions are addressed in the board committee approved emergency and disaster recovery policy and business continuity policy. In addition, for TPSPs of data processing and other significant services, the board committee approved vendor management policy and procedures require reviews of audit reports prepared by independent registered public accounting firms regarding their financial condition and the effectiveness of their internal controls.

These precautions may not protect our systems from all compromises or breaches of security and there can be no assurance that such events will not occur or that they will be adequately addressed if they do. The Bank carries a cyber liability insurance policy to mitigate the amount of any financial loss. However, the occurrence of any systems failure, interruption or breach of security could damage the Bank's reputation and result in a loss of customers and business, could subject the Bank to additional regulatory scrutiny, or could expose the Bank to civil litigation and possible financial liability beyond any insurance coverage. Any of these occurrences could have a material adverse effect on the Corporation's financial condition and results of operations.

**The inability to attract, motivate or retain qualified key personnel could negatively impact our performance.**

The Corporation's future success depends in part on the continued service of its executive officers and other key members of management and its staff, as well as its ability to continue to attract, motivate and retain additional highly qualified employees. The loss of services of key personnel and our inability to timely recruit or promote qualified replacements could have an adverse effect on the Bank's business, operating results and financial condition. Their skills, knowledge of the Bank's market and years of industry experience may be difficult to replace.

**Changes in laws, government regulation and supervisory guidance could have a significant negative impact on our financial condition and results of operations.**

The Corporation and the Bank are subject to regulation, supervision and examination by, among others, the Federal Reserve Board, OCC and FDIC. The FDIC also insures the Bank's deposits. Regulation and supervision govern the activities in which a bank and its holding company may engage and are intended primarily for the protection of depositors. Regulatory requirements affect virtually all aspects of the Corporation's and the Bank's business, including, among other things, investment practices, lending practices, deposit offerings and capital levels. The regulators have extensive discretion in connection with their supervisory and enforcement activities, including imposing restrictions on bank operations and expansion plans, imposing deposit insurance premiums and other assessments, setting required levels for the allowance for loan losses, capital and liquidity, and imposing restrictions on the ability to pay cash dividends and other capital distributions to stockholders. Changes in laws, regulations and supervisory guidance, or the Corporation's and the Bank's compliance with these laws and regulations as judged by the regulators, could have a significant negative impact on the Corporation's financial condition and results of operations. The Corporation manages the risk of noncompliance with laws and regulations by having board committee approved compliance policies, hiring and retaining employees with the experience and skills necessary to address compliance on an ongoing basis, and consulting, when necessary with legal counsel and other outside experts on compliance matters.

**We may be adversely affected by recent changes in U.S. tax laws.**

The Tax Cuts and Jobs Act ("Tax Act"), which was enacted in December 2017, is likely to have both positive and negative effects on our financial performance. For example, the new legislation will result in a reduction in the federal corporate tax rate from 35% to 21% beginning in 2018, which will have a favorable impact on our earnings and capital generation abilities. However, the new legislation also enacted limitations on certain deductions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. These limitations include (1) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (2) the elimination of interest deductions for home equity loans, (3) a limitation on the deductibility of business interest expense and (4) a limitation on the deductibility of property taxes and state and local income taxes.

The recent changes in the tax laws may have an adverse effect on the market for, and the valuation of, residential properties, and on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, like New York. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of properties securing loans in our portfolio may be adversely impacted as a result of the changing economics of home ownership,

which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

**Weather-related and terrorist events could cause significant harm to our business.**

Weather-related events have adversely impacted our market area, especially flood prone areas located near coastal waters and otherwise. Significant flooding and other storm-related damage may become more common in the future. Financial institutions have been, and continue to be, targets of terrorist threats aimed at compromising operating and communication systems, and the metropolitan New York area remains a central target for potential acts of terrorism. Weather-related and terrorist events could cause significant damage, impact the stability of our facilities and result in additional operating expenses, impair the ability of our borrowers to repay their loans, reduce the value of collateral securing repayment of our loans and result in the loss of revenue. While we have established and regularly test disaster recovery procedures, the occurrence of any such event could have a material adverse effect on our business, results of operations and financial condition.

**Competition within our market area could limit our ability to increase interest-earning assets.**

Competition in the banking and financial services industry is intense. In our market area, we compete with numerous commercial banks, savings institutions, mortgage brokers, credit unions, finance companies, mutual funds, insurance companies and brokerage and investment banking firms operating locally and elsewhere. Some of our competitors have substantially greater resources and lending limits than we have and have greater name recognition and market presence that benefit them in attracting business. In addition, large competitors may be able to price loans and deposits more aggressively than we do. Competitive forces may limit our ability to increase our interest-earning assets. Our profitability depends upon our continued ability to successfully compete in our market area. For additional information see “Item 1 – Business – Competition.”

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

The Corporation neither owns nor leases any real estate. Office facilities of the Corporation and the Bank’s main office are located at 10 Glen Head Road, Glen Head, New York in a building owned by the Bank.

As of December 31, 2017, the Bank owns 23 buildings and leases 38 other facilities, all of which are in Nassau and Suffolk Counties, Long Island and the New York City boroughs of Queens, Brooklyn and Manhattan. The Corporation believes that the physical facilities of the Bank are suitable and adequate at present and are being fully utilized.

**ITEM 3. LEGAL PROCEEDINGS**

In the ordinary course of business, the Corporation is party to various legal actions which are incidental to the operation of its business. Although the ultimate outcome and amount of liability, if any, with respect to these legal actions cannot presently be ascertained with certainty, in the opinion of management, based upon information currently available to us, any resulting liability is believed to be immaterial to the Corporation’s consolidated financial position, results of operations and cash flows.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.



## PART II

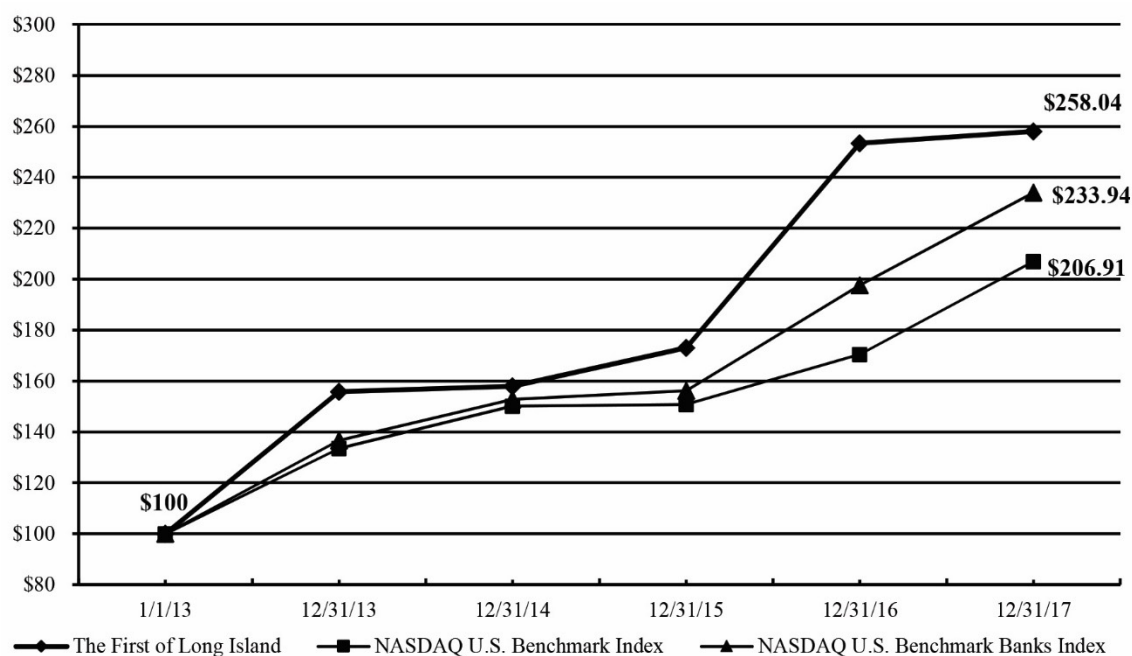
### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation's common stock trades on the NASDAQ Capital Market tier of the NASDAQ Stock Market under the symbol "FLIC." At December 31, 2017, there were 585 stockholders of record of the Corporation's Common Stock. The number of stockholders of record includes banks and brokers who act as nominees, each of whom may represent more than one stockholder. The following table sets forth high and low sales prices and dividends declared, by quarter, for the years ended December 31, 2017 and 2016.

Quarter	2017			2016		
	High	Low	Dividends Declared	High	Low	Dividends Declared
First.....	\$ 29.30	\$ 26.00	\$ .14	\$ 20.33	\$ 17.43	\$ .13
Second.....	30.15	25.60	.14	21.29	18.06	.13
Third.....	31.10	26.05	.15	22.35	18.68	.14
Fourth.....	33.50	27.50	.15	29.67	20.99	.14

#### Performance Graph

The following performance graph compares the Corporation's total stockholder return with the NASDAQ U.S. Benchmark and NASDAQ U.S. Benchmark Banks Indexes over a 5-year measurement period assuming \$100 invested on January 1, 2013, and dividends reinvested in the Corporation's stock.



#### Issuer Purchase of Equity Securities

The Corporation did not repurchase any shares of its own common stock in the fourth quarter of 2017.

## ITEM 6. SELECTED FINANCIAL DATA

The following is selected consolidated financial data for the past five years, adjusted as appropriate to reflect the Corporation's stock splits. This data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the accompanying consolidated financial statements and related notes.

<i>(dollars in thousands, except per share data)</i>	2017	2016	2015	2014	2013
<b>INCOME STATEMENT DATA:</b>					
Interest Income.....	\$ 118,265	\$ 104,123	\$ 92,135	\$ 81,976	\$ 74,851
Interest Expense .....	21,709	18,002	16,529	15,048	12,364
Net Interest Income .....	96,556	86,121	75,606	66,928	62,487
Provision for Loan Losses.....	4,854	3,480	4,317	3,189	2,997
Net Income .....	35,122	30,880	25,890	23,014	21,300
<b>PER SHARE DATA:</b>					
Basic Earnings.....	\$ 1.44	\$ 1.35	\$ 1.23	\$ 1.11	\$ 1.04
Diluted Earnings .....	1.43	1.34	1.22	1.10	1.03
Cash Dividends Declared .....	.58	.55	.52	.48	.45
Dividend Payout Ratio .....	40.56%	41.04%	42.62%	43.64%	43.69%
Book Value .....	\$ 14.37	\$ 12.90	\$ 11.85	\$ 11.20	\$ 10.04
Tangible Book Value .....	14.36	12.90	11.84	11.19	10.03
<b>BALANCE SHEET DATA AT YEAR END:</b>					
Total Assets .....	\$ 3,894,708	\$ 3,510,320	\$ 3,130,343	\$ 2,721,494	\$ 2,399,892
Loans.....	2,950,352	2,545,421	2,248,183	1,804,819	1,477,937
Allowance for Loan Losses.....	33,784	30,057	27,256	23,221	20,848
Deposits.....	2,821,997	2,608,717	2,284,675	1,985,025	1,782,128
Borrowed Funds.....	704,938	586,224	577,214	481,486	395,463
Stockholders' Equity .....	354,450	305,830	250,936	233,303	206,556
<b>AVERAGE BALANCE SHEET DATA:</b>					
Total Assets .....	\$ 3,695,850	\$ 3,329,308	\$ 2,897,548	\$ 2,515,103	\$ 2,240,139
Loans.....	2,758,116	2,364,187	1,990,823	1,584,198	1,286,227
Allowance for Loan Losses.....	32,022	28,238	24,531	21,554	19,847
Deposits.....	2,812,733	2,590,988	2,215,883	1,922,172	1,747,888
Borrowed Funds.....	540,307	432,554	419,372	347,946	272,737
Stockholders' Equity .....	334,088	290,806	243,330	224,585	203,125
<b>FINANCIAL RATIOS:</b>					
Return on Average Assets (ROA).....	.95%	.93%	.89%	.92%	.95%
Return on Average Stockholders' Equity (ROE)...	10.51%	10.62%	10.64%	10.25%	10.49%
Average Equity to Average Assets .....	9.04%	8.73%	8.40%	8.93%	9.07%

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview – 2017 Versus 2016

**Analysis of 2017 Earnings.** Net income and diluted earnings per share (“EPS”) for 2017 were \$35.1 million and \$1.43, respectively, representing increases of 13.7% and 6.7%, respectively, over the comparable 2016 amounts. Dividends per share increased 5.5% from \$.55 for 2016 to \$.58 for 2017. Returns on average assets and average equity for 2017 were .95% and 10.51%, respectively, as compared to .93% and 10.62%, respectively, for 2016.

Net income for 2017 increased \$4.2 million over 2016. The increase is primarily attributable to increases in net interest income of \$10.4 million, or 12.1%, and noninterest income, before securities gains and losses, of \$1.2 million, or 15.8%. The impact of these items was partially offset by securities losses of \$1.9 million and increases in the provision for loan losses of \$1.4 million, noninterest expense, before debt extinguishment costs of \$3.2 million, or 6.3%, and income tax expense of \$840,000.

The increase in net interest income is mainly attributable to growth in average interest-earning assets of \$335.6 million, or 10.4%, which was driven by an increase in the average balance of loans of \$393.9 million, or 16.7%. Although most of the loan growth occurred in residential and commercial mortgage loans, commercial and industrial loans also grew with an increase in average outstandings of \$19.6 million, or 18.9%. The growth in loans was funded mainly by growth in the average balances of noninterest-bearing checking deposits of \$81.0 million, or 10.2%, interest-bearing deposits of \$140.8 million, or 7.8%, short-term borrowings of \$74.7 million and stockholders' equity of \$43.3 million, or 14.9%. Also funding the growth in loans was a decrease in the average balance of taxable investment securities of \$46.7 million, or 12.5%.

The increase in noninterest income, before securities gains and losses, of \$1.2 million, or 15.8%, is primarily attributable to increases in income from BOLI of \$530,000, service charges on deposit accounts of \$126,000, checkbook income of \$116,000 and Investment Management Division income of \$90,000. Also contributing to the increase in noninterest income were refunds of sales taxes, real estate taxes and telecommunications charges of \$167,000.

The increase in noninterest expense, before debt extinguishment costs, of \$3.2 million, or 6.3%, is primarily attributable to increases in salaries of \$2.0 million, or 9.2%, employee benefits expense of \$261,000, or 3.8%, occupancy and equipment expense of \$981,000, or 10.6%, and marketing expense of \$389,000. Also contributing to the increase was a valuation allowance of \$725,000 recorded in the fourth quarter of 2017 on other real estate owned. The impact of these items was partially offset by decreases in consulting fees of \$635,000, computer and telecommunications expense of \$743,000 and FDIC insurance expense of \$201,000.

During the fourth quarter of 2017, the Bank sold approximately \$88.6 million of mortgage-backed securities with a yield of 1.55% and an expected average life of 3.4 years and reinvested substantially all of the proceeds in mortgage-backed securities with a yield of 2.61% and an expected average life of 4.9 years. The sale resulted in a pretax loss of \$1.9 million and an after-tax loss of \$1.3 million, or \$.05 per share. Due to changes in federal tax law enacted in December 2017, most of the future incremental income will be taxed at a federal tax rate of 21% while the \$1.9 million pre-tax loss in 2017 will receive a federal tax benefit at a rate of 35%. Considering both the future incremental income on the replacement securities and the change in the federal tax rate effective in 2018, the payback period for the 2017 loss is approximately 1.7 years. The securities loss negatively impacted 2017 ROA and ROE by 3 and 38 basis points, respectively.

The \$1.4 million increase in the provision for loan losses in 2017 is mainly due to more loan growth, an increase in net chargeoffs of \$448,000 from \$679,000 in 2016 to \$1,127,000 in 2017 and a decline in historical loss rates in 2016. The impact of these items was partially offset by improved economic conditions in 2017 and a \$510,000 decline in specific reserves on loans individually deemed to be impaired.

The \$840,000 increase in income tax expense is due to higher pre-tax earnings in 2017 and a decline in income from tax-exempt securities. Another important contributor to the increase in income tax expense is the fact that in 2017 the Corporation was subject to New York State (“NYS”) and New York City (“NYC”) taxes based on capital rather than business income and did not record the potential NYS and NYC tax benefits of deductible temporary differences that arose in 2017. The impact of these items was partially offset by a \$909,000 credit to income tax expense in 2017 resulting from a reduction in the Corporation's net deferred tax liability to reflect the decrease in the federal income tax rate effective January 1, 2018. In addition, the Corporation realized higher tax benefits in 2017 from stock awards and BOLI. The vesting and exercise of stock awards resulted in tax benefits over and above those accrued during the vesting period of \$762,000 and \$385,000 in 2017 and 2016, respectively.

**Analysis of Fourth Quarter 2017 Earnings.** Net income for the fourth quarter of 2017 was \$7.6 million, up slightly from \$7.5 million in the same quarter last year. The increase is primarily attributable to increases in net interest income and income from BOLI of \$1.9 million and \$188,000, respectively, and decreases in the provision for loan losses and income tax expense of \$319,000 and \$968,000, respectively. These items were substantially offset by increases in salaries and occupancy and equipment expense of

\$536,000 and \$380,000, respectively, and the aforementioned securities loss and valuation allowance of \$1.9 million and \$725,000, respectively. The securities loss negatively impacted fourth quarter 2017 ROA and ROE by 13 and 141 basis points, respectively. The decrease in the provision for loan losses was primarily driven by a decrease in specific reserves in the fourth quarter of 2017 of \$821,000 versus an increase of \$482,000 in the same quarter last year, as partially offset by higher net chargeoffs in the 2017 quarter and adjustments to qualitative factors used in determining the allowance for loan losses. The decrease in income tax expense occurred because of lower pretax earnings in the fourth quarter of 2017 and for the same reasons for a decrease discussed above with respect to the full year periods. Other fourth quarter variances occurred for substantially the same reasons discussed above with respect to the full year periods.

**Asset Quality.** The Bank's allowance for loan losses to total loans decreased three basis points from 1.18% at year-end 2016 to 1.15% at year-end 2017. The decrease is primarily due to an improvement in the local housing market and overall economic conditions and a decline in specific reserves.

The overall credit quality of the Bank's loan portfolio remains excellent. Nonaccrual loans amounted to \$1.0 million, or .03% of total loans outstanding, at December 31, 2017, compared to \$2.6 million, or .10%, at December 31, 2016. The decrease is attributable to paydowns and loans returned to an accrual status based on the demonstrated ability of the borrowers to service their debt, as partially offset by new nonaccrual loans. Troubled debt restructurings amounted to \$1.0 million, or .04% of total loans outstanding, at December 31, 2017, representing a decrease of \$498,000 from year-end 2016. The decrease was primarily attributable to payoffs of some loans and paydowns on other loans. Troubled debt restructurings at year-end include \$785,000 that are performing in accordance with their modified terms and \$100,000 that are nonaccrual and included in the aforementioned amount of nonaccrual loans. Loans past due 30 through 89 days amounted to \$2.8 million, or .09% of total loans outstanding, at December 31, 2017, compared to \$1.1 million, or .04%, at December 31, 2016. Management does not believe that the increase in loans past due 30 through 89 days is indicative of a deterioration in the overall credit quality of the Bank's loan portfolio.

The credit quality of the Bank's securities portfolio also remains excellent. The Bank's mortgage securities are backed by mortgages underwritten on conventional terms, with 74% of these securities being full faith and credit obligations of the U.S. government and the balance being obligations of U.S. government sponsored entities. The remainder of the Bank's securities portfolio principally consists of high quality, general obligation municipal securities rated AA or better by major rating agencies. In selecting municipal securities for purchase, the Bank uses credit agency ratings for screening purposes only and then performs its own credit analysis. On an ongoing basis, the Bank periodically assesses the credit strength of the municipal securities in its portfolio and makes decisions to hold or sell based on such assessments.

**Key Strategic Initiatives.** Key strategic initiatives will continue to include loan and deposit growth through effective relationship management, targeted solicitation efforts, new product offerings and continued expansion of the Bank's branch distribution system on Long Island and in the New York City boroughs of Queens and Brooklyn. With respect to loan growth, the Bank will continue to prudently manage concentration risk and further develop its broker and correspondent relationships. Small business credit scored loans, equipment finance loans and SBA loans, along with the Bank's traditional commercial and industrial loan products, will be originated to diversify the Bank's loan portfolio and help mitigate the impact of the low rate environment on the Bank's earnings.

The Bank achieved a significant milestone in December 2017 by opening its 50<sup>th</sup> branch which is located in Astoria, Queens. The Bank's growing branch distribution system consists of branches in Nassau and Suffolk Counties, Long Island and the New York City boroughs of Queens, Brooklyn and Manhattan. The Bank expects to open three or four more branches in Queens and Brooklyn over the next twelve months and continues to evaluate sites for further branch expansion. In addition to loan and deposit growth, management is also focused on growing noninterest income from existing and potential new sources, which may include the development or acquisition of fee-based businesses.

**Tax Reform.** On December 22, 2017, the Tax Act was signed into law. The most significant impact of the Tax Act on the Corporation is a reduction in the federal corporate tax rate from 35% to 21% commencing in 2018. Some of the other provisions affecting the Corporation are:

- Advance refunding municipal bonds issued after December 31, 2017 will no longer be tax-exempt.
- The Corporation will no longer be able to deduct any compensation in excess of \$1 million paid to a named executive officer.
- Bonus depreciation is increased to 100% for qualified property placed in service after September 27, 2017 and before January 1, 2023, with phase downs over the next four years.
- The immediate expensing of tangible property that qualifies as Internal Revenue Code Section 179 property is increased to \$1 million with an increase of the phase-out threshold to \$2.5 million.

The Corporation's effective tax rate for 2017 is 22.0%. Considering, among other things, the changes included in the Tax Act, the Corporation currently expects that its effective tax rate for 2018 will be in the range of 14% to 16%.

**Challenges We Face.** Beginning in December 2015, there have been five 25 basis point increases in the federal funds target rate to its current level of 1.25% to 1.50%. These increases have exerted upward pressure on non-maturity deposit rates and have caused these rates and overnight borrowing rates to move upward. Further increases in the federal funds target rate are expected in the foreseeable future. At the same time, the Bank generally lends and invests at a spread to intermediate and long-term interest rates which remain relatively low and without what management believes to be near term prospects for sustained improvement. This together with significant price competition for loans in the Bank's marketplace have resulted in suboptimal investing and lending rates. These factors are expected to continue to exert downward pressure on net interest margin.

The banking industry continues to be faced with new and complex regulatory requirements and enhanced supervisory oversight. The financial markets expect that regulatory relief will be forthcoming, but the timing, magnitude and positive impact of any such relief are yet to be determined. In the current environment, banking regulators are increasingly concerned about, among other things, growth, commercial real estate concentrations, underwriting of commercial real estate and commercial and industrial loans, capital levels, cyber security and predatory sales practices. Regulatory requirements and enhanced supervisory oversight are exerting downward pressure on revenues and upward pressure on required capital levels and the cost of doing business.

## Overview – 2016 Versus 2015

**Analysis of 2016 Earnings.** Net income and EPS for 2016 were \$30.9 million and \$1.34, respectively, representing increases of 19.3% and 9.8%, respectively, over the comparable 2015 amounts. Dividends per share increased 5.8% from \$.52 for 2015 to \$.55 for 2016. Returns on average assets and average equity for 2016 were .93% and 10.62%, respectively, as compared to .89% and 10.64%, respectively, for 2015.

Net income for 2016 increased \$5.0 million over 2015. The increase was primarily attributable to an increase in net interest income of \$10.5 million, or 13.9%, and a decrease in the provision for loan losses of \$837,000. The impact of these items was partially offset by increases in noninterest expense, before debt extinguishment costs, of \$4.7 million and income tax expense of \$1.6 million.

The increase in net interest income was primarily driven by growth in average interest-earning assets of \$431.2 million, or 15.4%, partially offset by a seven basis point decline in net interest margin. Average interest-earning assets grew mostly because of increases in the average balances of loans of \$373.4 million, or 18.8%, and securities of \$45.6 million, or 5.7%. Although most of the loan growth occurred in mortgage loans, commercial and industrial loans also grew with an increase in average outstandings of \$23.5 million, or 27.5%. The growth in loans and securities was primarily funded by growth in the average balances of noninterest-bearing checking deposits of \$56.0 million, or 7.6%, interest-bearing deposits of \$319.1 million, or 21.6%, and stockholders' equity of \$47.5 million, or 19.5%.

The decrease in the provision for loan losses for 2016 versus the prior year was largely due to lesser loan growth, a decline in historical loss rates and a lower increase in specific reserves. These items were partially offset by higher net chargeoffs in 2016.

The increase in noninterest expense, before debt extinguishment costs, of \$4.7 million, or 10.4%, was largely attributable to increases in salaries, employee benefits expense, consulting expense, occupancy and equipment expense and computer and telecommunications expense. The increase in consulting expense included a one-time charge of \$800,000 in 2016 for advisory services rendered in renegotiating the Bank's data processing contract. The Corporation expects that the cost savings negotiated by the consultant over the life of the contract will far exceed the one-time consulting charge.

In the fourth quarter of 2016, the Corporation adopted ASU 2016-09 "Improvements to Employee Share-Based Payment Accounting" effective as of January 1, 2016. Adoption of the ASU increased 2016 net income through a credit to income tax expense in the amount of \$385,000, or \$.02 per share.

The increase in income tax expense was attributable to higher pre-tax earnings in 2016 as compared to the prior year, partially offset by the credit to income tax expense from the adoption of ASU 2016-09, additional New York State income tax benefits derived from the Corporation's captive REIT and the inclusion of a one-time charge of \$402,000 in 2015 caused by changes in New York City tax law.

**Analysis of Fourth Quarter 2016 Earnings.** Net income for the fourth quarter of 2016 was \$7.5 million, an increase of \$900,000, or 13.6%, over \$6.6 million earned in the same quarter of 2015. EPS was \$.31 for the fourth quarter of 2016, unchanged from the fourth quarter of 2015. The increase in net income was primarily attributable to an increase in net interest income of \$2.1 million, partially offset by increases in salaries of \$133,000, occupancy and equipment expense of \$182,000 and income tax expense of \$414,000, and a partial writedown of \$168,000 on the Bank's investment in a trade association. The increases in net interest income, salaries and occupancy and equipment expense occurred for substantially the same reasons discussed with respect to the full year periods. Excluding the aforementioned one-time charge of \$402,000, income tax expense also increased for the same reasons discussed with respect to the full year periods.

**Asset Quality.** The Bank's allowance for loan losses to total loans decreased three basis points from 1.21% at year-end 2015 to 1.18% at year-end 2016. The decrease was primarily due to improved economic conditions and a reduction in the historical loss component of the allowance for loan losses.

The credit quality of the Bank's loan portfolio at year-end 2016 was excellent. Nonaccrual loans amounted to \$2.6 million, or .10% of total loans outstanding, compared to \$1.4 million, or .06%, at December 31, 2015, and troubled debt restructurings amounted to \$1.5 million, or .06% of total loans outstanding at December 31, 2016. Of the troubled debt restructurings, \$757,000 were performing in accordance with their modified terms and \$788,000 were nonaccrual and included in the aforementioned amount of nonaccrual loans. Troubled debt restructurings declined \$2.9 million during 2016 from \$4.5 million at year-end 2015. The decrease was primarily attributable to the payoff of two loans to one borrower, partially offset by two loans that were restructured in troubled debt restructurings during the year. Loans past due 30 through 89 days amounted to \$1.1 million, or .04% of total loans outstanding, at December 31, 2016, compared to \$1.0 million, or .04%, at December 31, 2015.

The credit quality of the Bank's securities portfolio at year-end 2016 was also excellent. The Bank's mortgage securities were backed by mortgages underwritten on conventional terms, with 60% of these securities being full faith and credit obligations of the U.S. government and the balance being obligations of U.S. government sponsored entities. The remainder of the Bank's securities portfolio principally consisted of high quality, general obligation municipal securities rated AA or better by major rating agencies.

### **Application of Critical Accounting Policies**

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported asset and liability balances and revenue and expense amounts. Our determination of the allowance for loan losses is a critical accounting estimate because it is based on our subjective evaluation of a variety of factors at a specific point in time and involves difficult and complex judgments about matters that are inherently uncertain. In the event that management's estimate needs to be adjusted based on, among other things, additional information that comes to light after the estimate is made or changes in circumstances, such adjustment could result in the need for a significantly different allowance for loan losses and thereby materially impact, either positively or negatively, the Bank's results of operations.

The Bank's Allowance for Loan and Lease Losses Committee ("ALLL Committee"), which is a management committee chaired by the Chief Credit Officer, meets on a quarterly basis and is responsible for determining the allowance for loan losses after considering, among other things, the results of credit reviews performed by the Bank's independent loan review consultants and the Bank's credit department. In addition, and in consultation with the Bank's Chief Financial Officer and Chief Risk Officer, the ALLL Committee is responsible for implementing and maintaining accounting policies and procedures surrounding the calculation of the required allowance. The Board Loan Committee reviews and approves the Bank's Loan Policy at least once each calendar year. The Bank's allowance for loan losses is reviewed and ratified by the Board Loan Committee on a quarterly basis and is subject to periodic examination by the OCC whose safety and soundness examination includes a determination as to the adequacy of the allowance for loan losses to absorb probable incurred losses.

The first step in determining the allowance for loan losses is to identify loans in the Bank's portfolio that are individually deemed to be impaired and then measure impairment losses based on either the fair value of collateral or the discounted value of expected future cash flows. In estimating the fair value of real estate collateral, management utilizes appraisals or evaluations adjusted for costs to dispose and a distressed sale adjustment, if needed. Estimating the fair value of collateral other than real estate is also subjective in nature and sometimes requires difficult and complex judgments. Determining expected future cash flows can be more subjective than determining fair values. Expected future cash flows could differ significantly, both in timing and amount, from the cash flows actually received over the loan's remaining life.

In addition to estimating losses for loans individually deemed to be impaired, management also estimates collective impairment losses for pools of loans that are not specifically reviewed. The Bank's highest average annualized loss experience over periods of 24, 36, 48 or 60 months is generally the starting point in determining its allowance for loan losses for each pool of loans. Management believes that this approach appropriately reflects losses from the current economic cycle and those incurred losses in the Bank's loan portfolio. However, since future losses could vary significantly from those experienced in the past, on a quarterly basis management adjusts its historical loss experience to reflect current conditions. In doing so, management considers a variety of general qualitative factors and then subjectively determines the weight to assign to each in estimating losses. The factors include, among others: (1) delinquencies, (2) economic conditions as judged by things such as national and local unemployment levels, (3) changes in value of underlying collateral as judged by things such as median home prices, commercial vacancy rates and forecasted vacancy and rental rates in the Bank's service area, (4) trends in the nature and volume of loans, (5) concentrations of credit, (6) changes in lending policies and procedures, (7) experience, ability and depth of lending staff, (8) changes in the quality of the loan review function, (9) environmental risks, and (10) loan risk ratings. Substantially all of the Bank's allowance for loan losses allocable to pools of loans that are collectively evaluated for impairment results from these qualitative adjustments to historical loss experience. Because of the nature of the qualitative factors and the difficulty in assessing their impact, management's resulting estimate of losses may not accurately reflect actual losses in the portfolio.

Although the allowance for loan losses has two separate components, one for impairment losses on individual loans and one for collective impairment losses on pools of loans, the entire allowance for loan losses is available to absorb realized losses as they occur whether they relate to individual loans or pools of loans.

## Net Interest Income

**Average Balance Sheet; Interest Rates and Interest Differential.** The following table sets forth the average daily balances for each major category of assets, liabilities and stockholders' equity as well as the amounts and average rates earned or paid on each major category of interest-earning assets and interest-bearing liabilities. The average balances of investment securities include unrealized gains and losses on available-for-sale securities, and the average balances of loans include nonaccrual loans.

<i>(dollars in thousands)</i>	2017			2016			2015		
	Average Balance	Interest/ Dividends	Average Rate	Average Balance	Interest/ Dividends	Average Rate	Average Balance	Interest/ Dividends	Average Rate
<b>Assets:</b>									
Interest-earning bank balances .....	\$ 25,356	\$ 281	1.11%	\$ 32,711	\$ 168	.51%	\$ 20,568	\$ 52	.25%
Investment securities:									
Taxable .....	327,491	7,473	2.28	374,199	7,813	2.09	355,177	7,939	2.24
Nontaxable (1) .....	461,149	20,744	4.50	465,457	21,056	4.52	438,835	20,902	4.76
Loans (1) .....	2,758,116	97,040	3.52	2,364,187	82,469	3.49	1,990,823	70,573	3.54
Total interest-earning assets ...	3,572,112	125,538	3.51	3,236,554	111,506	3.45	2,805,403	99,466	3.55
Allowance for loan losses.....	(32,022)			(28,238)			(24,531)		
Net interest-earning assets.....	3,540,090			3,208,316			2,780,872		
Cash and due from banks .....	31,555			30,450			28,665		
Premises and equipment, net..	36,279			31,597			29,011		
Other assets .....	87,926			58,945			59,000		
	<u>\$ 3,695,850</u>			<u>\$ 3,329,308</u>			<u>\$ 2,897,548</u>		
<b>Liabilities and Stockholders' Equity:</b>									
<b>Equity:</b>									
Savings, NOW & money market deposits .....	\$ 1,635,044	7,113	.44	\$ 1,501,096	5,344	.36	\$ 1,159,573	2,564	.22
Time deposits .....	305,029	5,479	1.80	298,194	5,107	1.71	320,626	5,987	1.87
Total interest-bearing deposits .....	1,940,073	12,592	.65	1,799,290	10,451	.58	1,480,199	8,551	.58
Short-term borrowings .....	132,137	1,345	1.02	57,395	296	.52	55,134	183	.33
Long-term debt.....	408,170	7,772	1.90	375,159	7,255	1.93	364,238	7,795	2.14
Total interest-bearing liabilities .....	2,480,380	21,709	.88	2,231,844	18,002	.81	1,899,571	16,529	.87
Checking deposits .....	872,660			791,698			735,684		
Other liabilities.....	8,722			14,960			18,963		
	3,361,762			3,038,502			2,654,218		
Stockholders' equity .....	334,088			290,806			243,330		
	<u>\$ 3,695,850</u>			<u>\$ 3,329,308</u>			<u>\$ 2,897,548</u>		
Net interest income (1).....		<u>\$ 103,829</u>			<u>\$ 93,504</u>			<u>\$ 82,937</u>	
Net interest spread (1) .....			<u>2.63%</u>			<u>2.64%</u>			<u>2.68%</u>
Net interest margin (1) .....			<u>2.91%</u>			<u>2.89%</u>			<u>2.96%</u>

(1) Tax-equivalent basis. Interest income on a tax-equivalent basis includes the additional amount of interest income that would have been earned if the Corporation's investment in tax-exempt loans and investment securities had been made in loans and investment securities subject to federal income taxes yielding the same after-tax income. The tax-equivalent amount of \$1.00 of nontaxable income was \$1.54 for each period presented, using the statutory federal income tax rate of 35%.

**Rate/Volume Analysis.** The following table sets forth the effect of changes in volumes, rates and rate/volume on tax-equivalent interest income, interest expense and net interest income.

<i>(in thousands)</i>	2017 versus 2016				2016 versus 2015			
	Increase (decrease) due to changes in:				Increase (decrease) due to changes in:			
	Volume	Rate	Rate/ Volume(1)	Net Change	Volume	Rate	Rate/ Volume(1)	Net Change
<b>Interest Income:</b>								
Interest-earning bank balances..	\$ (38)	\$ 195	\$ (44)	\$ 113	\$ 31	\$ 54	\$ 31	\$ 116
Investment securities:								
Taxable.....	(975)	726	(91)	(340)	425	(523)	(28)	(126)
Nontaxable .....	(195)	(118)	1	(312)	1,268	(1,050)	(64)	154
Loans.....	13,741	711	119	14,571	13,235	(1,128)	(211)	11,896
Total interest income.....	<u>12,533</u>	<u>1,514</u>	<u>(15)</u>	<u>14,032</u>	<u>14,959</u>	<u>(2,647)</u>	<u>(272)</u>	<u>12,040</u>
<b>Interest Expense:</b>								
Savings, NOW & money								
market deposits.....	477	1,186	106	1,769	755	1,564	461	2,780
Time deposits.....	117	249	6	372	(419)	(495)	34	(880)
Short-term borrowings.....	385	288	376	1,049	7	102	4	113
Long-term debt.....	638	(112)	(9)	517	234	(751)	(23)	(540)
Total interest expense.....	<u>1,617</u>	<u>1,611</u>	<u>479</u>	<u>3,707</u>	<u>577</u>	<u>420</u>	<u>476</u>	<u>1,473</u>
Increase (decrease) in net								
interest income.....	<u>\$ 10,916</u>	<u>\$ (97)</u>	<u>\$ (494)</u>	<u>\$ 10,325</u>	<u>\$ 14,382</u>	<u>\$ (3,067)</u>	<u>\$ (748)</u>	<u>\$ 10,567</u>

(1) Represents the change not solely attributable to change in rate or change in volume but a combination of these two factors. The rate/volume variance could be allocated between the volume and rate variances shown in the table based on the absolute value of each to the total for both.

#### Net Interest Income – 2017 Versus 2016

Net interest income on a tax-equivalent basis was \$103.8 million in 2017, an increase of \$10.3 million, or 11.0%, over \$93.5 million in 2016. The increase is mainly attributable to growth in average interest-earning assets of \$335.6 million, or 10.4%, which was driven by an increase in the average balance of loans of \$393.9 million, or 16.7%. The growth in loans was funded mainly by growth in the average balances of noninterest bearing checking deposits of \$81.0 million, or 10.2%, interest-bearing deposits of \$140.8 million, or 7.8%, short-term borrowings of \$74.7 million and stockholders' equity of \$43.3 million, or 14.9%. Also funding the growth in loans was a decrease in the average balance of taxable investment securities of \$46.7 million, or 12.5%. Substantial contributors to the growth in deposits were new branch openings, the Bank's ongoing municipal deposit initiative and deposit promotions. Substantial contributors to the growth in stockholders' equity were net income, \$35.3 million of capital raised in an underwritten public offering in the first half of 2016 and an ongoing issuance of shares under the Corporation's DRIP. During 2017, shares issued under the DRIP added \$22.6 million to capital. These sources of capital were partially offset by the declaration of cash dividends which amounted to \$14.1 million.

Net interest income also benefitted from an improvement in the Bank's net interest margin. Net interest margin was 2.91% for 2017 as compared to 2.89% for 2016. The increase in net interest margin is attributable to higher portfolio yields on loans and taxable securities partially offset by higher rates on deposits and borrowings. The cost of deposits and borrowings has been driven up, by among other things, increases in the federal funds target rate. The current level of net interest margin reflects the low interest rate environment that has persisted for an extended period of time. Management anticipates that net interest margin may be difficult to maintain and could even decline and inhibit earnings growth.

#### Net Interest Income – 2016 Versus 2015

Net interest income on a tax-equivalent basis was \$93.5 million in 2016, an increase of \$10.6 million, or 12.7%, from \$82.9 million in 2015. The increase was primarily driven by growth in average interest-earning assets of \$431.2 million, or 15.4%, partially offset by a seven basis point decline in net interest margin. Average interest-earning assets grew mostly because of increases in the average balances of loans of \$373.4 million, or 18.8%, and securities of \$45.6 million, or 5.7%.

The growth in loans and securities was primarily funded by growth in the average balances of noninterest-bearing checking deposits of \$56.0 million, or 7.6%, interest-bearing deposits of \$319.1 million, or 21.6%, and stockholders' equity of \$47.5 million, or 19.5%. The increase in stockholders' equity was mostly attributable to retained net income and the sale of common stock through an



underwritten public offering completed in the second quarter of 2016 and to a lesser extent the ongoing issuance of shares under the DRIP.

The seven basis point decline in net interest margin was primarily a result of the low rate environment. In a low interest rate environment: (1) loans are sometimes originated and investments are sometimes made at yields lower than existing portfolio yields; (2) some loans prepay in full resulting in the immediate writeoff of deferred costs; (3) prepayment speeds on mortgage-backed securities can be elevated resulting in accelerated amortization of purchase premiums; (4) the benefit of no cost funding in the form of noninterest-bearing checking deposits and capital is suppressed; and (5) the Bank's ability to reduce deposit rates diminishes. The impact of these factors was partially offset in 2016 by increased prepayment activity accompanied by higher levels of prepayment penalty income.

### **Noninterest Income**

Noninterest income includes service charges on deposit accounts, Investment Management Division income, gains or losses on sales of securities, income on BOLI, and all other items of income, other than interest, resulting from the business activities of the Corporation.

Noninterest income before securities gains and losses increased \$1.2 million, or 15.8%, when comparing 2017 to 2016. The increase is primarily attributable to increases in income from BOLI of \$530,000, service charges on deposit accounts of \$126,000, checkbook income of \$116,000 and Investment Management Division income of \$90,000. Also contributing to the increase in noninterest income were refunds of sales taxes, real estate taxes and telecommunications charges of \$167,000. BOLI income increased largely because of \$25 million in BOLI purchased during the first quarter of 2017. The increase in service charges on deposit accounts is due to higher overdraft and maintenance and activity charges resulting from, among other things, growth in the number of deposit accounts. Growth in the number of deposit accounts and a reduction in fee waivers contributed to the increase in checkbook income. Investment Management Division income increased largely because equity market gains resulted in an increase in assets under management.

Noninterest income before securities gains increased \$77,000, or 1.0%, when comparing 2016 to 2015. The increase was primarily attributable to proceeds of BOLI that exceeded the cash surrender value by \$106,000, increases in service charges on deposit accounts of \$89,000, income from the sale of mutual funds and annuities of \$76,000 and cash value accretion on BOLI of \$52,000. These increases were partially offset by a decrease in real estate tax refunds and a sales tax refund of \$160,000 and \$91,000, respectively, in 2015.

### **Noninterest Expense**

Noninterest expense is comprised of salaries, employee benefits, occupancy and equipment expense and other operating expenses incurred in supporting the various business activities of the Corporation.

Noninterest expense before debt extinguishment costs increased \$3.2 million, or 6.3%, when comparing 2017 to 2016. The increase is primarily attributable to increases in salaries of \$2.0 million, or 9.2%, employee benefits expense of \$261,000, or 3.8%, occupancy and equipment expense of \$981,000, or 10.6%, and marketing expense of \$389,000. Also contributing to the increase was a valuation allowance of \$725,000 recorded in the fourth quarter of 2017 on other real estate owned. The impact of these items was partially offset by decreases in consulting fees of \$635,000, computer and telecommunications expense of \$743,000 and FDIC insurance expense of \$201,000. The increase in salaries is primarily due to new branch openings, additions to staff in the back office, higher stock-based compensation expense and normal annual salary adjustments. The increase in employee benefits expense resulted primarily from increases in group health insurance expense of \$260,000, incentive compensation expense of \$101,000 and payroll tax expense of \$88,000, partially offset by a decrease in retirement plan expense of \$257,000. The increase in group health insurance expense resulted from increases in staff count and the rates being charged by insurance carriers and the decrease in retirement plan expense resulted from an increase in the discount rate and the favorable performance of plan assets. The increase in occupancy and equipment expense is primarily due to the operating costs of new branches, a growth-related increase in depreciation on the Bank's facilities and equipment and the cost of servicing equipment. The increase in marketing expense is largely due to new branch and deposit account promotions. The decrease in consulting fees is mainly due to a charge of \$800,000 in the second quarter of 2016 for advisory services rendered in connection with renegotiating the Bank's data processing contract. The decrease in computer and telecommunications expense reflects the cost savings arising from this renegotiation. The decrease in FDIC insurance expense is attributable to a lower FDIC assessment rate effective July 1, 2016, partially offset by a growth-related increase in the assessment base.

Noninterest expense before debt extinguishment costs increased \$4.7 million, or 10.4%, when comparing 2016 to 2015. The increase was largely attributable to increases in salaries of \$1.4 million, or 6.9%, employee benefits expense of \$868,000, or 14.4%, consulting expense of \$761,000, occupancy and equipment expense of \$466,000, computer and telecommunications expense of \$419,000, marketing expense of \$175,000 and a partial writedown of \$168,000 on the Bank's investment in a trade association. The increase in salaries was primarily due to new branch openings, additions to staff in the back office, higher stock-based compensation expense and normal annual salary adjustments. The increase in employee benefits expense included a \$464,000 increase in group health insurance expense resulting from increases in staff count and the rates being charged by insurance carriers. Employee benefits expense also increased because pension expense was a credit of \$489,000 in 2015 versus a charge of \$17,000 in 2016. Pension expense increased largely because of an increase in the number of plan participants, a market driven increase in interest on the benefit obligation and the amortization of actuarial losses resulting from, among other things, the return on plan assets falling short of expectation in 2015. The increase in consulting expense was primarily attributable to a one-time charge of \$800,000 in the second quarter of 2016 for advisory services rendered in renegotiating the Bank's data processing contract. The increase in occupancy and equipment expense included the operating costs of new branches and a growth-related increase in depreciation on the Bank's facilities and equipment. The increase in computer and telecommunications expense was mainly attributable to a growth-related increase in telecommunications capacity and one-time expenses of approximately \$126,000 in the second quarter of 2016.

## **Income Taxes**

Income tax expense as a percentage of pre-tax book income ("effective tax rate") was 22.0%, 22.7% and 22.4% in 2017, 2016 and 2015, respectively. Among other things, the Corporation's effective tax rate reflects the tax benefits derived from the Bank's municipal securities portfolio, ownership of bank-owned life insurance and maintenance of a captive REIT.

**2017 Versus 2016.** The Corporation's effective tax rate decreased from 22.7% in 2016 to 22.0% in 2017. The decrease is almost entirely due to higher tax benefits in 2017 from stock awards and BOLI and a \$909,000 credit to income tax expense in 2017 resulting from a reduction in the Corporation's net deferred tax liability to reflect the recent changes in federal tax law. The impact of these items in reducing the effective tax rate was partially offset by higher state and local taxes and a decrease in tax-exempt interest on securities and loans. The vesting and exercise of stock awards resulted in tax benefits over and above those accrued during the vesting period of \$762,000 and \$385,000 in 2017 and 2016, respectively, resulting in a decrease in the effective tax rate of .8%. Higher tax benefits from BOLI resulted in a decrease in the effective tax rate of .3%. The credit to income tax expense from the reduction in the Corporation's net deferred tax liability decreased the effective tax rate by 2.0%. Higher state and local taxes increased the effective tax rate by 1.1% and occurred because for 2017 the Corporation is subject to NYS and NYC taxes based on capital rather than business income and did not record the potential NYS and NYC tax benefits of deductible temporary differences arising in 2017. The decrease in tax exempt interest on securities and loans increased the effective tax rate by 1.6%.

**2016 Versus 2015.** The Corporation's effective tax rate increased from 22.4% in 2015 to 22.7% in 2016. The increase was primarily attributable to a decline in the percentage of pre-tax book income represented by income on tax-exempt securities, loans and bank-owned life insurance, partially offset by additional funding of the Corporation's captive REIT and the \$385,000 credit to income tax expense from the adoption in 2016 of ASU 2016-09. Tax-exempt income as a percentage of pre-tax book income declined from 43.4% in 2015 to 36.7% in 2016 increasing the effective tax rate by 2.2%. Additional funding of the Corporation's captive REIT and the adoption of ASU 2016-09 reduced the effective tax rate by 1.2% and .9%, respectively.

## **Financial Condition**

Total assets were \$3.9 billion at December 31, 2017, an increase of \$384.4 million, or 11.0%, from the previous year-end. The increase was primarily attributable to growth in loans of \$404.9 million, or 15.9%, partially offset by a decline in available-for-sale securities of \$95.2 million, or 11.7%. The growth in loans helped to offset the negative impact of the low interest rate environment on net interest income.

Asset growth during 2017 was largely funded by the aforementioned decline in available-for-sale securities and growth in deposits, borrowings and stockholders' equity. Total deposits grew \$213.3 million, or 8.2%, to \$2.8 billion at December 31, 2017. The growth in deposits is comprised of increases in noninterest-bearing checking deposits of \$87.8 million, or 10.9%, savings, NOW and money market deposits of \$82.7 million, or 5.4%, and time deposits of \$42.8 million, or 15.2%. The growth in borrowings is comprised of increases in short-term borrowings of \$74.1 million and long-term debt of \$44.6 million. Substantial contributors to the growth in stockholders' equity were net income and the ongoing issuance of shares under the Corporation's stock-based compensation plan and DRIP, as partially offset by dividends declared.

**Investment Securities.** The following table presents the estimated fair value of available-for-sale securities and amortized cost of held-to-maturity securities at December 31, 2017, 2016 and 2015.

<i>(in thousands)</i>	2017	2016	2015
<b>Held-to-Maturity Securities:</b>			
State and municipals .....	\$ 6,970	\$ 10,419	\$ 12,922
Pass-through mortgage securities .....	311	361	576
Collateralized mortgage obligations .....	355	607	873
	<u>\$ 7,636</u>	<u>\$ 11,387</u>	<u>\$ 14,371</u>
<b>Available-for-Sale Securities:</b>			
State and municipals .....	\$ 461,323	\$ 450,660	\$ 435,693
Pass-through mortgage securities .....	71,391	185,809	147,265
Collateralized mortgage obligations .....	187,414	178,830	154,742
	<u>\$ 720,128</u>	<u>\$ 815,299</u>	<u>\$ 737,700</u>

The following table presents the maturities and weighted average tax equivalent yields of the Bank's investment securities at December 31, 2017.

<i>(dollars in thousands)</i>	Principal Maturing (1)							
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
<b>Held-to-Maturity Securities:</b>								
State and municipals .....	\$ 4,409	4.27%	\$ 2,311	6.33%	\$ 250	6.23%	\$ —	—%
Pass-through mortgage securities .....	—	—	68	6.39	—	—	243	5.09
Collateralized mortgage obligations .....	—	—	—	—	—	—	355	7.45
	<u>\$ 4,409</u>	<u>4.27%</u>	<u>\$ 2,379</u>	<u>6.33%</u>	<u>\$ 250</u>	<u>6.23%</u>	<u>\$ 598</u>	<u>6.49%</u>
<b>Available-for-Sale Securities: (2)</b>								
State and municipals .....	\$ 24,444	5.81%	\$ 95,566	4.78%	\$ 172,905	4.15%	\$ 168,408	4.57%
Pass-through mortgage securities .....	—	—	—	—	1,376	2.65	70,015	2.34
Collateralized mortgage obligations .....	—	—	—	—	—	—	187,414	2.35
	<u>\$ 24,444</u>	<u>5.81%</u>	<u>\$ 95,566</u>	<u>4.78%</u>	<u>\$ 174,281</u>	<u>4.14%</u>	<u>\$ 425,837</u>	<u>3.23%</u>

(1) Maturities shown are stated maturities, except in the case of municipal securities, which are shown at the earlier of their stated maturity or pre-refunded dates. Securities backed by mortgages, which include the pass-through mortgage securities and collateralized mortgage obligations shown above, are expected to have substantial periodic repayments resulting in weighted average lives considerably shorter than would be surmised from the above table.

(2) Yields on available-for-sale securities have been computed based on amortized cost.

During 2017, the Bank received cash dividends of \$1.6 million on its FRB and FHLB stock, representing an average yield of 5.44%.

**Loans.** The composition of the Bank's loan portfolio is set forth below.

<i>(in thousands)</i>	December 31,				
	2017	2016	2015	2014	2013
Commercial and industrial .....	\$ 109,623	\$ 126,038	\$ 93,056	\$ 77,140	\$ 71,818
Commercial mortgages:					
Multifamily .....	682,593	610,385	572,322	529,093	469,486
Other .....	414,783	371,142	348,909	222,537	162,874
Owner-occupied .....	95,631	103,671	115,100	107,345	83,651
Residential mortgages:					
Closed end .....	1,558,564	1,238,431	1,025,215	779,994	605,343
Revolving home equity .....	83,625	86,461	87,848	83,109	77,581
Consumer and other .....	5,533	9,293	5,733	5,601	7,184
	<u>2,950,352</u>	<u>2,545,421</u>	<u>2,248,183</u>	<u>1,804,819</u>	<u>1,477,937</u>
Allowance for loan losses .....	<u>(33,784)</u>	<u>(30,057)</u>	<u>(27,256)</u>	<u>(23,221)</u>	<u>(20,848)</u>
	<u>\$ 2,916,568</u>	<u>\$ 2,515,364</u>	<u>\$ 2,220,927</u>	<u>\$ 1,781,598</u>	<u>\$ 1,457,089</u>

Maturity and rate information for commercial and industrial loans outstanding at December 31, 2017 is set forth below.

<i>(in thousands)</i>	Maturity			
	Within One Year	After One But Within Five Years	After Five Years	Total
Commercial and industrial loans:				
Fixed rate .....	\$ 508	\$ 25,270	\$ 8,734	\$ 34,512
Variable rate .....	37,172	30,974	6,965	75,111
	<u>\$ 37,680</u>	<u>\$ 56,244</u>	<u>\$ 15,699</u>	<u>\$ 109,623</u>

**Asset Quality.** The Corporation has identified certain assets as risk elements. These assets include nonaccrual loans, other real estate owned, loans that are contractually past due 90 days or more as to principal or interest payments and still accruing and troubled debt restructurings. These assets present more than the normal risk that the Corporation will be unable to eventually collect or realize their full carrying value. Information about the Corporation's risk elements is set forth below.

<i>(dollars in thousands)</i>	December 31,				
	2017	2016	2015	2014	2013
Nonaccrual loans (includes loans held-for-sale):					
Troubled debt restructurings .....	\$ 100	\$ 788	\$ 900	\$ 1,280	\$ 2,548
Other .....	900	1,770	535	424	1,948
Total nonaccrual loans .....	1,000	2,558	1,435	1,704	4,496
Loans past due 90 days or more and still accruing .....	—	621	—	—	—
Other real estate owned .....	5,125	—	—	—	—
Total nonperforming assets .....	6,125	3,179	1,435	1,704	4,496
Troubled debt restructurings – performing .....	947	757	3,581	704	541
Total risk elements .....	<u>\$ 7,072</u>	<u>\$ 3,936</u>	<u>\$ 5,016</u>	<u>\$ 2,408</u>	<u>\$ 5,037</u>
Nonaccrual loans as a percentage of total loans.....	<u>.03%</u>	<u>.10%</u>	<u>.06%</u>	<u>.09%</u>	<u>.30%</u>
Nonperforming assets as a percentage of total loans and other real estate owned .....	<u>.21%</u>	<u>.12%</u>	<u>.06%</u>	<u>.09%</u>	<u>.30%</u>
Risk elements as a percentage of total loans and other real estate owned .....	<u>.24%</u>	<u>.15%</u>	<u>.22%</u>	<u>.13%</u>	<u>.34%</u>

The following table sets forth the gross interest income that would have been recorded under their original terms on nonaccrual loans and troubled debt restructurings and the actual amounts recorded for the years indicated.

<i>(in thousands)</i>	Year Ended December 31,				
	2017	2016	2015	2014	2013
Gross interest income on nonaccrual loans and troubled debt restructurings:					
Amount that would have been recorded during the year under original terms.....	\$ 101	\$ 153	\$ 276	\$ 127	\$ 311
Actual amount recorded during the year .....	66	82	171	33	60

The past due status of a loan is based on the contractual terms in the loan agreement. Unless a loan is well secured and in the process of collection, the accrual of interest income is discontinued when a loan becomes 90 days past due as to principal or interest payments. The accrual of interest income on a loan is also discontinued when it is determined that the borrower will not be able to make principal and interest payments according to the contractual terms of the current loan agreement. When the accrual of interest income is discontinued on a loan, any accrued but unpaid interest is reversed against current period income.

In addition to the Bank's past due, nonaccrual and restructured loans, the disclosure of other potential problem loans can be found in "Note C – Loans" to the Corporation's consolidated financial statements of this Form 10-K.

In 2017, the Bank took a deed-in-lieu of foreclosure for one commercial real estate property. The property is recorded as other real estate owned and has a carrying value of \$5.1 million at December 31, 2017, which is net of a valuation allowance of \$725,000. The Bank sold the property for its carrying value in the first quarter of 2018.

**Loan Risk Ratings.** Risk ratings of the Corporation's commercial and industrial loans and commercial real estate loans are set forth in the tables below. Risk ratings are defined in "Note C – Loans" to the Corporation's consolidated financial statements of this Form 10-K.

<i>(in thousands)</i>	December 31, 2017							Total
	Internally Assigned Risk Rating							
	Pass		5 - 6	Watch	Special Mention	Substandard		
1 - 2	3 - 4							
Commercial and industrial .....	\$ 5,633	\$ 5,594	\$ 97,619	\$ 450	\$ 279	\$ 48	\$ —	\$ 109,623
Commercial mortgages:								
Multifamily .....	—	35,429	637,699	2,354	7,111	—	—	682,593
Other .....	—	20,372	384,007	7,567	2,837	—	—	414,783
Owner-occupied .....	—	887	92,731	—	1,482	531	—	95,631
	<u>\$ 5,633</u>	<u>\$ 62,282</u>	<u>\$ 1,212,056</u>	<u>\$ 10,371</u>	<u>\$ 11,709</u>	<u>\$ 579</u>	<u>\$ —</u>	<u>\$ 1,302,630</u>
	December 31, 2016							
Commercial and industrial .....	\$ 1,993	\$ 3,733	\$ 119,371	\$ 810	\$ —	\$ 131	\$ —	\$ 126,038
Commercial mortgages:								
Multifamily .....	—	44,513	558,590	—	7,282	—	—	610,385
Other .....	—	12,770	356,970	1,402	—	—	—	371,142
Owner-occupied .....	621	2,408	99,696	389	—	557	—	103,671
	<u>\$ 2,614</u>	<u>\$ 63,424</u>	<u>\$ 1,134,627</u>	<u>\$ 2,601</u>	<u>\$ 7,282</u>	<u>\$ 688</u>	<u>\$ —</u>	<u>\$ 1,211,236</u>

Risk ratings of the Corporation's residential mortgage loans, home equity lines and other consumer loans are set forth in the tables below. Risk ratings are defined in "Note C – Loans" to the Corporation's consolidated financial statements of this Form 10-K.

<i>(in thousands)</i>	December 31, 2017							
	Internally Assigned Risk Rating							
	Pass			Watch	Special		Substandard	Doubtful
1	2	3	Mention					
Residential mortgages:								
Closed end.....	\$ 1,512,041	\$ 29,270	\$ 12,857	\$ 2,200	\$ 828	\$ 1,368	\$ —	\$ 1,558,564
Revolving home equity .....	79,084	2,112	1,469	256	704	—	—	83,625
Consumer and other .....	4,829	299	108	—	—	—	—	5,236
	<u>\$ 1,595,954</u>	<u>\$ 31,681</u>	<u>\$ 14,434</u>	<u>\$ 2,456</u>	<u>\$ 1,532</u>	<u>\$ 1,368</u>	<u>\$ —</u>	<u>\$ 1,647,425</u>
	December 31, 2016							
Residential mortgages:								
Closed end.....	\$ 1,170,479	\$ 50,978	\$ 14,695	\$ 982	\$ 441	\$ 856	\$ —	\$ 1,238,431
Revolving home equity .....	81,791	1,121	1,277	—	501	1,771	—	86,461
Consumer and other .....	8,476	47	91	—	—	—	—	8,614
	<u>\$ 1,260,746</u>	<u>\$ 52,146</u>	<u>\$ 16,063</u>	<u>\$ 982</u>	<u>\$ 942</u>	<u>\$ 2,627</u>	<u>\$ —</u>	<u>\$ 1,333,506</u>

Deposit account overdrafts are not assigned a risk rating and are therefore excluded from consumer loans in the above tables.

**Allowance and Provision for Loan Losses.** The allowance for loan losses increased by \$3.7 million during 2017, amounting to \$33.8 million, or 1.15% of total loans, at December 31, 2017, as compared to \$30.1 million, or 1.18% of total loans, at December 31, 2016. The decrease of three basis points in the reserve coverage ratio is primarily due to an improvement in the local housing market and in overall economic conditions and a decline in specific reserves.

During 2017, the Bank had loan chargeoffs and recoveries of \$1.1 million and \$19,000, respectively, and recorded a \$4.9 million provision for loan losses. The \$4.9 million provision for loan losses for 2017 was primarily attributable to loan growth and net chargeoffs, partially offset by an improvement in the local housing market and in overall economic conditions. The \$3.5 million provision for loan losses for 2016 was primarily attributable to loan growth and net chargeoffs, partially offset by a decrease in historical loss rates. Net chargeoffs were driven higher in 2017 by an \$820,000 chargeoff recorded on one commercial mortgage when the Bank took a deed-in-lieu of foreclosure. Other real estate owned at year-end 2017 consists solely of the property taken. The Bank sold this property for its carrying value of \$5.1 million in the first quarter of 2018.

The allowance for loan losses is an amount that management currently believes will be adequate to absorb probable incurred losses in the Bank's loan portfolio. As more fully discussed in the "Application of Critical Accounting Policies" section of this discussion and analysis of financial condition and results of operations, the process for estimating credit losses and determining the allowance for loan losses as of any balance sheet date is subjective in nature and requires material estimates. Actual results could differ significantly from those estimates. Other detailed information on the Bank's allowance for loan losses, impaired loans and the aging of loans can be found in "Note C – Loans" to the Corporation's consolidated financial statements of this Form 10-K.

The following table sets forth changes in the Bank's allowance for loan losses.

<i>(dollars in thousands)</i>	Year ended December 31,				
	2017	2016	2015	2014	2013
Balance, beginning of year .....	\$ 30,057	\$ 27,256	\$ 23,221	\$ 20,848	\$ 18,624
Loans charged off:					
Commercial and industrial .....	102	445	166	96	—
Commercial mortgages:					
Multifamily.....	—	—	91	—	—
Other.....	—	—	1	37	—
Owner-occupied .....	820	—	—	400	—
Residential mortgages:					
Closed end.....	97	259	7	121	914
Revolving home equity .....	100	—	67	173	—
Consumer and other .....	27	5	37	7	18
	<u>1,146</u>	<u>709</u>	<u>369</u>	<u>834</u>	<u>932</u>
Recoveries of loans charged off:					
Commercial and industrial .....	13	4	7	2	19
Commercial mortgages:					
Multifamily.....	—	—	27	—	—
Other.....	—	—	39	—	113
Residential mortgages:					
Closed end.....	3	9	9	3	13
Revolving home equity .....	—	12	5	4	—
Consumer and other .....	3	5	—	9	14
	<u>19</u>	<u>30</u>	<u>87</u>	<u>18</u>	<u>159</u>
Net chargeoffs.....	1,127	679	282	816	773
Provision for loan losses .....	4,854	3,480	4,317	3,189	2,997
Balance, end of year.....	<u>\$ 33,784</u>	<u>\$ 30,057</u>	<u>\$ 27,256</u>	<u>\$ 23,221</u>	<u>\$ 20,848</u>
Ratio of net chargeoffs to average loans outstanding.....	<u>.04%</u>	<u>.03%</u>	<u>.01%</u>	<u>.05%</u>	<u>.06%</u>

The following table sets forth the allocation of the Bank's total allowance for loan losses by loan type.

<i>(dollars in thousands)</i>	December 31,									
	2017		2016		2015		2014		2013	
	Amount	% of Loans to Total	Amount	% of Loans to Total	Amount	% of Loans to Total	Amount	% of Loans to Total	Amount	% of Loans to Total
Commercial and industrial.....	\$ 1,441	3.7%	\$ 1,408	4.9%	\$ 928	4.1%	\$ 838	4.3%	\$ 808	4.9%
Commercial mortgages:										
Multifamily .....	6,423	23.2	6,119	24.0	6,858	25.5	7,207	29.3	7,348	31.8
Other .....	4,734	14.1	4,296	14.6	3,674	15.5	2,340	12.3	1,501	11.0
Owner-occupied.....	1,076	3.2	959	4.1	1,047	5.1	1,023	6.0	1,191	5.7
Residential mortgages:										
Closed end.....	19,347	52.8	15,740	48.6	13,639	45.6	10,599	43.2	8,607	40.9
Revolving home equity .....	689	2.8	1,401	3.4	1,016	3.9	1,121	4.6	1,240	5.2
Consumer and other .....	74	.2	134	.4	94	.3	93	.3	153	.5
	<u>\$ 33,784</u>	<u>100.0%</u>	<u>\$ 30,057</u>	<u>100.0%</u>	<u>\$ 27,256</u>	<u>100.0%</u>	<u>\$ 23,221</u>	<u>100.0%</u>	<u>\$ 20,848</u>	<u>100.0%</u>

The amount of future chargeoffs and provisions for loan losses will be affected by, among other things, economic conditions on Long Island and in New York City. Such conditions could affect the financial strength of the Bank's borrowers and will affect the value of real estate collateral securing the Bank's mortgage loans. Loans secured by real estate represent approximately 96% of the Bank's total loans outstanding at December 31, 2017. Most of these loans were made to borrowers domiciled on Long Island and in the boroughs of New York City. Although economic conditions are showing signs of improvement, they have been sluggish for an extended period of time. These conditions have caused some of the Bank's borrowers to be unable to make the required contractual

payments on their loans and could cause the Bank to be unable to realize the full carrying value of such loans through foreclosure or other collection efforts.

Future provisions and chargeoffs could also be affected by environmental impairment of properties securing the Bank's mortgage loans. At the present time, management is not aware of any environmental pollution originating on or near properties securing the Bank's loans that would materially affect the carrying value of such loans.

**Deposits and Other Borrowings.** Total deposits grew \$213.3 million, or 8.2%, to \$2.8 billion at December 31, 2017. The increase was attributable to growth in noninterest-bearing checking deposits of \$87.8 million, or 10.9%, savings, NOW and money market deposits of \$82.7 million, or 5.4% and time deposits of \$42.8 million, or 15.2%. The largest segment of the deposit base is savings, NOW and money market deposits, which represent 56.8% of total deposits at December 31, 2017.

The remaining maturities of the Bank's time deposits at December 31, 2017 can be found in "Note E – Deposits" to the Corporation's December 31, 2017 consolidated financial statements.

Borrowings include short-term and long-term FHLB borrowings and borrowings under repurchase agreements. Total borrowings increased \$118.7 million during 2017 to \$704.9 million at year-end. The increase is comprised of increases in short-term borrowings of \$74.1 million and long-term debt of \$44.6 million. Short-term borrowings are used to, among other things, offset the seasonal outflow of deposits. The increase in long-term debt includes new fixed rate long-term FHLB borrowings of \$71.6 million, partially offset by maturities of \$27.0 million.

**Deleveraging Transactions.** During the first quarter of 2017, the Bank executed a deleveraging transaction. This transaction involved the sale of approximately \$40 million of mortgage-backed securities at a gain of \$57,000 and use of the resulting proceeds to pay down short-term borrowings. During the second quarter of 2016, the Bank executed a deleveraging transaction. That transaction involved the sale of \$40.3 million of mortgage-backed securities at a gain of \$1,795,000 and the prepayment of \$30 million of long-term debt at a cost of \$1,756,000. The Bank completed a similar deleveraging transaction in the second quarter of 2015. The 2015 transaction involved the sale of \$61.8 million of mortgage-backed securities at a gain of \$995,000 and utilization of the resulting proceeds to prepay \$63.5 million of long-term debt at a cost of \$1.1 million. These deleveraging transactions were undertaken to eliminate inefficient leverage and accrete Tier 1 leverage capital.

**Capital.** Stockholders' equity totaled \$354.5 million at December 31, 2017, an increase of \$48.6 million from \$305.8 million at December 31, 2016. The increase was primarily attributable to net income of \$35.1 million and the issuance of shares under the Corporation's stock-based compensation and DRIP of \$23.6 million, partially offset by cash dividends declared of \$14.1.

During 2017, the Corporation's Board of Directors increased the amount of stock that an individual can purchase on a quarterly basis under the stock purchase component of the DRIP from \$50,000 to \$75,000. This change is providing additional capital that is being used to accommodate balance sheet growth. During 2017, shares issued under the Plan added \$22.6 million to capital.

The ratio of average stockholders' equity to average total assets increased to 9.04% for 2017 from 8.73% for 2016. The increase occurred because the growth rate in average stockholders' equity of 14.9% during 2017, primarily due to retained net income and the previously discussed issuance of shares under the DRIP, exceeded the 11.0% growth rate in average assets. The Corporation had returns on average equity of 10.51%, 10.62% and 10.64% and returns on average assets of .95%, .93% and .89%, for the years ended December 31, 2017, 2016 and 2015, respectively. Book value per share increased 11.4% during 2017 to \$14.37 at December 31, 2017. Book value per share was \$12.90 and \$11.85 at December 31, 2016 and 2015, respectively.

The Corporation's capital management policy is designed to build and maintain capital levels that exceed regulatory standards and appropriately provide for growth. The Basel III regulatory capital ratios of the Corporation and the Bank as of December 31, 2017 are set forth in the table below. The Corporation and the Bank exceeded the Basel III minimum capital adequacy requirements, including the capital conservation buffer of 1.25% applicable to the Bank for 2017, and the Bank was well capitalized under the PCA provisions at December 31, 2017.

	<u>Corporation</u>	<u>Bank</u>
Tier 1 leverage .....	9.34%	9.34%
Common Equity Tier 1 risk-based .....	15.28%	15.29%
Tier 1 risk-based .....	15.28%	15.29%
Total risk-based.....	16.54%	16.54%

The Corporation and the Bank implemented the Basel III regulatory capital standards issued by the Federal Reserve Board and the OCC. Basel III includes guidelines with respect to the calculation of risk weighted assets for both on and off-balance-sheet positions. The Corporation and the Bank made a one-time election upon implementation of Basel III on January 1, 2015 to exclude accumulated other comprehensive income ("AOCI") components from regulatory capital.



## Cash Flows and Liquidity

**Cash Flows.** During 2017, the Corporation's cash and cash equivalent position increased by \$32.7 million, from \$36.9 million at December 31, 2016 to \$69.7 million at December 31, 2017. The increase occurred primarily because cash provided by the growth in deposits and borrowings, paydowns and sales of securities, paydowns of loans, common stock issued under the DRIP and operations exceeded cash used to originate loans, purchase investment securities and BOLI and pay cash dividends.

**Liquidity.** The Bank has a board committee approved liquidity policy and liquidity contingency plan, which are intended to ensure that the Bank has sufficient liquidity at all times to meet the ongoing needs of its customers in terms of credit and deposit outflows, take advantage of earnings enhancement opportunities and respond to liquidity stress conditions should they arise.

At December 31, 2017, the Bank had approximately \$297 million of unencumbered available-for-sale securities. In addition, based on securities and loan collateral in place at the FRB of New York and FHLB of New York, the Bank had borrowing capacity of approximately \$1.3 billion at December 31, 2017.

## Off-Balance-Sheet Arrangements and Contractual Obligations

The Corporation's off-balance-sheet arrangements and contractual obligations at December 31, 2017 are summarized in the table that follows. Since some of the commitments to extend credit and letters of credit are expected to expire without being drawn upon and, with respect to unused home equity, small business credit scored and certain other lines, can be frozen, reduced or terminated by the Bank based on the financial condition of the borrower, the total commitment amounts shown in the table do not necessarily represent future cash requirements. The amounts shown for long-term debt and time deposits are based on the contractual maturities and do not include interest payments. Repurchase agreements can be terminated by the Bank prior to contractual maturity (see "Note F – Borrowed Funds" to the Corporation's December 31, 2017 consolidated financial statements for more information regarding repurchase agreements). The Corporation believes that its current sources of liquidity are more than sufficient to fulfill the obligations it has at December 31, 2017 pursuant to off-balance-sheet arrangements and contractual obligations.

	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		One Year or Less	Over One Year Through Three Years	Over Three Years Through Five Years	Over Five Years
<i>(in thousands)</i>					
Commitments to extend credit .....	\$ 318,020	\$ 195,901	\$ 46,656	\$ 10,932	\$ 64,531
Standby letters of credit .....	4,244	3,821	423	—	—
Long-term debt .....	423,797	101,450	156,250	130,097	36,000
Operating lease obligations .....	21,120	2,763	5,364	4,947	8,046
Purchase obligations .....	11,731	2,080	3,580	3,933	2,138
Time deposits .....	323,408	75,626	110,144	91,049	46,589
	<u>\$ 1,102,320</u>	<u>\$ 381,641</u>	<u>\$ 322,417</u>	<u>\$ 240,958</u>	<u>\$ 157,304</u>

Commitments to extend credit and letters of credit arise in the normal course of the Bank's business of meeting the financing needs of its customers and involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to financial instruments for commitments to extend credit and letters of credit is represented by the contractual notional amount of these instruments. The Bank uses the same credit policies in making commitments to extend credit, and generally uses the same credit policies for letters of credit, as it does for on-balance sheet instruments such as loans.

The purchase obligations shown in the preceding table are pursuant to contracts that the Bank has with providers of data processing services.

## **Impact of Inflation and Changing Prices**

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with accounting principles generally accepted in the United States, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The primary effect of inflation on the operations of the Corporation is reflected in increased operating costs. Unlike industrial companies, most of the assets and liabilities of a financial institution are monetary in nature. As a result, changes in interest rates generally have a more significant effect on the performance of a financial institution than do the effects of changes in the general rate of inflation and changes in prices. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Interest rates are highly sensitive to many factors, which are beyond the control of the Corporation, including the influence of domestic and foreign economic conditions and the monetary and fiscal policies of the United States government and federal agencies, particularly the Federal Reserve Board, and foreign governments.

## **Impact of Issued But Not Yet Effective Accounting Standards**

For a discussion regarding the impact of issued but not yet effective accounting standards, see Note A to the Consolidated Financial Statements included in Item 8 of this Form 10-K.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Bank invests in interest-earning assets, which are funded by interest-bearing deposits and borrowings, noninterest-bearing deposits and capital. The Bank's results of operations are subject to risk resulting from interest rate fluctuations generally and having assets and liabilities that have different maturity, repricing, and prepayment/withdrawal characteristics. The Bank defines interest rate risk as the risk that the Bank's net interest income and/or economic value of equity will change when interest rates change. The principal objective of the Bank's asset liability management activities is to optimize current and future net interest income while at the same time maintain acceptable levels of interest rate and liquidity risk and facilitate the funding needs of the Bank.

The Bank monitors and manages interest rate risk through a variety of techniques including traditional gap analysis and the use of interest rate sensitivity models. Both gap analysis and interest rate sensitivity modeling involve a variety of significant estimates and assumptions and are done at a specific point in time. Changes in the estimates and assumptions made in gap analysis and interest rate sensitivity modeling could have a significant impact on projected results and conclusions. Therefore, these techniques may not accurately reflect the actual impact of changes in the interest rate environment on the Bank's net interest income or EVE.

**Gap Analysis.** Traditional gap analysis involves arranging the Bank's interest-earning assets and interest-bearing liabilities by repricing periods and then computing the difference, or interest-rate sensitivity gap, between the assets and liabilities which are estimated to reprice during each time period and cumulatively through the end of each time period. Gap analysis requires estimates as to when individual categories of interest-sensitive assets and liabilities will reprice and assumes that assets and liabilities assigned to the same repricing period will reprice at the same time and in the same amount. Among other things, gap analysis does not fully take into account the fact that the repricing of some assets and liabilities is discretionary and subject to competitive and other pressures.

The table that follows summarizes the Corporation's cumulative interest rate sensitivity gap at December 31, 2017, based upon significant estimates and assumptions that the Corporation believes to be reasonable. The table arranges interest-earning assets and interest-bearing liabilities according to the period in which they contractually mature or, if earlier, are estimated to repay or reprice. Repayment and repricing estimates are based on internal data, market data and management's assumptions about factors that are inherently uncertain. These factors include, among others, prepayment speeds, changes in market interest rates and the Bank's response thereto, early withdrawal of deposits and competition. The balances of non-maturity deposit products have been included in categories beyond three months in the table because management believes, based on past experience and its knowledge of current competitive pressures, that the repricing of these products will lag market changes in interest rates to varying degrees.

	Repricing Period							Total
	Three Months or Less	Over Three Months Through Six Months	Over Six Months Through One Year	Total Within One Year	Over One Year Through Five Years	Over Five Years	Non-Interest-Sensitive	
<i>(in thousands)</i>								
<b>Assets:</b>								
Investment securities.....	\$ 18,235	\$ 21,239	\$ 34,394	\$ 73,868	\$ 208,633	\$ 441,007	\$ 4,256	\$ 727,764
Loans.....	211,086	47,077	125,704	383,867	1,152,127	1,413,358	(32,784)	2,916,568
Other assets.....	37,659	—	59,872	97,531	—	—	152,845	250,376
	<u>266,980</u>	<u>68,316</u>	<u>219,970</u>	<u>555,266</u>	<u>1,360,760</u>	<u>1,854,365</u>	<u>124,317</u>	<u>3,894,708</u>
<b>Liabilities &amp; Stockholders' Equity:</b>								
Checking deposits.....	—	—	—	—	—	—	896,129	896,129
Savings, NOW and money market deposits.....	291,423	94,701	189,399	575,523	845,649	181,288	—	1,602,460
Time deposits, \$100,000 and over.....	17,190	3,488	26,976	47,654	129,915	26,321	—	203,890
Time deposits, other.....	12,487	4,976	10,509	27,972	71,278	20,268	—	119,518
Borrowed funds.....	307,591	22,500	52,500	382,591	286,347	36,000	—	704,938
Other liabilities.....	—	—	—	—	—	—	13,323	13,323
Stockholders' equity.....	—	—	—	—	—	—	354,450	354,450
	<u>628,691</u>	<u>125,665</u>	<u>279,384</u>	<u>1,033,740</u>	<u>1,333,189</u>	<u>263,877</u>	<u>1,263,902</u>	<u>3,894,708</u>
Interest-rate sensitivity gap.....	<u>\$(361,711)</u>	<u>\$(57,349)</u>	<u>\$(59,414)</u>	<u>\$(478,474)</u>	<u>\$ 27,571</u>	<u>\$1,590,488</u>	<u>\$(1,139,585)</u>	<u>\$ —</u>
Cumulative interest-rate sensitivity gap.....	<u>\$(361,711)</u>	<u>\$(419,060)</u>	<u>\$(478,474)</u>	<u>\$(478,474)</u>	<u>\$(450,903)</u>	<u>\$1,139,585</u>	<u>\$ —</u>	<u>\$ —</u>

As shown in the preceding table, the Bank has a larger volume of interest-bearing deposit accounts and borrowings than interest-earning assets that are subject to repricing in a one-year time frame. Net interest income in the near-term could be negatively impacted if the rates paid on the Bank's deposit accounts and short-term borrowings are increased at the same time and in an amount equal to or greater than the increases in the rates earned on the Bank's interest-earning assets. Conversely, an increase in short-term interest rates could positively impact the Bank's net interest income in the near-term if increases in the rates paid on the Bank's deposit accounts lag and occur in lesser amounts than increases in the rates earned on the Bank's interest-earning assets.

**Interest Rate Sensitivity Modeling.** Through use of interest rate sensitivity modeling, the Bank first projects net interest income over a five-year time period assuming a static balance sheet and no changes in interest rates from current levels. Utilization of a static balance sheet ensures that interest rate risk embedded in the Bank's current balance sheet is not masked by assumed balance sheet growth or contraction. Net interest income is then projected over a five-year time period utilizing: (1) a static balance sheet and various interest rate change scenarios, including both ramped and shock changes and changes in the shape of the yield curve; and (2) a most likely balance sheet growth scenario and these same interest rate change scenarios. The interest rate scenarios modeled are based on, among other things, the shape of the current yield curve and the relative level of rates and management's expectations as to potential future yield curve shapes and rate levels.

The Bank also uses interest rate sensitivity modeling to calculate EVE in the current rate environment assuming shock increases and decreases in interest rates. EVE is the difference between the present value of expected future cash flows from the Bank's assets and the present value of the expected future cash flows from the Bank's liabilities. Present values are determined using discount rates that management believes are reflective of current market conditions. EVE can capture long-term interest rate risk that would not be captured in a five-year projection of net interest income.

In utilizing interest rate sensitivity modeling to project net interest income and calculate EVE, management makes a variety of estimates and assumptions which include, among others, the following: (1) how much and when yields and costs on individual categories of interest-earning assets and interest-bearing liabilities will change in response to projected changes in market interest rates; (2) future cash flows, including prepayments of mortgage assets and calls of municipal securities; (3) cash flow reinvestment assumptions; (4) appropriate discount rates to be applied to loan, deposit and borrowing cash flows; and (5) decay or runoff rates for nonmaturity deposits such as checking, savings, NOW and money market accounts. The repricing of loans and borrowings and the reinvestment of loan and security cash flows are generally assumed to be impacted by the full amount of each assumed rate change, while the repricing of nonmaturity deposits is not. For nonmaturity deposits, management makes estimates of how much and when it will need to change the rates paid on the Bank's various deposit products in response to changes in general market interest rates. These estimates are based on, among other things, product type, management's experience with needed deposit rate adjustments in prior interest rate change cycles, the results of a nonmaturity deposit study conducted by an independent consultant and management's assessment of competitive conditions in its marketplace.

The information provided in the following table is based on a variety of estimates and assumptions that management believes to be reasonable, the more significant of which are set forth hereinafter. The base case information in the table shows (1) a calculation of the Corporation's EVE at December 31, 2017 arrived at by discounting estimated future cash flows at rates that management believes are reflective of current market conditions and (2) an estimate of net interest income for the year ending December 31, 2018 assuming a static balance sheet, the adjustment of repricing balances to current rate levels, and the reinvestment at current rate levels of cash flows from maturing assets and liabilities in a mix of assets and liabilities that mirrors the Bank's strategic plan. In addition, in calculating EVE, cash flows for nonmaturity deposits are derived using a base case average life by product as determined by a nonmaturity deposit study and the current mix of deposits.

The rate change information in the table shows estimates of net interest income for the year ending December 31, 2018 and calculations of EVE at December 31, 2017 assuming rate changes of plus 100, 200 and 300 basis points and minus 100 basis points. The rate change scenarios were selected based on, among other things, the relative level of current interest rates and are: (1) assumed to be shock or immediate changes, (2) occur uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities, and (3) impact the repricing and reinvestment of all assets and liabilities, except nonmaturity deposits, by the full amount of the rate change. In projecting future net interest income under the indicated rate change scenarios, activity is simulated by assuming that cash flows from maturing assets and liabilities are reinvested in a mix of assets and liabilities that mirrors the Bank's strategic plan. The changes in EVE from the base case have not been tax effected.

Rate Change Scenario ( <i>dollars in thousands</i> )	Economic Value of Equity at December 31, 2017		Net Interest Income for 2018	
	Amount	Percent Change From Base Case	Amount	Percent Change From Base Case
		Case		Case
+ 300 basis point rate shock.....	\$ 311,418	-27.0%	\$ 85,729	-15.1%
+ 200 basis point rate shock.....	386,626	-9.4%	92,120	-8.7%
+ 100 basis point rate shock.....	412,460	-3.4%	96,761	-4.1%
Base case (no rate change).....	426,825	—	100,933	—
- 100 basis point rate shock.....	407,155	-4.6%	103,398	2.4%

As shown in the preceding table, assuming a static balance sheet, an immediate increase in interest rates of 100, 200 or 300 basis points could negatively impact the Bank's net interest income for the year ended December 31, 2018 because, among other things, the Bank would need to pay more for overnight borrowings and it is assumed the Bank would need to increase the rates paid on its nonmaturity deposits in order to remain competitive. Conversely, an immediate decrease in interest rates of 100 basis points could positively impact the Bank's net interest income for the same time period because, among other things, the Bank would immediately pay less for overnight borrowings and be able to reduce deposit rates. Changes in management's estimates as to the rates that will need to be paid on nonmaturity deposits could have a significant impact on the net interest income amounts shown for each scenario in the table.

### Forward-Looking Statements

This report on Form 10-K and the documents incorporated into it by reference contain or may contain various forward-looking statements. These forward-looking statements include statements of goals; intentions and expectations; estimates of risks and of future costs and benefits; assessments of probable loan losses; assessments of market risk; and statements of the ability to achieve financial and other goals. Forward-looking statements are typically identified by words such as "would," "should," "could," "believe," "expect," "anticipate," "intend," "outlook," "estimate," "forecast," "project" and other similar words and expressions. Forward-looking statements are subject to numerous assumptions, risks and uncertainties which may change over time. Forward-looking statements speak only as of the date they are made. We do not assume any duty and do not undertake to update our forward-

looking statements. Because forward-looking statements are subject to assumptions and uncertainties, actual results or future events could differ, possibly materially, from those that we anticipated in our forward-looking statements and future results could differ materially from historical performance.

Our forward-looking statements are subject to the following principal risks and uncertainties: general economic conditions and trends, either nationally or locally; conditions in the securities markets; fluctuations in the trading price of our common stock; changes in interest rates; changes in deposit flows and in the demand for deposit and loan products and other financial services; changes in real estate values; changes in the quality or composition of our loan or investment portfolios; changes in competitive pressures among financial institutions or from non-financial institutions; our ability to retain key members of management; changes in legislation, regulation, and policies; and a variety of other matters which, by their nature, are subject to significant uncertainties. We provide greater detail regarding some of these factors in Item 1A, "Risk Factors" included in this report. Our forward-looking statements may also be subject to other risks and uncertainties, including those that we may discuss elsewhere in other documents we file with the SEC from time to time.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### CONSOLIDATED BALANCE SHEETS

December 31 (in thousands)	2017	2016
<b>Assets:</b>		
Cash and cash equivalents.....	\$ 69,672	\$ 36,929
Investment securities:		
Held-to-maturity, at amortized cost (fair value of \$7,749 and \$11,637).....	7,636	11,387
Available-for-sale, at fair value .....	720,128	815,299
	<u>727,764</u>	<u>826,686</u>
Loans:		
Commercial and industrial.....	109,623	126,038
Secured by real estate:		
Commercial mortgages.....	1,193,007	1,085,198
Residential mortgages .....	1,558,564	1,238,431
Home equity lines.....	83,625	86,461
Consumer and other .....	5,533	9,293
	<u>2,950,352</u>	<u>2,545,421</u>
Allowance for loan losses .....	(33,784)	(30,057)
	<u>2,916,568</u>	<u>2,515,364</u>
Restricted stock, at cost.....	37,314	31,763
Bank premises and equipment, net.....	39,648	34,361
Bank-owned life insurance.....	59,665	33,097
Pension plan assets, net.....	19,152	17,316
Other assets .....	24,925	14,804
	<u>\$ 3,894,708</u>	<u>\$ 3,510,320</u>
<b>Liabilities:</b>		
Deposits:		
Checking.....	\$ 896,129	\$ 808,311
Savings, NOW and money market.....	1,602,460	1,519,749
Time, \$100,000 and over .....	203,890	178,918
Time, other .....	119,518	101,739
	<u>2,821,997</u>	<u>2,608,717</u>
Short-term borrowings .....	281,141	207,012
Long-term debt.....	423,797	379,212
Accrued expenses and other liabilities .....	10,942	9,481
Deferred income taxes payable .....	2,381	68
	<u>3,540,258</u>	<u>3,204,490</u>
<b>Commitments and Contingent Liabilities (Note L)</b>		
<b>Stockholders' Equity:</b>		
Common stock, par value \$.10 per share:		
Authorized, 40,000,000 shares;		
Issued and outstanding, 24,668,390 and 23,699,107 shares .....	2,467	2,370
Surplus .....	127,122	101,738
Retained earnings .....	224,315	203,326
	<u>353,904</u>	<u>307,434</u>
Accumulated other comprehensive income (loss), net of tax.....	546	(1,604)
	<u>354,450</u>	<u>305,830</u>
	<u>\$ 3,894,708</u>	<u>\$ 3,510,320</u>

See notes to consolidated financial statements

## CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 (dollars in thousands, except per share data)	2017	2016	2015
<b>Interest and dividend income:</b>			
Loans .....	\$ 97,027	\$ 82,456	\$ 70,558
Investment securities:			
Taxable .....	7,754	7,981	7,991
Nontaxable .....	13,484	13,686	13,586
	<u>118,265</u>	<u>104,123</u>	<u>92,135</u>
<b>Interest expense:</b>			
Savings, NOW and money market deposits .....	7,113	5,344	2,564
Time deposits .....	5,479	5,107	5,987
Short-term borrowings .....	1,345	296	183
Long-term debt.....	7,772	7,255	7,795
	<u>21,709</u>	<u>18,002</u>	<u>16,529</u>
Net interest income .....	96,556	86,121	75,606
<b>Provision for loan losses</b> .....	4,854	3,480	4,317
Net interest income after provision for loan losses .....	<u>91,702</u>	<u>82,641</u>	<u>71,289</u>
<b>Noninterest income:</b>			
Investment Management Division income.....	2,090	2,000	2,044
Service charges on deposit accounts .....	2,792	2,666	2,577
Net gains (losses) on sales of securities .....	(1,866)	1,868	1,324
Other .....	3,813	2,845	2,813
	<u>6,829</u>	<u>9,379</u>	<u>8,758</u>
<b>Noninterest expense:</b>			
Salaries.....	24,159	22,116	20,680
Employee benefits .....	7,150	6,889	6,021
Occupancy and equipment .....	10,245	9,264	8,798
Debt extinguishment .....	—	1,756	1,084
Other .....	11,966	12,066	10,108
	<u>53,520</u>	<u>52,091</u>	<u>46,691</u>
Income before income taxes .....	45,011	39,929	33,356
<b>Income tax expense</b> .....	9,889	9,049	7,466
<b>Net income</b> .....	<u>\$ 35,122</u>	<u>\$ 30,880</u>	<u>\$ 25,890</u>
<b>Earnings per share:</b>			
Basic.....	<u>\$1.44</u>	<u>\$1.35</u>	<u>\$1.23</u>
Diluted .....	<u>\$1.43</u>	<u>\$1.34</u>	<u>\$1.22</u>
<b>Cash dividends declared per share</b> .....	<u>\$ .58</u>	<u>\$ .55</u>	<u>\$ .52</u>

See notes to consolidated financial statements

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Year Ended December 31 (in thousands)	2017	2016	2015
<b>Net income</b> .....	<b>\$ 35,122</b>	<b>\$ 30,880</b>	<b>\$ 25,890</b>
<b>Other comprehensive income (loss):</b>			
Change in net unrealized holding gains on available-for-sale securities.....	1,631	(17,004)	(3,034)
Change in funded status of pension plan.....	1,718	1,443	(2,573)
Other comprehensive income (loss) before income taxes .....	3,349	(15,561)	(5,607)
<b>Income tax expense (benefit)</b> .....	<b>1,199</b>	<b>(6,433)</b>	<b>(2,346)</b>
<b>Other comprehensive income (loss)</b> .....	<b>2,150</b>	<b>(9,128)</b>	<b>(3,261)</b>
<b>Comprehensive income</b> .....	<b>\$ 37,272</b>	<b>\$ 21,752</b>	<b>\$ 22,629</b>

*See notes to consolidated financial statements*



## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)	Common Stock		Surplus	Retained Earnings	Accumulated Other Comprehensive	Total
	Shares	Amount			Income (Loss)	
Balance, January 1, 2015 .....	13,887,134	\$ 1,389	\$ 51,009	\$ 170,120	\$ 10,785	\$ 233,303
Net income .....				25,890		25,890
Other comprehensive loss .....					(3,261)	(3,261)
Shares withheld upon the vesting and conversion of RSUs.....	(12,227)	(1)	(286)			(287)
Common stock issued under stock compensation plans, including tax benefit .....	88,981	9	1,034			1,043
Common stock issued under dividend reinvestment and stock purchase plan.....	152,789	15	3,855			3,870
Stock-based compensation .....			1,319			1,319
Cash dividends declared.....				(10,941)		(10,941)
Balance, December 31, 2015 .....	14,116,677	1,412	56,931	185,069	7,524	250,936
Net income .....				30,880		30,880
Other comprehensive loss .....					(9,128)	(9,128)
Common stock issued in public offering, net of issuance costs .....	1,300,000	130	35,140			35,270
Shares withheld upon the vesting and conversion of RSUs.....	(13,393)	(1)	(369)			(370)
Common stock issued under stock compensation plans .....	109,409	11	895			906
Common stock issued under dividend reinvestment and stock purchase plan.....	287,498	28	8,414			8,442
3-for-2 stock split .....	7,898,916	790	(790)			—
Stock-based compensation .....			1,517			1,517
Cash dividends declared.....				(12,623)		(12,623)
Balance, December 31, 2016 .....	<b>23,699,107</b>	<b>2,370</b>	<b>101,738</b>	<b>203,326</b>	<b>(1,604)</b>	<b>305,830</b>
Net income .....				35,122		35,122
Other comprehensive income.....					2,150	2,150
Shares withheld upon the vesting and conversion of RSUs.....	(19,339)	(2)	(525)			(527)
Common stock issued under stock compensation plans .....	164,720	17	959			976
Common stock issued under dividend reinvestment and stock purchase plan.....	823,902	82	22,516			22,598
Stock-based compensation .....			2,434			2,434
Cash dividends declared.....				(14,133)		(14,133)
Balance, December 31, 2017 .....	<b>24,668,390</b>	<b>\$ 2,467</b>	<b>\$ 127,122</b>	<b>\$ 224,315</b>	<b>\$ 546</b>	<b>\$ 354,450</b>

*See notes to consolidated financial statements*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31 (in thousands)	2017	2016	2015
<b>Cash Flows From Operating Activities:</b>			
Net income .....	\$ 35,122	\$ 30,880	\$ 25,890
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses .....	4,854	3,480	4,317
Provision (credit) for deferred income taxes .....	1,114	1,233	(881)
Provision for losses on other real estate owned .....	725	—	—
Depreciation and amortization .....	3,604	3,219	3,013
Premium amortization on investment securities, net .....	3,045	4,002	4,632
Net losses (gains) on sales of securities .....	1,866	(1,868)	(1,324)
Loss on debt extinguishment .....	—	1,756	1,084
Stock-based compensation expense .....	2,434	1,517	1,319
Common stock issued in lieu of cash for director fees .....	59	—	—
Accretion of cash surrender value on bank-owned life insurance .....	(1,568)	(932)	(879)
Pension expense (credit) less contribution .....	(118)	(1,536)	(489)
(Increase) decrease in other assets and other .....	(4,996)	(2,849)	107
Increase (decrease) in accrued expenses and other liabilities .....	1,031	(3,313)	(1,117)
Net cash provided by operating activities .....	<u>47,172</u>	<u>35,589</u>	<u>35,672</u>
<b>Cash Flows From Investing Activities:</b>			
Proceeds from sales of investment securities:			
Held-to-maturity .....	355	123	4,203
Available-for-sale .....	135,695	62,047	69,649
Proceeds from maturities and redemptions of investment securities:			
Held-to-maturity .....	6,089	4,322	5,479
Available-for-sale .....	100,994	108,486	106,900
Purchases of investment securities:			
Held-to-maturity .....	(2,606)	(1,403)	(2,005)
Available-for-sale .....	(144,885)	(267,329)	(146,661)
Proceeds from sales of loans and loans held-for-sale .....	—	544	1,176
Net increase in loans .....	(411,908)	(298,361)	(444,927)
Net increase in restricted stock .....	(5,551)	(3,328)	(5,131)
(Purchases of) proceeds from bank-owned life insurance .....	(25,000)	388	—
Purchases of premises and equipment, net .....	(8,891)	(7,250)	(5,489)
Net cash used in investing activities .....	<u>(355,708)</u>	<u>(401,761)</u>	<u>(416,806)</u>
<b>Cash Flows From Financing Activities:</b>			
Net increase in deposits .....	213,280	324,042	299,650
Net increase (decrease) in short-term borrowings .....	74,129	(4,490)	75,016
Proceeds from long-term debt .....	71,635	43,500	94,212
Repayment of long-term debt .....	(27,050)	(31,756)	(74,584)
Proceeds from issuance of common stock, net .....	22,598	43,712	3,870
Proceeds from exercise of stock options .....	917	906	707
Shares withheld upon the vesting and conversion of RSUs .....	(527)	(370)	(287)
Cash dividends paid .....	(13,703)	(12,078)	(10,759)
Net cash provided by financing activities .....	<u>341,279</u>	<u>363,466</u>	<u>387,825</u>
Net increase (decrease) in cash and cash equivalents .....	32,743	(2,706)	6,691
Cash and cash equivalents, beginning of year .....	36,929	39,635	32,944
Cash and cash equivalents, end of period .....	<u>\$ 69,672</u>	<u>\$ 36,929</u>	<u>\$ 39,635</u>
<b>Supplemental Cash Flow Disclosures:</b>			
Cash paid for interest .....	\$ 21,545	\$ 21,158	\$ 18,361
Cash paid for income taxes .....	12,838	9,006	8,065
Noncash investing and financing activities:			
Cash dividends payable .....	3,798	3,368	2,823
Additions to other real estate owned .....	5,850	—	—
Loans transferred from portfolio to held-for-sale .....	—	—	105

See notes to consolidated financial statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### ***NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES***

The consolidated financial statements include the accounts of The First of Long Island Corporation and its wholly-owned subsidiary, The First National Bank of Long Island, and subsidiaries wholly-owned by the Bank, either directly or indirectly: The First of Long Island Agency, Inc.; FNY Service Corp. (“FNY”); and The First of Long Island REIT, Inc. (“REIT”). The Corporation’s financial condition and operating results principally reflect those of the Bank and its subsidiaries. The consolidated entity is referred to as the “Corporation,” and the Bank and its subsidiaries are collectively referred to as the “Bank.” All intercompany balances and amounts have been eliminated. In preparing the consolidated financial statements, management is required to make estimates, such as the allowance for loan losses, and assumptions that affect the reported asset and liability balances, revenue and expense amounts and the disclosure of contingent assets and liabilities. Actual results could differ significantly from those estimates.

The accounting and reporting policies of the Corporation reflect banking industry practice and conform to generally accepted accounting principles in the United States. The following is a summary of the Corporation’s significant accounting policies.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash and deposits with other financial institutions that generally mature within 90 days.

#### **Investment Securities**

Current accounting standards require that investment securities be classified as held-to-maturity, available-for-sale or trading. The trading category is not applicable to any securities in the Bank's portfolio because the Bank does not buy or hold debt or equity securities principally for the purpose of selling in the near term. Held-to-maturity securities, or debt securities which the Bank has the intent and ability to hold to maturity, are reported at amortized cost. Available-for-sale securities, or debt and equity securities which are neither held-to-maturity securities nor trading securities, are reported at fair value, with unrealized gains and losses, net of the related income tax effect, included in other comprehensive income.

Interest income includes amortization or accretion of purchase premium or discount. Premiums and discounts on securities are amortized or accreted on the level-yield method. Prepayments are anticipated for mortgage-backed securities. Premiums on municipal securities are amortized to the earlier of the stated maturity date or the first call date, while discounts on municipal securities are accreted to the stated maturity date. Realized gains and losses on the sale of securities are determined using the specific identification method.

Investment securities are evaluated for other-than-temporary impairment (“OTTI”) no less often than quarterly. In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer; (3) whether the market decline was affected by macroeconomic conditions; and (4) whether management has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, management considers whether it intends to sell, or, more likely than not, will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in earnings. For securities that do not meet the aforementioned criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income.

#### **Loans Held-for-Sale**

Loans held-for-sale are carried at the lower of cost or fair value. Any subsequent declines in fair value below the initial carrying value are recorded as a valuation allowance established through a charge to noninterest income.

#### **Loans and Allowance for Loan Losses**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance less any chargeoffs and the allowance for loan losses and plus or minus net deferred loan costs and fees, respectively. Interest on loans is credited to income based on the principal amount outstanding. Direct loan origination costs, net of loan origination fees, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

The past due status of a loan is based on the contractual terms in the loan agreement. Unless a loan is well secured and in the process of collection, the accrual of interest income is discontinued when a loan becomes 90 days past due as to principal or interest payments. The accrual of interest income on a loan is also discontinued when it is determined that the borrower will not be able to make principal and interest payments according to the contractual terms of the current loan agreement. When the accrual of interest income is discontinued on a loan, any accrued but unpaid interest is reversed against current period income. Interest received on nonaccrual loans is applied against the outstanding principal balance until the loans qualify for return to an accrual status, if ever. Return to an accrual status occurs when all the principal and interest amounts contractually past due are brought current and all future payments are reasonably assured.

The allowance for loan losses is established through provisions for loan losses charged against income. When available information confirms that specific loans, or portions thereof, are uncollectible, these amounts are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is an amount that management currently believes will be adequate to absorb probable incurred losses in the Bank's loan portfolio. The process for estimating credit losses and determining the allowance for loan losses as of any balance sheet date is subjective in nature and requires material estimates. Actual results could differ significantly from those estimates.

The allowance for loan losses is comprised of specific reserves allocated to individually impaired loans plus estimated losses on pools of loans that are collectively reviewed. Although the allowance for loan losses has two separate components, one for impairment losses on individual loans and one for collective impairment losses on pools of loans, the entire allowance for loan losses is available to absorb realized losses as they occur whether they relate to individual loans or pools of loans.

Estimated losses for loans individually deemed to be impaired are based on either the fair value of collateral or the discounted value of expected future cash flows. For all collateral dependent impaired loans, impairment losses are measured based on the fair value of the collateral. A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled principal and interest when due according to the contractual terms of the current loan agreement. Loans that experience insignificant payment delays and payment shortfalls are not automatically considered to be 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 financial condition and the amount of the shortfall in relation to the principal and interest owed. In estimating the fair value of real estate collateral, management utilizes appraisals or evaluations adjusted for costs to dispose and a distressed sale adjustment, if needed.

In addition to estimating losses for loans individually deemed to be impaired, management also estimates collective impairment losses for pools of loans that are not specifically reviewed. Loan pools include: commercial and industrial loans; small business credit scored loans; owner-occupied commercial mortgages; multifamily commercial mortgages; other commercial mortgages; construction and land development loans; first-lien residential mortgages; junior-lien residential mortgages; first-lien home equity lines; junior-lien home equity lines; and consumer loans. The Bank's highest average annualized loss experience over periods of 24, 36, 48 or 60 months is generally the starting point in determining its allowance for loan losses for each pool of loans. Management believes that this approach appropriately reflects losses from the current economic cycle and those incurred losses in the Bank's loan portfolio. However, since future losses could vary significantly from those experienced in the past, on a quarterly basis management adjusts its historical loss experience to reflect current conditions. In doing so, management considers a variety of general qualitative factors and then subjectively determines the weight to assign to each in estimating losses. The factors include, among others: (1) delinquencies, (2) economic conditions as judged by things such as national and local unemployment levels, (3) changes in value of underlying collateral as judged by things such as median home prices, commercial vacancy rates and forecasted vacancy and rental rates in the Bank's service area, (4) trends in the nature and volume of loans, (5) concentrations of credit, (6) changes in lending policies and procedures, (7) experience, ability and depth of lending staff, (8) changes in the quality of the loan review function, (9) environmental risks, and (10) loan risk ratings. Substantially all of the Bank's allowance for loan losses allocable to pools of loans that are collectively evaluated for impairment results from these qualitative adjustments to historical loss experience. Because of the nature of the qualitative factors and the difficulty in assessing their impact, management's resulting estimate of losses may not accurately reflect actual losses in the portfolio.

Troubled debt restructurings are by definition impaired loans and are generally reported at the present value of estimated future cash flows using the loan's effective rate at inception. However, if a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported at the fair value of the collateral.

### **Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, the transferee obtains the right (free of

conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

### **Bank Premises and Equipment**

Land is carried at cost. Other bank premises and equipment are carried at cost less accumulated depreciation and amortization. Buildings are depreciated using the straight-line method over their estimated useful lives, which range from thirty-one to forty years. Building and leasehold improvements are depreciated using the straight-line method over the remaining lives of the buildings or leases, as applicable, or their estimated useful lives, whichever is shorter. The lives of the respective leases range from five to twenty years. Furniture, fixtures and equipment are depreciated using the straight-line method over their estimated useful lives, which range from three to ten years. Land and building held-for-sale is included in Other Assets on the Corporation's consolidated balance sheet and carried at the lower of cost or fair value.

### **Bank-owned Life Insurance**

The Bank is the owner and beneficiary of insurance policies on the lives of certain officers. Bank-owned life insurance ("BOLI") is recorded at the amount that can be realized under the contract at the balance sheet date, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement, if any.

### **Restricted Stock**

The Bank is a member of and is required to own stock in the Federal Home Loan Bank of New York ("FHLB") and the Federal Reserve Bank of New York ("FRB"). The amount of FHLB stock held is based on membership and the level of FHLB advances. The amount of FRB stock held is based on the Bank's capital and surplus balances. These stocks do not have a readily determinable fair value, are carried at cost, classified as restricted stock and periodically evaluated for impairment based on the prospects for the ultimate recovery of cost. Cash dividends, if any, are reported as interest income on taxable investment securities.

### **Other Real Estate Owned**

Real estate acquired through foreclosure or by deed-in-lieu of foreclosure is initially recorded at the lower of cost or fair value, less estimated selling costs and is included in other assets on the consolidated balance sheet. Chargeoffs recorded at the time of acquisition are charged to the allowance for loan losses. Thereafter, the Bank maintains a valuation allowance, representing decreases in the property's estimated fair value, through charges to earnings. Such charges are included in other noninterest expense along with any additional property maintenance costs incurred in owning the property. Rental income received from tenants of other real estate owned is included in other noninterest income.

### **Long-term Assets**

Premises and equipment, intangible assets, BOLI and other long-term assets, if any, are reviewed for impairment when events indicate that their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

### **Loan Commitments and Related Financial Instruments**

Financial instruments include off-balance-sheet credit instruments, such as commitments to make loans, commercial letters of credit and standby letters of credit. The face amount of these items represents the exposure to loss, before considering collateral held or ability to repay. The Bank maintains a reserve for losses on off-balance-sheet credit exposures which is included in accrued expenses and other liabilities on the consolidated balance sheet. Off-balance-sheet credit instruments are recorded on the balance sheet when they are funded or drawn down.

### **Checking Deposits**

The Bank's commercial checking accounts generally have a related noninterest-bearing sweep account. The sole purpose of the sweep accounts is to reduce the reserve balances that the Bank is required to maintain with the FRB, and thereby increase funds available for investment. Although the sweep accounts are classified as savings accounts for regulatory purposes, they are included in checking deposits in the accompanying consolidated balance sheets.

### **Income Taxes**

A current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the current year. A deferred tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences and

carryforwards. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law. The effects of future changes in tax laws or rates are not considered. The Corporation recognizes interest and/or penalties related to income tax matters in noninterest income or noninterest expense as appropriate.

## Retirement Plans

Pension expense is the sum of service cost, interest cost, amortization of actuarial gains and losses and plan expenses, net of the expected return on plan assets and participant contributions. Employee 401(k) plan expense is equal to the amount of matching contributions.

## Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

## Stockholders' Equity

**Earnings Per Share.** The Corporation calculates basic and diluted earnings per share ("EPS") using the two-class method. Under the two-class method, net income for the period is allocated between common stockholders and participating securities according to dividends declared and participation rights in undistributed earnings. Basic EPS excludes the dilutive effect of outstanding stock options and restricted stock units ("RSUs") and is computed by dividing net income allocated to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if outstanding stock options and RSUs were converted into shares of common stock that then shared in the earnings of the Corporation. Diluted EPS is computed by dividing net income allocated to common stockholders by the weighted average number of common shares and dilutive stock options and RSUs. There were no anti-dilutive stock options or RSUs at December 31, 2017 or 2016. Anti-dilutive stock options and RSUs at December 31, 2015 were de minimis. Other than the stock options and RSUs described in "Note I – Stock-Based Compensation", the Corporation has no securities that could be converted into common stock nor does the Corporation have any contracts that could result in the issuance of common stock.

The following table is a calculation of basic and diluted EPS for the periods indicated.

<i>(dollars in thousands, except per share data)</i>	2017	2016	2015
Net income .....	\$ 35,122	\$ 30,880	\$ 25,890
Income allocated to participating securities (1) .....	128	127	—
Income allocated to common stockholders .....	<u>\$ 34,994</u>	<u>\$ 30,753</u>	<u>\$ 25,890</u>
Weighted average:			
Common shares .....	24,219,813	22,745,967	21,017,808
Dilutive stock options and restricted stock units (1) .....	<u>255,333</u>	<u>271,929</u>	<u>244,452</u>
	<u>24,475,146</u>	<u>23,017,896</u>	<u>21,262,260</u>
Earnings per share:			
Basic .....	\$1.44	\$1.35	\$1.23
Diluted .....	\$1.43	\$1.34	\$1.22

(1) RSUs awarded in 2016 accrue dividends at the same rate as the dividends declared by the Board of Directors on the Corporation's common stock. For purposes of computing EPS, these RSUs are considered to participate with common stock in the earnings of the Corporation and, therefore, the Corporation calculates basic and diluted EPS using the two-class method. Under the two-class method, net income for the period is allocated between common stockholders and participating securities according to dividends declared and participation rights in undistributed earnings. See "Note I – Stock-Based Compensation" for additional details on the RSUs awarded in 2016.

**Stock Split.** On October 27, 2016, the Corporation declared a 3-for-2 stock split. The stock split was effected through a 50% stock dividend. Additional shares issued as a result of the stock split were distributed on November 28, 2016 to stockholders of record on November 10, 2016, and are shown for 2016 on the line captioned "3-for-2 stock split" in the Consolidated Statement of Changes in Stockholders' Equity. Share and per share amounts included in the consolidated financial statements and notes thereto have been adjusted as appropriate to reflect the effect of the split.

**Public Offering of Common Stock.** In May 2016, the Corporation sold 1,300,000 shares of common stock (1,950,000 shares post-split) in an underwritten public offering at a price of \$29.00 per share (\$19.33 post-split). The net proceeds of the offering, after the underwriting discount and offering expenses paid by the Corporation, were \$35,270,000.

### Stock-based Compensation

The Corporation's stock-based compensation plans are described in "Note I – Stock-Based Compensation". Compensation cost is determined for stock options and RSUs issued to employees and non-employee directors based on the grant date fair value of the award.

Compensation expense for performance-based RSUs is recognized over a three-year performance period, which is usually the vesting period, and adjusted at the end of the performance period to reflect the actual number of shares of the Corporation's common stock into which the RSUs will be converted. Compensation expense for service-based RSUs is recognized over the applicable service period, which is usually the vesting period. Compensation expense for stock options is recognized ratably over the five-year vesting period or the period from the grant date to the participant's eligible retirement date, whichever is shorter. The Corporation accounts for forfeitures as they occur.

### Comprehensive Income

Comprehensive income includes net income and other comprehensive income (loss). Other comprehensive income (loss) includes revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income but excluded from net income. Other comprehensive income for the Corporation consists of net unrealized holding gains or losses on available-for-sale securities and changes in the funded status of the Bank's defined benefit pension plan, both net of related income taxes. Accumulated other comprehensive income (loss) is recognized as a separate component of stockholders' equity.

The components of other comprehensive income (loss) and the related tax effects are as follows:

<i>(in thousands)</i>	2017	2016	2015
Change in net unrealized holding gains on available-for-sale securities:			
Change arising during the period .....	\$ (236)	\$ (15,153)	\$ (1,851)
Reclassification adjustment for losses (gains) included in net income (1) .....	1,867	(1,851)	(1,183)
Change in net unrealized holding gains on available-for-sale securities....	1,631	(17,004)	(3,034)
Tax effect .....	685	(6,983)	(1,249)
	<u>946</u>	<u>(10,021)</u>	<u>(1,785)</u>
Change in funded status of pension plan:			
Unrecognized net gain (loss) arising during the period.....	1,700	1,199	(2,573)
Amortization of net actuarial loss included in pension expense (2).....	18	244	—
	1,718	1,443	(2,573)
Tax effect .....	514	550	(1,097)
	<u>1,204</u>	<u>893</u>	<u>(1,476)</u>
Other comprehensive income (loss) .....	<u>\$ 2,150</u>	<u>\$ (9,128)</u>	<u>\$ (3,261)</u>

(1) Reclassification adjustment represents net realized gains and losses arising from the sale of available-for-sale securities. These net realized gains and losses are included in the consolidated statements of income in the line item, "Net gains (losses) on sales of securities." See "Note B – Investment Securities" for the income tax expense (benefit) related to these net realized gains and losses.

(2) Represents the amortization into expense of net actuarial loss relating to the Corporation's defined benefit pension plan. This item is included in net periodic pension cost (see "Note J – Retirement Plans") and in the consolidated statements of income in the line item, "Employee benefits." The income tax expense relating to this cost is included in the consolidated statements of income in the line item, "Income tax expense."

The following sets forth the components of accumulated other comprehensive income (loss), net of tax:

<i>(in thousands)</i>	Balance 12/31/16	Current Period Change	Balance 12/31/17
Unrealized holding gains on available-for-sale securities.....	\$ 1,654	\$ 946	\$ 2,600
Unrealized actuarial losses on pension plan.....	(3,258)	1,204	(2,054)
Total accumulated other comprehensive income (loss), net of tax .....	<u>\$ (1,604)</u>	<u>\$ 2,150</u>	<u>\$ 546</u>

## **Operating Segments**

While senior management monitors the revenue streams of the Bank's various products and services, the identifiable segments are not material and operations are managed and financial performance is evaluated on a company-wide basis. Accordingly, all of the financial operations of the Bank are aggregated in one reportable operating segment.

## **Investment Management Division**

Assets held in a fiduciary capacity are not assets of the Corporation and, accordingly, are not included in the accompanying consolidated financial statements. The Investment Management Division records fees on the accrual basis.

## **Reclassifications**

When appropriate, items in the prior year financial statements are reclassified to conform to the current period presentation.

## **Adoption of New Accounting Standards**

There were no accounting standards adopted during 2017.

## **Impact of Issued But Not Yet Effective Accounting Standards**

The pronouncements discussed in this section are not intended to be an all-inclusive list, but rather only those pronouncements that could potentially have an impact on the Corporation's financial position, results of operations or disclosures.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 "Revenue from Contracts with Customers." The amendments in ASU 2014-09 provide a comprehensive framework for addressing revenue recognition issues that can be applied to all contracts with customers. While the guidance in ASU 2014-09 supersedes most existing industry-specific revenue recognition accounting guidance, much of a bank's revenue comes from financial instruments such as debt securities and loans that are scoped-out of the guidance. The amendments in ASU 2014-09 also include improved disclosures to enable users of financial statements to better understand the nature, amount, timing and uncertainty of revenue that is recognized. For public entities such as the Corporation, ASU 2014-09, as amended, is effective for interim and annual reporting periods beginning after December 15, 2017. Implementation of ASU 2014-09 on January 1, 2018 will result in enhancements to certain revenue recognition disclosures, but the amendments in the ASU did not have a material impact on the Corporation's financial position or results of operations. Management used the modified retrospective transition method to implement the standard and has updated its internal control procedures to address the new requirements.

In January 2016, the FASB issued ASU 2016-01 "Financial Instruments – Overall." The amendments in ASU 2016-01 are intended to improve the recognition, measurement, presentation and disclosure of financial assets and liabilities to provide users of financial statements with information that is more useful for decision-making purposes. Among other changes, ASU 2016-01 requires equity securities to be measured at fair value with changes in fair value recognized through net income, but allows equity securities that do not have readily determinable fair values to be remeasured at fair value either upon the occurrence of an observable price change or upon identification of an impairment. The amendments simplify the impairment assessment of such equity securities and require enhanced disclosure about these investments. ASU 2016-01 also requires the use of an exit price when measuring the fair value of financial instruments and separate presentation of financial assets and liabilities by measurement category and type of instrument on the balance sheet or in the notes. The ASU eliminates certain disclosures relating to the methods and assumptions used to estimate fair value. For public entities such as the Corporation, the amendments in ASU 2016-01 are effective for interim and annual reporting periods beginning after December 15, 2017. Implementation of ASU 2016-01 on January 1, 2018 did not have a material impact on the Corporation's financial position or results of operations, but will result in certain modifications to fair value disclosures.

In February 2016, the FASB issued ASU 2016-02 "Leases." ASU 2016-02 affects any entity that enters into a lease and is intended to increase the transparency and comparability of financial statements among organizations. The ASU requires, among other changes, a lessee to recognize on its balance sheet a lease asset and a lease liability for those leases previously classified as operating leases. The lease asset would represent the right to use the underlying asset for the lease term and the lease liability would represent the discounted value of the required lease payments to the lessor. The ASU would also require entities to disclose key information about leasing arrangements. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018. Upon implementation of the ASU, the Corporation's assets and liabilities will increase due to the recognition of a lease asset and a lease obligation. Management has allocated staffing resources to implement the ASU and is developing an implementation plan including, among other things, engaging a third party software provider and evaluating the impact that other aspects of ASU 2016-02 will have on the Corporation's financial position, results of operations and disclosures.



In June 2016, the FASB issued ASU 2016-13 “Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 affects entities holding financial assets that are not accounted for at fair value through net income, including loans, debt securities, and other financial assets. The ASU requires financial assets measured at amortized cost to be presented at the net amount expected to be collected by recording an allowance for credit losses. ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted beginning after December 15, 2018, including interim periods within those fiscal years. Management has established an internal committee to manage the implementation of the ASU. The committee is led by the Bank’s Chief Accounting Officer and includes the Chief Financial Officer and Chief Risk Officer. A broader advisory group has been established to assist in implementing the ASU and includes representatives of the Bank’s loan operations, credit administration, lending, investments and technology functions. The committee has selected and engaged a third-party software provider, and is currently accumulating historical data needed to implement the ASU. In addition, the committee continues to analyze the provisions of the ASU to understand the impact that it will have on the Corporation’s financial position, results of operations and disclosures.

In August 2016, the FASB issued ASU 2016-15 “Classification of Certain Cash Receipts and Cash Payments.” ASU 2016-15 affects all entities that are required to present a statement of cash flows under Accounting Standards Codification (“ASC”) Topic 230, Statement of Cash Flows, and other ASC Topics, addressing eight specific cash flow issues with the objective of reducing diversity in practice. ASU 2016-15 is effective for interim and annual reporting periods beginning after December 15, 2017. Implementation of ASU 2016-15 on January 1, 2018 did not have a material impact on the Corporation’s financial position, results of operations or disclosures.

In March 2017, the FASB issued ASU 2017-07 “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” ASU 2017-07 applies to all employers that offer to their employees defined benefit pension plans, other postretirement benefit plans or other types of benefits accounted for under ASC Topic 715. The ASU requires, among other things, that an employer disaggregate the service cost component from other components of net benefit cost and provides explicit guidance on how to present the service cost component and other components of net benefit cost in the income statement. ASU 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Implementation of ASU 2017-07 on January 1, 2018 results in reclassifications between certain income statement categories, but the amendments in the ASU did not have a material impact on the Corporation’s financial position, results of operations or disclosures.

In February 2018, the FASB issued ASU 2018-02 “Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” ASU 2018-02 affects any entity that has items of other comprehensive income for which the related tax effects are presented in other comprehensive income. The ASU allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act which was signed into law on December 22, 2017. ASU 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. Management plans to implement the ASU in the first quarter of 2018 with no impact on the Corporation’s financial position or results of operations.

**NOTE B – INVESTMENT SECURITIES**

The following tables set forth the amortized cost and estimated fair values of the Bank’s investment securities at December 31, 2017 and 2016.

	<b>2017</b>			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(in thousands)</i>				
<b>Held-to-Maturity Securities:</b>				
State and municipals .....	\$ 6,970	\$ 78	\$ —	\$ 7,048
Pass-through mortgage securities.....	311	21	—	332
Collateralized mortgage obligations.....	355	14	—	369
	<u>\$ 7,636</u>	<u>\$ 113</u>	<u>\$ —</u>	<u>\$ 7,749</u>
<b>Available-for-Sale Securities:</b>				
State and municipals .....	\$ 453,158	\$ 10,051	\$ (1,886)	\$ 461,323
Pass-through mortgage securities.....	72,539	84	(1,232)	71,391
Collateralized mortgage obligations.....	190,175	15	(2,776)	187,414
	<u>\$ 715,872</u>	<u>\$ 10,150</u>	<u>\$ (5,894)</u>	<u>\$ 720,128</u>

**2016**

<i>(in thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Held-to-Maturity Securities:</b>				
State and municipals .....	\$ 10,419	\$ 177	\$ —	\$ 10,596
Pass-through mortgage securities.....	361	33	—	394
Collateralized mortgage obligations.....	607	40	—	647
	<u>\$ 11,387</u>	<u>\$ 250</u>	<u>\$ —</u>	<u>\$ 11,637</u>
<b>Available-for-Sale Securities:</b>				
State and municipals .....	\$ 444,154	\$ 10,137	\$ (3,631)	\$ 450,660
Pass-through mortgage securities.....	188,527	156	(2,874)	185,809
Collateralized mortgage obligations.....	179,993	862	(2,025)	178,830
	<u>\$ 812,674</u>	<u>\$ 11,155</u>	<u>\$ (8,530)</u>	<u>\$ 815,299</u>

At December 31, 2017 and 2016, investment securities with a carrying value of \$423,360,000 and \$415,419,000, respectively, were pledged as collateral to secure public deposits and borrowed funds.

There were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity at December 31, 2017 and 2016.

**Securities With Unrealized Losses.** The following tables set forth securities with unrealized losses at December 31, 2017 and 2016 presented by length of time the securities had been in a continuous unrealized loss position.

<i>(in thousands)</i>	<b>2017</b>					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
State and municipals .....	\$ 54,732	\$ (574)	\$ 28,723	\$ (1,312)	\$ 83,455	\$ (1,886)
Pass-through mortgage securities.....	10,172	(81)	52,652	(1,151)	62,824	(1,232)
Collateralized mortgage obligations	130,267	(1,230)	54,751	(1,546)	185,018	(2,776)
Total temporarily impaired.....	<u>\$ 195,171</u>	<u>\$ (1,885)</u>	<u>\$ 136,126</u>	<u>\$ (4,009)</u>	<u>\$ 331,297</u>	<u>\$ (5,894)</u>
<b>2016</b>						
State and municipals .....	\$ 117,181	\$ (3,631)	\$ —	\$ —	\$ 117,181	\$ (3,631)
Pass-through mortgage securities.....	175,000	(2,874)	—	—	175,000	(2,874)
Collateralized mortgage obligations	125,424	(1,820)	7,737	(205)	133,161	(2,025)
Total temporarily impaired.....	<u>\$ 417,605</u>	<u>\$ (8,325)</u>	<u>\$ 7,737</u>	<u>\$ (205)</u>	<u>\$ 425,342</u>	<u>\$ (8,530)</u>

Because the unrealized losses reflected in the preceding tables are deemed by management to be attributable to changes in interest rates and not credit losses, and because management does not have the intent to sell these securities and it is not more likely than not that it will be required to sell these securities before their anticipated recovery, the Bank does not consider these securities to be other-than-temporarily impaired at December 31, 2017.

**Sales of Available-for-Sale Securities.** Sales of available-for-sale securities were as follows:

<i>(in thousands)</i>	2017	2016	2015
Proceeds .....	<u>\$ 135,695</u>	<u>\$ 62,047</u>	<u>\$ 69,649</u>
Gains .....	\$ 382	\$ 1,869	\$ 1,560
Losses.....	(2,249)	(18)	(377)
Net gain (loss).....	<u>\$ (1,867)</u>	<u>\$ 1,851</u>	<u>\$ 1,183</u>

The income tax expense (benefit) related to these net realized gains (losses) was (\$782,000), \$772,000 and \$487,000 in 2017, 2016 and 2015, respectively, and is included in the consolidated statements of income in the line item, "Income tax expense."

**Sales of Held-to-Maturity Securities.** During 2017, the Bank sold one municipal security that was classified as held-to-maturity. The sale was in response to a significant deterioration in the creditworthiness of the issuer. The security sold had a carrying value of \$354,000 at the time of sale and the Bank realized a gain upon sale of \$1,000.

During 2016, the Bank sold one mortgage-backed security that was classified as held-to-maturity. The sale occurred after the Bank collected 85% or more of the principal amount outstanding at acquisition. The security sold had a carrying value of \$106,000 at the time of sale and the Bank realized a gain upon sale of \$17,000.

During 2015, the Bank sold municipal securities that were classified as held-to-maturity securities. These sales were in response to a significant deterioration in the creditworthiness of the issuers. The securities sold had a carrying value of \$4,062,000 at the time of sale and the Bank realized a gain upon sale of \$141,000.

**Maturities.** The following table sets forth by maturity the amortized cost and fair value of the Bank's state and municipal securities at December 31, 2017 based on the earlier of their stated maturity or, if applicable, their pre-refunded date. The remaining securities in the Bank's investment securities portfolio are mortgage-backed securities, consisting of pass-through mortgage securities and collateralized mortgage obligations. Although these securities are expected to have substantial periodic repayments they are reflected in the table below in aggregate amounts.

<i>(in thousands)</i>	Amortized Cost	Fair Value
<b>Held-to-Maturity Securities:</b>		
Within one year .....	\$ 4,409	\$ 4,425
After 1 through 5 years .....	2,311	2,373
After 5 through 10 years .....	250	250
After 10 years .....	—	—
Mortgage-backed securities .....	666	701
	<u>\$ 7,636</u>	<u>\$ 7,749</u>
<b>Available-for-Sale Securities:</b>		
Within one year .....	\$ 24,160	\$ 24,444
After 1 through 5 years .....	93,467	95,566
After 5 through 10 years .....	169,372	172,905
After 10 years .....	166,159	168,408
Mortgage-backed securities .....	262,714	258,805
	<u>\$ 715,872</u>	<u>\$ 720,128</u>

#### NOTE C – LOANS

The following tables set forth by class of loans as of December 31, 2017 and 2016 the amount of loans individually and collectively evaluated for impairment and the portion of the allowance for loan losses allocable to such loans.

<i>(in thousands)</i>	December 31, 2017					
	Loans			Allowance for Loan Losses		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Ending Balance	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Ending Balance
Commercial and industrial .....	\$ 48	\$ 109,575	\$ 109,623	\$ —	\$ 1,441	\$ 1,441
Commercial mortgages:						
Multifamily .....	—	682,593	682,593	—	6,423	6,423
Other .....	—	414,783	414,783	—	4,734	4,734
Owner-occupied .....	531	95,100	95,631	—	1,076	1,076
Residential mortgages:						
Closed end .....	1,368	1,557,196	1,558,564	18	19,329	19,347
Revolving home equity .....	—	83,625	83,625	—	689	689
Consumer and other .....	—	5,533	5,533	—	74	74
	<u>\$ 1,947</u>	<u>\$ 2,948,405</u>	<u>\$ 2,950,352</u>	<u>\$ 18</u>	<u>\$ 33,766</u>	<u>\$ 33,784</u>
	<b>December 31, 2016</b>					
Commercial and industrial .....	\$ 131	\$ 125,907	\$ 126,038	\$ —	\$ 1,408	\$ 1,408
Commercial mortgages:						
Multifamily .....	—	610,385	610,385	—	6,119	6,119
Other .....	—	371,142	371,142	—	4,296	4,296
Owner-occupied .....	558	103,113	103,671	—	959	959
Residential mortgages:						
Closed end .....	856	1,237,575	1,238,431	45	15,695	15,740
Revolving home equity .....	1,770	84,691	86,461	482	919	1,401
Consumer and other .....	—	9,293	9,293	—	134	134
	<u>\$ 3,315</u>	<u>\$ 2,542,106</u>	<u>\$ 2,545,421</u>	<u>\$ 527</u>	<u>\$ 29,530</u>	<u>\$ 30,057</u>

The following tables present the activity in the allowance for loan losses for the years ended December 31, 2017, 2016 and 2015.

<i>(in thousands)</i>	Balance at 1/1/17	Chargeoffs	Recoveries	Provision for Loan Losses (Credit)	Balance at 12/31/17
Commercial and industrial .....	\$ 1,408	\$ 102	\$ 13	\$ 122	\$ 1,441
Commercial mortgages:					
Multifamily .....	6,119	—	—	304	6,423
Other .....	4,296	—	—	438	4,734
Owner-occupied .....	959	820	—	937	1,076
Residential mortgages:					
Closed end .....	15,740	97	3	3,701	19,347
Revolving home equity .....	1,401	100	—	(612)	689
Consumer and other .....	134	27	3	(36)	74
	<u>\$ 30,057</u>	<u>\$ 1,146</u>	<u>\$ 19</u>	<u>\$ 4,854</u>	<u>\$ 33,784</u>

<i>(in thousands)</i>	Balance at 1/1/16	Chargeoffs	Recoveries	Provision for Loan Losses (Credit)	Balance at 12/31/16
Commercial and industrial .....	\$ 928	\$ 445	\$ 4	\$ 921	\$ 1,408
Commercial mortgages:					
Multifamily .....	6,858	—	—	(739)	6,119
Other .....	3,674	—	—	622	4,296
Owner-occupied .....	1,047	—	—	(88)	959
Residential mortgages:					
Closed end .....	13,639	259	9	2,351	15,740
Revolving home equity .....	1,016	—	12	373	1,401
Consumer and other .....	94	5	5	40	134
	<u>\$ 27,256</u>	<u>\$ 709</u>	<u>\$ 30</u>	<u>\$ 3,480</u>	<u>\$ 30,057</u>

<i>(in thousands)</i>	Balance at 1/1/15	Chargeoffs	Recoveries	Provision for Loan Losses (Credit)	Balance at 12/31/15
Commercial and industrial .....	\$ 838	\$ 166	\$ 7	\$ 249	\$ 928
Commercial mortgages:					
Multifamily .....	7,207	91	27	(285)	6,858
Other .....	2,340	1	39	1,296	3,674
Owner-occupied .....	1,023	—	—	24	1,047
Residential mortgages:					
Closed end .....	10,599	7	9	3,038	13,639
Revolving home equity .....	1,121	67	5	(43)	1,016
Consumer and other .....	93	37	—	38	94
	<u>\$ 23,221</u>	<u>\$ 369</u>	<u>\$ 87</u>	<u>\$ 4,317</u>	<u>\$ 27,256</u>

For individually impaired loans, the following tables set forth by class of loans at December 31, 2017, 2016 and 2015 the recorded investment, unpaid principal balance and related allowance. The tables also set forth the average recorded investment of individually impaired loans and interest income recognized while the loans were impaired during the years ended December 31, 2017, 2016 and 2015. The recorded investment is the unpaid principal balance of the loans less any interest payments applied to principal and any direct chargeoffs plus or minus net deferred loan costs and fees. Any principal and interest payments received on nonaccrual impaired loans are applied to the recorded investment in the loans. The Bank recognizes interest income on other impaired loans using the accrual method of accounting.

<i>(in thousands)</i>	<b>2017</b>				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>With no related allowance recorded:</b>					
Commercial and industrial .....	\$ 48	\$ 48	\$ —	\$ 67	\$ 5
Commercial mortgages - owner-occupied .....	531	615	—	654	21
Residential mortgages - closed end .....	1,095	1,102	—	1,122	7
<b>With an allowance recorded:</b>					
Residential mortgages - closed end .....	273	272	18	280	13
<b>Total:</b>					
Commercial and industrial .....	48	48	—	67	5
Commercial mortgages - owner-occupied .....	531	615	—	654	21
Residential mortgages - closed end .....	1,368	1,374	18	1,402	20
	<u>\$ 1,947</u>	<u>\$ 2,037</u>	<u>\$ 18</u>	<u>\$ 2,123</u>	<u>\$ 46</u>
<b>2016</b>					
<b>With no related allowance recorded:</b>					
Commercial and industrial .....	\$ 131	\$ 131	\$ —	\$ 134	\$ 1
Commercial mortgages - owner-occupied .....	558	636	—	575	—
Residential mortgages:					
Closed end .....	230	313	—	245	—
Revolving home equity .....	280	279	—	280	—
<b>With an allowance recorded:</b>					
Residential mortgages:					
Closed end .....	626	634	45	641	29
Revolving home equity .....	1,490	1,491	482	1,493	—
<b>Total:</b>					
Commercial and industrial .....	131	131	—	134	1
Commercial mortgages - owner-occupied .....	558	636	—	575	—
Residential mortgages:					
Closed end .....	856	947	45	886	29
Revolving home equity .....	1,770	1,770	482	1,773	—
	<u>\$ 3,315</u>	<u>\$ 3,484</u>	<u>\$ 527</u>	<u>\$ 3,368</u>	<u>\$ 30</u>
<b>2015</b>					
<b>With no related allowance recorded:</b>					
Commercial mortgages - owner-occupied .....	\$ 594	\$ 654	\$ —	\$ 612	\$ —
Residential mortgages:					
Closed end .....	306	405	—	530	—
Revolving home equity .....	522	521	—	525	6
<b>With an allowance recorded:</b>					
Residential mortgages - closed end .....	3,491	3,494	428	3,555	89
<b>Total:</b>					
Commercial mortgages - owner-occupied .....	594	654	—	612	—
Residential mortgages:					
Closed end .....	3,797	3,899	428	4,085	89
Revolving home equity .....	522	521	—	525	6
	<u>\$ 4,913</u>	<u>\$ 5,074</u>	<u>\$ 428</u>	<u>\$ 5,222</u>	<u>\$ 95</u>

**Aging of Loans.** The following tables present the aging of the recorded investment in loans by class of loans.

<i>(in thousands)</i>	<b>December 31, 2017</b>						
	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More and Still Accruing	Nonaccrual Loans	Total Past Due Loans & Nonaccrual Loans	Current	Total Loans
Commercial and industrial .....	\$ 20	\$ —	\$ —	\$ —	\$ 20	\$ 109,603	\$ 109,623
Commercial mortgages:							
Multifamily .....	—	—	—	—	—	682,593	682,593
Other .....	—	—	—	—	—	414,783	414,783
Owner-occupied .....	—	—	—	—	—	95,631	95,631
Residential mortgages:							
Closed end .....	2,186	21	—	1,000	3,207	1,555,357	1,558,564
Revolving home equity .....	522	—	—	—	522	83,103	83,625
Consumer and other .....	7	—	—	—	7	5,526	5,533
	<u>\$ 2,735</u>	<u>\$ 21</u>	<u>\$ —</u>	<u>\$ 1,000</u>	<u>\$ 3,756</u>	<u>\$2,946,596</u>	<u>\$2,950,352</u>

<i>(in thousands)</i>	<b>December 31, 2016</b>						
	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More and Still Accruing	Nonaccrual Loans	Total Past Due Loans & Nonaccrual Loans	Current	Total Loans
Commercial and industrial .....	\$ 224	\$ —	\$ —	\$ —	\$ 224	\$ 125,814	\$ 126,038
Commercial mortgages:							
Multifamily .....	—	—	—	—	—	610,385	610,385
Other .....	—	—	—	—	—	371,142	371,142
Owner-occupied .....	—	—	621	558	1,179	102,492	103,671
Residential mortgages:							
Closed end .....	881	—	—	230	1,111	1,237,320	1,238,431
Revolving home equity .....	—	—	—	1,770	1,770	84,691	86,461
Consumer and other .....	1	—	—	—	1	9,292	9,293
	<u>\$ 1,106</u>	<u>\$ —</u>	<u>\$ 621</u>	<u>\$ 2,558</u>	<u>\$ 4,285</u>	<u>\$2,541,136</u>	<u>\$2,545,421</u>

There were no loans in the process of foreclosure nor did the Bank hold any foreclosed residential real estate property at December 31, 2017 or 2016. In 2017, the Bank took a deed-in-lieu of foreclosure for one commercial real estate property. The property is recorded as other real estate owned at December 31, 2017 and has a carrying value of \$5,125,000, which is net of a valuation allowance of \$725,000. Other real estate owned at December 31, 2017 consists solely of the property taken and is included in the consolidated balance sheet under "other assets." The Bank sold the property for its carrying value in the first quarter of 2018.

**Troubled Debt Restructurings.** A restructuring constitutes a troubled debt restructuring when the restructuring includes a concession by the Bank and the borrower is experiencing financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. The Bank performs the evaluation under its internal underwriting policy.

The following table presents information about loans modified in troubled debt restructurings during the year ended December 31, 2016 and 2015. The Bank did not modify any loans in troubled debt restructurings during 2017.

<i>(dollars in thousands)</i>	Outstanding Recorded Investment			Interest Rates	
	Number of Loans	Pre- Modification	Post- Modification	Pre- Modification	Post- Modification
2016:					
Commercial and industrial .....	2	\$ 1,131	\$ 1,131	5.00% and 6.75%	5.00% and 6.75%
Residential mortgages - closed end	1	109	109	3.95%	3.95%
	<u>3</u>	<u>\$ 1,240</u>	<u>\$ 1,240</u>		
2015:					
Residential mortgages:					
Closed end .....	1	\$ 2,713	\$ 2,713	5.25%	4.00%
Revolving home equity .....	1	245	245	5.25%	4.00%
	<u>2</u>	<u>\$ 2,958</u>	<u>\$ 2,958</u>		

The 2016 troubled debt restructurings include the modification of a \$1.0 million commercial and industrial loan into a new time loan with a maturity of December 31, 2016. The loan was subsequently repaid during 2016. The 2015 restructurings involved two loans to a single borrower and resulted in a charge to the provision for loan losses at the time of restructuring of \$332,000. The post-modification interest rates for all of the 2016 and 2015 restructurings in the table above were lower than the current market rate for new debt with similar risk.

At December 31, 2017, 2016 and 2015, the Bank had an allowance for loan losses of \$18,000, \$45,000 and \$395,000, respectively, allocated to specific troubled debt restructurings. The Bank had no commitments to lend additional amounts to loans that were classified as troubled debt restructurings.

There were no troubled debt restructurings for which there was a payment default during 2017, 2016 and 2015 that were modified during the twelve-month period prior to default. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

**Risk Characteristics.** Credit risk within the Bank’s loan portfolio primarily stems from factors such as changes in the borrower’s financial condition, credit concentrations, changes in collateral values, economic conditions and environmental contamination of properties securing mortgage loans. The Bank’s commercial loans, including those secured by real estate mortgages, are primarily made to small and medium-sized businesses. Such loans sometimes involve a higher degree of risk than those to larger companies because such businesses may have shorter operating histories, higher debt-to-equity ratios and may lack sophistication in internal record keeping and financial and operational controls. In addition, most of the Bank’s loans are made to businesses and consumers on Long Island and in the boroughs of New York City, and a large percentage of these loans are mortgage loans secured by properties located in those areas. The primary source of repayment for residential mortgage loans is cash flows from individual borrowers and co-borrowers. The primary source of repayment for multifamily loans is cash flows from the underlying properties, a substantial portion of which are rent stabilized or rent controlled. Such cash flows for both residential mortgage and multifamily loans are dependent on the strength of the local economy.

**Credit Quality Indicators.** The Corporation categorizes loans into risk categories based on relevant information about the borrower’s ability to service their debt including, but not limited to, current financial information of the borrower and any guarantors, payment experience, credit underwriting, documentation, public records, due diligence checks and current economic trends.

Commercial and industrial loans and commercial mortgage loans are risk rated utilizing a ten point rating system. The ten point risk rating system is described hereinafter.

Internally  
Assigned  
Risk Rating

- |       |   |
|-------|---|
| 1 – 2 | Cash flow is of high quality and stable. Borrower has very good liquidity and ready access to traditional sources of credit. This category also includes loans to borrowers secured by cash and/or marketable securities within approved margin requirements.   |
| 3 – 4 | Cash flow quality is strong, but shows some variability. Borrower has good liquidity and asset quality. Borrower has access to traditional sources of credit with minimal restrictions.   |
| 5 – 6 | Cash flow quality is acceptable but shows some variability. Liquidity varies with operating cycle and assets provide an adequate margin of protection. Borrower has access to traditional sources of credit, but generally on a secured basis.  |
| 7     | Watch - Cash flow has a high degree of variability and subject to economic downturns. Liquidity is strained and the ability of the borrower to access traditional sources of credit is diminished.  |
| 8     | Special Mention - The borrower has potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank’s credit position at some future date. Special mention assets are not adversely classified and do not expose the Bank to risk sufficient to warrant adverse classification. |
| 9     | Substandard - Loans are inadequately protected by the current sound worth and paying capacity of the borrower or the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.                       |
| 10    | Doubtful - Loans have all the inherent weaknesses of those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.  |

Risk ratings on commercial and industrial loans and commercial mortgages are initially assigned during the underwriting process and affirmed as part of the approval process. The ratings are periodically reviewed and evaluated based upon borrower contact, credit department review or independent loan review.

The Bank's loan risk rating and review policy establishes requirements for the annual review of commercial real estate and commercial and industrial loans. The requirements include details of the scope of coverage and selection process based on loan-type and risk rating. Among other things, at least 80% of the recorded investment of commercial real estate loans as of December 31 of the prior year must be reviewed annually. Lines of credit are also reviewed annually at each proposed reaffirmation. The frequency of the review of other loans is determined by the Bank's ongoing assessments of the borrower's condition.

Residential mortgage loans, revolving home equity lines and other consumer loans are risk rated utilizing a three point rating system. In most cases, the borrower's credit score dictates the risk rating. However, regardless of credit score, loans that are on management's watch list or have been criticized or classified by management are assigned a risk rating of 3. A credit score is a tool used in the Bank's loan approval process, and a minimum score of 680 is generally required for new loans. Credit scores for each borrower are updated at least annually. The risk ratings along with their definitions are as follows:

Internally  
Assigned  
Risk Rating

- 1 Credit score is equal to or greater than 680.
- 2 Credit score is 635 to 679.
- 3 Credit score is below 635 or, regardless of credit score, the loan has been classified, criticized or placed on watch.

The following tables present the recorded investment in commercial and industrial loans and commercial real estate loans by class of loans and risk rating. Loans shown as Pass are all loans other than those risk rated Watch, Special Mention, Substandard or Doubtful.

<i>(in thousands)</i>	December 31, 2017					
	Internally Assigned Risk Rating					Total
	Pass	Watch	Special Mention	Substandard	Doubtful	
Commercial and industrial .....	\$ 108,846	\$ 450	\$ 279	\$ 48	\$ —	\$ 109,623
Commercial mortgages:						
Multifamily .....	673,128	2,354	7,111	—	—	682,593
Other .....	404,379	7,567	2,837	—	—	414,783
Owner-occupied .....	93,618	—	1,482	531	—	95,631
	<u>\$ 1,279,971</u>	<u>\$ 10,371</u>	<u>\$ 11,709</u>	<u>\$ 579</u>	<u>\$ —</u>	<u>\$ 1,302,630</u>
	December 31, 2016					
Commercial and industrial .....	\$ 125,097	\$ 810	\$ —	\$ 131	\$ —	\$ 126,038
Commercial mortgages:						
Multifamily .....	603,103	—	7,282	—	—	610,385
Other .....	369,740	1,402	—	—	—	371,142
Owner-occupied .....	102,725	389	—	557	—	103,671
	<u>\$ 1,200,665</u>	<u>\$ 2,601</u>	<u>\$ 7,282</u>	<u>\$ 688</u>	<u>\$ —</u>	<u>\$ 1,211,236</u>

The following tables present the recorded investment in residential mortgage loans, home equity lines and other consumer loans by class of loans and risk rating. Loans shown as Pass are all loans other than those risk rated Watch, Special Mention, Substandard or Doubtful.

<i>(in thousands)</i>	December 31, 2017					
	Internally Assigned Risk Rating					Total
	Pass	Watch	Special Mention	Substandard	Doubtful	
Residential mortgages:						
Closed end .....	\$ 1,554,168	\$ 2,200	\$ 828	\$ 1,368	\$ —	\$ 1,558,564
Revolving home equity .....	82,665	256	704	—	—	83,625
Consumer and other .....	5,236	—	—	—	—	5,236
	<u>\$ 1,642,069</u>	<u>\$ 2,456</u>	<u>\$ 1,532</u>	<u>\$ 1,368</u>	<u>\$ —</u>	<u>\$ 1,647,425</u>
	December 31, 2016					
Residential mortgages:						
Closed end .....	\$ 1,236,152	\$ 982	\$ 441	\$ 856	\$ —	\$ 1,238,431
Revolving home equity .....	84,189	—	501	1,771	—	86,461
Consumer and other .....	8,614	—	—	—	—	8,614
	<u>\$ 1,328,955</u>	<u>\$ 982</u>	<u>\$ 942</u>	<u>\$ 2,627</u>	<u>\$ —</u>	<u>\$ 1,333,506</u>



Deposit account overdrafts were \$297,000 and \$679,000 at December 31, 2017 and 2016, respectively. They are not assigned a risk rating and are therefore excluded from consumer loans in the above tables.

**Loans to Directors and Executive Officers.** Certain directors, including their immediate families and companies in which they are principal owners, and executive officers were loan customers of the Bank during 2017 and 2016. The aggregate outstanding amount of these loans was \$36,000 and \$99,000 at December 31, 2017 and 2016, respectively. During 2017, no new loans were made to such persons. Repayments totaled \$63,000 in 2017. There were no loans to directors or executive officers that were nonaccrual at December 31, 2017 or 2016.

**NOTE D – PREMISES AND EQUIPMENT**

Bank premises and equipment consist of the following:

<i>(in thousands)</i>	December 31,	
	2017	2016
Land .....	\$ 9,038	\$ 8,466
Buildings and improvements .....	26,825	21,660
Leasehold improvements .....	12,652	11,808
Furniture and equipment .....	30,800	29,016
Construction in process .....	2,425	1,911
	<u>81,740</u>	<u>72,861</u>
Accumulated depreciation and amortization .....	(42,092)	(38,500)
	<u>\$ 39,648</u>	<u>\$ 34,361</u>

**NOTE E – DEPOSITS**

The following table sets forth the remaining maturities of the Bank's time deposits.

<i>Year (dollars in thousands)</i>	Less than \$100,000	\$100,000 or More	Total
2018 .....	\$ 27,972	\$ 47,654	\$ 75,626
2019 .....	35,742	54,911	90,653
2020 .....	6,245	13,246	19,491
2021 .....	18,862	33,461	52,323
2022 .....	10,429	28,297	38,726
Thereafter .....	20,268	26,321	46,589
	<u>\$ 119,518</u>	<u>\$ 203,890</u>	<u>\$ 323,408</u>

The total amount of time deposits that meet or exceed the FDIC insurance limit of \$250,000 at December 31, 2017 and 2016 was \$75.1 million and \$63.3 million, respectively. Deposits from executive officers, directors and their affiliates at December 31, 2017 and 2016 were approximately \$9.4 million and \$4.9 million, respectively.

**NOTE F – BORROWED FUNDS**

The following table summarizes borrowed funds at December 31, 2017 and 2016.

<i>(in thousands)</i>	December 31,	
	2017	2016
Short-term borrowings:		
Securities sold under repurchase agreements .....	\$ 11,141	\$ 7,012
Federal Home Loan Bank advances .....	270,000	200,000
	<u>281,141</u>	<u>207,012</u>
Long-term debt:		
Securities sold under repurchase agreements .....	5,000	5,000
Federal Home Loan Bank advances .....	418,797	374,212
	<u>423,797</u>	<u>379,212</u>
	<u>\$ 704,938</u>	<u>\$ 586,224</u>

Accrued interest payable on borrowed funds is included in “accrued expenses and other liabilities” in the consolidated balance sheets and amounted to \$711,000 and \$598,000 at December 31, 2017 and 2016, respectively.

**Securities Sold Under Repurchase Agreements.** Securities sold under repurchase agreements are fixed rate financing arrangements with remaining contractual maturities of up to one year as of December 31, 2017.

At December 31, 2017, the Bank has a \$5 million repurchase agreement outstanding with a commercial bank. At maturity, the securities underlying the agreement will be returned to the Bank. The agreement is subject to counterparty risk arising from the Bank’s pledge of securities collateral in excess of the amount borrowed. This risk is monitored on an ongoing basis through the Bank’s existing correspondent concentration risk policy. The repurchase agreement is callable as of December 31, 2017.

The following table sets forth information concerning securities sold under repurchase agreements.

<i>(dollars in thousands)</i>	2017	2016
Average daily balance during the year .....	\$ 15,903	\$ 24,403
Average interest rate during the year .....	1.77%	2.58%
Maximum month-end balance during the year .....	\$ 19,188	\$ 47,938
Weighted average interest rate at year-end .....	1.72%	2.30%

The following table sets forth as of December 31, 2017 the contractual maturities and weighted average interest rates of securities sold under repurchase agreements for each of the next five years. There are no securities sold under repurchase agreements with contractual maturities after 2018.

<i>Contractual Maturity (dollars in thousands)</i>	Amount	Weighted Average Rate
Overnight .....	\$ 11,141	.05%
2018 .....	5,000	5.45
	<u>\$ 16,141</u>	<u>1.72%</u>

Overnight repurchase agreements at December 31, 2017 are collateralized by \$3.2 million of municipal securities and repurchase agreements due in 2018 are collateralized by \$5.5 million of mortgage-backed securities.

**Federal Home Loan Bank Advances.** FHLB advances are collateralized by a blanket lien on residential and commercial mortgage loans with a lendable value of \$2.0 billion at December 31, 2017 and residential and commercial mortgage loans with a lendable value of \$1.7 billion at December 31, 2016. Each advance is non-amortizing and, for those advances with a term greater than one day, subject to a prepayment penalty.

The following table sets forth information concerning FHLB advances.

<i>(dollars in thousands)</i>	2017	2016
Average daily balance during the year .....	\$ 524,404	\$ 408,151
Average interest rate during the year .....	1.68%	1.70%
Maximum month-end balance during the year .....	\$ 688,797	\$ 574,212
Weighted average interest rate at year-end .....	1.75%	1.45%

The following table sets forth as of December 31, 2017 the contractual maturities and weighted average interest rates of FHLB advances for each of the next five years and the period thereafter.

<u>Contractual Maturity (dollars in thousands)</u>	<u>Amount</u>	<u>Weighted Average Rate</u>
Overnight .....	\$ 270,000	1.53%
2018 .....	96,450	1.71
2019 .....	73,500	1.91
2020 .....	82,750	1.84
2021 .....	54,225	1.90
2022 .....	75,872	2.05
After 2022 .....	36,000	2.06
	<u>418,797</u>	<u>1.89</u>
	<u>\$ 688,797</u>	<u>1.75%</u>

**Other Borrowings.** The Bank had no other borrowings at December 31, 2017 or 2016, or at any time during 2016. In 2017, the average balance of other borrowings were de minimis.

#### **NOTE G – INCOME TAXES**

The Corporation, the Bank and the Bank’s subsidiaries, except for the REIT, file a consolidated federal income tax return. Income taxes charged to earnings in 2017, 2016 and 2015 had effective tax rates of 22.0%, 22.7% and 22.4%, respectively. The following table sets forth a reconciliation of the statutory federal income tax rate to the Corporation’s effective tax rate.

	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutory federal income tax rate .....	35.0%	35.0%	35.0%
State and local income taxes, net of federal income tax benefit .....	2.0	.9	2.1
Tax-exempt income, net of disallowed cost of funding .....	(10.2)	(11.8)	(14.0)
BOLI income .....	(1.2)	(.9)	(.9)
Excess tax benefit of stock-based compensation .....	(1.7)	(.9)	—
Impact of federal tax reform on deferred taxes .....	(2.0)	—	—
Other .....	.1	.4	.2
	<u>22.0%</u>	<u>22.7%</u>	<u>22.4%</u>

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. The Corporation recorded a \$909,000 credit to income tax expense in 2017, representing a 2.0% reduction in the effective tax rate, resulting from a decrease in the net deferred tax liability to reflect the change in federal tax law.

**Provision for Income Taxes.** The following table sets forth the components of the provision for income taxes.

<u>(in thousands)</u>	<u>Year Ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current:			
Federal .....	\$ 8,139	\$ 7,407	\$ 7,473
State and local .....	636	409	874
	<u>8,775</u>	<u>7,816</u>	<u>8,347</u>
Deferred:			
Federal .....	335	1,114	(1,059)
State and local .....	779	119	178
	<u>1,114</u>	<u>1,233</u>	<u>(881)</u>
	<u>\$ 9,889</u>	<u>\$ 9,049</u>	<u>\$ 7,466</u>

**Net Deferred Tax Liability.** The following table sets forth the components of the Corporation's net deferred tax liability.

<i>(in thousands)</i>	December 31,	
	2017	2016
Deferred tax assets:		
Allowance for loan losses and off-balance-sheet credit exposure .....	\$ 10,097	\$ 12,613
Interest on nonperforming loans .....	55	75
Accrued bonuses .....	—	622
Accrued legal settlement .....	12	21
Stock-based compensation .....	1,382	1,548
Supplemental executive retirement expense .....	17	24
Directors' retirement expense .....	47	66
Accrued rent expense .....	224	277
Depreciation .....	724	567
Other real estate owned valuation allowance and asset writedown .....	266	70
	12,824	15,883
Valuation allowance .....	—	—
	12,824	15,883
Deferred tax liabilities:		
Prepaid pension .....	5,615	7,144
Unrealized gains on available-for-sale securities .....	1,259	1,101
Deferred loan costs .....	5,142	6,840
Prepaid expenses .....	146	141
REIT spillover dividend and other .....	3,043	725
	15,205	15,951
Net deferred tax liability .....	\$ 2,381	\$ 68

Unrecognized tax benefits at December 31, 2017 were immaterial. The Corporation had no unrecognized tax benefits at December 31, 2016 and 2015. The Corporation has not taken any tax positions for which it is reasonably possible that unrecognized tax benefits will significantly increase within the next twelve months.

The Corporation is subject to Federal, New York State, New York City, New Jersey and Connecticut income taxes. The Corporation did not incur any amounts for interest and penalties due taxing authorities for calendar years 2017, 2016 or 2015. The Corporation's 2015 federal income tax return is currently under examination.

#### **NOTE H – REGULATORY MATTERS**

**Minimum Regulatory Capital Requirements.** The Corporation and the Bank are subject to the Basel III regulatory capital requirements issued by the Federal Reserve Board and the Office of the Comptroller of the Currency. These requirements are intended to ensure that the Corporation and the Bank maintain minimum ratios of Tier 1 capital to average assets as well as Common Equity Tier 1 capital, Tier 1 capital and Total capital to risk weighted assets. Failure to meet the minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on the financial statements of the Corporation and Bank.

Basel III includes guidelines with respect to the components of regulatory capital and calculation of risk weighted assets for balance sheet assets and liabilities and off-balance-sheet positions. The Corporation and the Bank exclude accumulated other comprehensive income components from Tier 1 and Total regulatory capital.

Basel III sets forth prompt corrective action (“PCA”) requirements for all banks and establishes a capital conservation buffer and multi-year capital ratio phase-in schedule with full phase-in by 2019. The Corporation and the Bank exceeded the Basel III minimum capital adequacy requirements, including the capital conservation buffer of 1.25% applicable to the Bank for 2017, and the Bank was well capitalized under the PCA provisions at December 31, 2017. The Corporation’s and the Bank’s actual capital amounts and ratios under the Basel III rules at December 31, 2017 and 2016 are presented in the table below.

<i>(dollars in thousands)</i>	2017					
	Actual Capital		Minimum Capital Adequacy Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 capital to average assets:						
Consolidated.....	\$ 353,684	9.34%	\$ 151,398	4.00%	N/A	N/A
Bank .....	353,568	9.34	151,358	4.00	\$ 189,197	5.00%
Common equity tier 1 capital to risk weighted assets:						
Consolidated.....	353,684	15.28	104,128	4.50	N/A	N/A
Bank .....	353,568	15.29	104,051	4.50	150,296	6.50
Tier 1 capital to risk weighted assets:						
Consolidated.....	353,684	15.28	138,837	6.00	N/A	N/A
Bank .....	353,568	15.29	138,735	6.00	184,980	8.00
Total capital to risk weighted assets:						
Consolidated.....	382,670	16.54	185,116	8.00	N/A	N/A
Bank .....	382,533	16.54	184,980	8.00	231,225	10.00
	2016					
Tier 1 capital to average assets:						
Consolidated.....	\$ 307,214	8.89%	\$ 138,249	4.00%	N/A	N/A
Bank .....	307,491	8.90	138,224	4.00	\$ 172,781	5.00%
Common equity tier 1 capital to risk weighted assets:						
Consolidated.....	307,214	14.70	94,032	4.50	N/A	N/A
Bank .....	307,491	14.72	94,022	4.50	135,809	6.50
Tier 1 capital to risk weighted assets:						
Consolidated.....	307,214	14.70	125,377	6.00	N/A	N/A
Bank .....	307,491	14.72	125,362	6.00	167,150	8.00
Total capital to risk weighted assets:						
Consolidated.....	333,384	15.95	167,169	8.00	N/A	N/A
Bank .....	333,658	15.97	167,150	8.00	208,937	10.00

**Other Matters.** A source of funds for dividend payments to shareholders is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid by the Bank without prior approval of regulatory agencies. Under these regulations, the amount of dividends that the Bank may pay in any calendar year is limited to the current year’s net profits, combined with the retained net profits of the preceding two years, subject to the minimum capital requirements described above. During 2018, the Bank could, without prior approval, declare dividends of approximately \$52,669,000 plus any 2018 net profits retained to the date of the dividend declaration.

Regulation D of the Board of Governors of The Federal Reserve System requires banks to maintain reserves against certain deposit balances. The Bank’s average reserve requirement for 2017 was approximately \$29,917,000.

**NOTE I – STOCK-BASED COMPENSATION**

On April 22, 2014, the stockholders of the Corporation approved the 2014 Equity Incentive Plan (“2014 Plan”). Upon approval of the 2014 Plan, no further awards could be made under the 2006 Stock Compensation Plan (“2006 Plan”).

**2014 Plan.** Under the 2014 Plan, awards may be granted to employees and non-employee directors as non-qualified stock options (“NQSOs”), stock appreciation rights (“SARs”), restricted stock awards, RSUs, or any combination thereof, any of which may be subject to performance-based vesting conditions. Awards may also be granted to employees as incentive stock options (“ISOs”). The exercise price of stock options and SARs granted under the 2014 Plan may not be less than the fair market value of the Corporation’s common stock on the date the stock option is granted. The 2014 Plan is administered by the Compensation Committee of the Board of Directors. Almost all of the awards granted to date under the 2014 Plan are RSUs. All awards granted under the 2014 Plan will immediately vest upon an involuntary termination following a change in control, total and permanent disability, as defined, or death, and with certain exceptions, will immediately vest in the event of retirement, as defined.

The Corporation has 2,250,000 shares of common stock reserved for awards under the 2014 Plan. Awards granted under the 2006 Plan that expire or are forfeited after April 22, 2014 will be added to the number of shares of common stock reserved for issuance of awards under the 2014 Plan. All of the 2,250,000 shares may be issued pursuant to the exercise of stock options or SARs. A maximum of 787,500 shares may be issued as restricted stock awards or RSUs. At December 31, 2017, 1,933,819 equity awards remain available to be granted under the 2014 Plan of which 454,449 may be granted as restricted stock awards or RSUs.

**Details of RSUs.** The following table summarizes the vesting schedule of RSUs outstanding at December 31, 2017.

	2017	2016	2015
Number of RSUs :			
Awarded during the year .....	94,329	107,274	112,868
Outstanding at December 31, 2017.....	<u>92,997</u>	<u>88,074</u>	<u>93,063</u>
Vested and convertible at December 31, 2017 ....	—	—	86,532
Scheduled to vest during:			
2018 .....	10,113	78,278	6,531
2019 .....	69,208	7,546	—
2020 .....	10,426	2,250	—
2021 .....	3,250	—	—
Total RSUs vested and expected to vest.....	<u>92,997</u>	<u>88,074</u>	<u>93,063</u>

The RSUs in the table above include performance-based RSUs with vesting based on the financial performance of the Corporation in 2017, 2018 and 2019 and service-based RSUs with various service-based vesting periods. The grant date fair value of RSUs awarded in 2016 is equal to the market price of the shares underlying the awards on the grant date. The grant date fair value of RSUs awarded in 2015 and 2017 is equal to the market price of the shares underlying the awards on the grant date, discounted for dividends that are not paid on these RSUs. The fair values of awards made in 2017, 2016 and 2015, as well as the assumptions utilized in determining such values, is presented below.

	<b>2017</b>	
	Performance-Based Vesting	Service-Based Vesting
Grant date fair value .....	\$26.27	\$25.35 to \$26.00
Market price on grant date.....	\$27.90	\$27.50 to \$28.15
Expected annual dividend.....	\$.56	\$.56
Expected term (in years).....	3.0	3.0 to 4.0
Risk-free interest rate .....	1.49%	1.60% to 1.67%
	<b>2016</b>	
Grant date fair value .....	\$18.17	\$18.17 to \$22.17
Market price on grant date.....	\$18.17	\$18.17 to \$22.17
	<b>2015</b>	
Grant date fair value .....	\$14.12	\$15.61 to \$16.94
Market price on grant date.....	\$15.63	\$17.13 to \$18.51
Expected annual dividend.....	\$.51	\$.51 to \$.53
Expected term (in years).....	3.0	3.0
Risk-free interest rate .....	.21%	.28% to .38%

In January 2018, 72,128 RSUs were awarded under the 2014 Plan, including 32,840 performance-based RSUs and 39,288 service-based RSUs.

The following table presents a summary of RSUs outstanding at December 31, 2017 and changes during the year then ended.

	Number of RSUs	Weighted- Average Grant-Date Fair Value	Weighted- Average Remaining Contractual Term (yrs.)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2017.....	245,010	\$ 16.52		
Granted .....	94,329	26.24		
Converted.....	(65,205)	17.48		
Outstanding at December 31, 2017.....	<u>274,134</u>	<u>\$ 19.64</u>	<u>0.94</u>	<u>\$ 7,813</u>
Vested and Convertible at December 31, 2017.....	<u>86,532</u>	<u>\$ 14.12</u>	<u>—</u>	<u>\$ 2,466</u>

The performance-based RSUs granted in 2017 have a maximum payout potential of 1.25 shares of the Corporation's common stock for each RSU awarded. All other RSUs outstanding at December 31, 2017 have a maximum payout potential of one share of the Corporation's common stock for each RSU awarded. RSUs outstanding at December 31, 2017 include 86,532 RSUs that were vested and convertible into common stock at year-end and 187,602 RSUs that are currently expected to vest and become convertible in the future. The total intrinsic value of RSUs converted in 2017, 2016 and 2015 was \$1,779,000, \$1,445,000 and \$965,000, respectively.

**2006 Plan.** The 2006 Plan was approved by the stockholders of the Corporation on April 18, 2006. The 2006 Plan permitted the granting of stock options, SARs, restricted stock awards and RSUs to employees and non-employee directors. Under the terms of the 2006 Plan, stock options and SARs could not have an exercise price that was less than 100% of the fair market value of one share of the underlying common stock on the date of grant. Through December 31, 2011, equity grants to executive officers and directors under the 2006 Plan consisted of a combination of NQSOs and RSUs, while equity grants to other officers consisted solely of NQSOs. Beginning in 2012, equity grants under the 2006 Plan consisted solely of RSUs. Stock options granted under the 2006 Plan have a five year vesting period and a ten year term.

**Fair Value of Stock Options.** The grant date fair value of options was estimated on the date of grant using the Black-Scholes option pricing model. Expected volatility was based on historical volatility for the expected term of the options. The Corporation used historical data to estimate the expected term of options granted. The risk-free interest rate was the implied yield at the time of grant on U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the options.

**Stock Option Activity.** The following table presents a summary of options outstanding at December 31, 2017 and changes during the year then ended.

	Number of Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (yrs.)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2017.....	257,262	\$ 10.61		
Exercised.....	(97,455)	9.41		
Outstanding at December 31, 2017.....	<u>159,807</u>	<u>\$ 11.35</u>	<u>2.08</u>	<u>\$ 2,741</u>
Exercisable at December 31, 2017.....	<u>159,357</u>	<u>\$ 11.33</u>	<u>2.07</u>	<u>\$ 2,736</u>

All options outstanding at December 31, 2017 are either fully vested or expected to vest. The total intrinsic value of options exercised in 2017, 2016 and 2015 was \$1,833,000, \$853,000 and \$602,000, respectively.

**Compensation Expense.** The Corporation recorded compensation expense for share-based payments of \$2,434,000, \$1,517,000 and \$1,319,000 in 2017, 2016 and 2015, respectively, and related income tax benefits of \$1,019,000, \$637,000 and \$543,000, respectively.

**Unrecognized Compensation Cost.** As of December 31, 2017, there was \$1,408,000 of total unrecognized compensation cost related to non-vested equity awards comprised of \$2,000 for options and \$1,406,000 for RSUs. The total cost is expected to be recognized over a weighted-average period of 1.50 years which is based on weighted average periods of 2.43 years and 1.49 years for options and RSUs, respectively.

**Cash Received and Tax Benefits Realized.** Cash received from option exercises in 2017, 2016 and 2015, was \$917,000, \$906,000 and \$707,000, respectively. Tax benefits from stock option exercises were \$767,000, \$356,000 and \$240,000 in 2017, 2016 and 2015, respectively.

**Other.** No cash was used to settle stock options in 2017, 2016 or 2015. The Corporation uses newly issued shares to settle stock option exercises and for the conversion of RSUs. During 2017, 2,060 shares of the Corporation's common stock were issued to a member of the Board of Directors in payment of director fees.

**NOTE J – RETIREMENT PLANS**

The Bank has a 401(k) plan, defined benefit pension plan and supplemental executive retirement plan. Employees are immediately eligible to participate in the 401(k) plan provided they are at least 18 years of age. Participants may elect to contribute, on a tax-deferred basis, up to 100% of gross compensation, as defined, subject to the limitations of Section 401(k) of the Internal Revenue Code. The Bank may, at its sole discretion, make matching contributions to each participant's account based on the amount of the participant's tax deferred contributions. Participants are fully vested in their elective contributions and, after five years of participation in the 401(k) plan, are fully vested (20% vesting per year) in the matching contributions, if any, made by the Bank. The Bank's expense for matching contributions was \$441,000, \$396,000 and \$397,000 for 2017, 2016 and 2015, respectively.

The Bank has a defined benefit pension plan ("Pension Plan" or "Plan"). An internal management committee (the "Committee") oversees the affairs of the Plan and acts as named fiduciary. The Committee has retained Vanguard Group, Inc., including its subsidiaries and affiliates ("Vanguard"), to act as discretionary investment agent, trustee and custodian for the Plan. Vanguard has formulated investment recommendations customized to meet the Committee's objectives and, after approval by the Committee, such investment recommendations are incorporated into the investment guidelines and policies contained in the investment management agreement between the Bank and Vanguard (the "Investment Management Agreement"). The Committee adopted a formal Investment Policy Statement which includes, among other things, the investment guidelines and policies contained in the Investment Management Agreement. The Investment Policy Statement is periodically revised by the Committee as deemed appropriate.

Employees are eligible to participate in the Pension Plan after attaining 21 years of age and completing 12 full months of service. Pension benefits are generally based on a percentage of average annual compensation during the period of creditable service. The Bank makes contributions to the Pension Plan which, when taken together with participant contributions equal to 2% of their compensation, will be sufficient to fund these benefits. The Bank's funding method, the unit credit actuarial cost method, is consistent with the funding requirements of applicable federal laws and regulations which set forth both minimum required and maximum tax deductible contributions. Employees become fully vested after four years of participation in the Pension Plan (no vesting occurs during the four-year period).

**Significant Actuarial Assumptions.** The following table sets forth the significant actuarial assumptions used to determine the benefit obligation at December 31, 2017, 2016 and 2015 and the benefit cost for each of the Plan years then ended.

	2017	2016	2015
Weighted average assumptions used to determine the benefit obligation at year end:			
Discount rate .....	3.93%	4.40%	4.54%
Rate of increase in compensation levels .....	3.50%	3.50%	3.50%
Weighted average assumptions used to determine net pension cost:			
Discount rate .....	4.40%	4.54%	4.02%
Rate of increase in compensation levels .....	3.50%	3.50%	3.50%
Expected long-term rate of return on plan assets .....	5.50%	6.00%	6.00%

The decrease in the discount rate from 4.40% in 2016 to 3.93% in 2017 increased the projected benefit obligation at December 31, 2017 by approximately \$2,377,000. In calculating the benefit obligation at December 31, 2017, the mortality table previously utilized, RP-2014 Healthy Annuitant/Employee Mortality Table with Projection Scale MP-2016, was adjusted to reflect Scale MP-2017. The updated mortality table decreased the projected benefit obligation at December 31, 2017 by approximately \$277,000.

The decrease in the discount rate from 4.54% in 2015 to 4.40% in 2016 increased the projected benefit obligation at December 31, 2016 by \$643,000. In calculating the benefit obligation at December 31, 2016, the mortality table previously utilized, RP-2014 Healthy Annuitant/Employee Mortality Table with Projection Scale MP-2015, was adjusted to reflect Scale MP-2016. The updated mortality table decreased the projected benefit obligation at December 31, 2016 by approximately \$536,000. In addition, a change in the withdrawal/ turnover assumption from the T-3 table of the Pension Actuary's Handbook to the 2003 SOA Pension Plan Turnover Table decreased the projected benefit obligation at December 31, 2016 by \$157,000.



The increase in the discount rate from 4.02% in 2014 to 4.54% in 2015 decreased the projected benefit obligation at December 31, 2015 by \$2,915,000. In calculating the benefit obligation at December 31, 2015, the mortality table was changed from RP-2014 Healthy Annuitant/Employee Mortality Table with Projection Scale MP-2014 to reflect Scale MP-2015. The updated mortality table decreased the projected benefit obligation at December 31, 2015 by approximately \$270,000.

**Net Pension Cost.** The following table sets forth the components of net periodic pension cost.

<i>(in thousands)</i>	2017	2016	2015
Service cost plus expected expenses and net of expected plan participant contributions .....	\$ 1,214	\$ 1,142	\$ 1,189
Interest cost .....	1,590	1,584	1,408
Expected return on plan assets .....	(2,940)	(2,953)	(3,086)
Amortization of net actuarial loss .....	18	244	—
Net pension cost (credit) .....	<u>\$ (118)</u>	<u>\$ 17</u>	<u>\$ (489)</u>

No portion of the net actuarial loss for the defined benefit plan will be amortized from accumulated other comprehensive income into net periodic pension cost in 2018. Prior service cost was fully amortized from accumulated other comprehensive income into net periodic pension cost as of December 31, 2014.

**Funded Status of the Plan.** The following table sets forth the change in the projected benefit obligation and Plan assets for each year and, as of the end of each year, the funded status of the Plan and accumulated benefit obligation.

<i>(in thousands)</i>	2017	2016	2015
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year .....	\$ 37,016	\$ 35,684	\$ 35,787
Service cost .....	1,386	1,283	1,267
Interest cost .....	1,590	1,584	1,408
Benefits paid .....	(1,510)	(1,364)	(1,288)
Assumption changes .....	2,100	(50)	(3,185)
Experience loss (gain) and other .....	802	(121)	1,695
Projected benefit obligation at end of year .....	<u>41,384</u>	<u>37,016</u>	<u>35,684</u>
Change in fair value of plan assets:			
Fair value of plan assets at beginning of year .....	54,332	50,021	52,208
Actual return on plan assets .....	7,497	3,919	(1,071)
Employer contributions .....	—	1,553	—
Plan participant contributions .....	321	301	270
Benefits paid .....	(1,510)	(1,365)	(1,288)
Expenses .....	(104)	(97)	(98)
Fair value of plan assets at end of year .....	<u>60,536</u>	<u>54,332</u>	<u>50,021</u>
Funded status at end of year .....	<u>\$ 19,152</u>	<u>\$ 17,316</u>	<u>\$ 14,337</u>
Accumulated benefit obligation .....	<u>\$ 38,544</u>	<u>\$ 34,451</u>	<u>\$ 32,716</u>

During 2017, the Bank did not make a contribution into the Plan and the Bank has no minimum required pension contribution for the Plan year ending September 30, 2018. The Bank cannot make a tax-deductible contribution for the tax year beginning January 1, 2018.

**Plan Assets.** The objective for the Plan's assets is to generate long-term investment returns from both income and capital appreciation which outpaces the rate of inflation, while maintaining sufficient liquidity to ensure the Plan's ability to pay all anticipated benefit and expense obligations when due. The Plan will maintain a de minimis amount of cash equivalents, with the remaining assets allocated across two broadly-defined financial asset categories: (1) equity, both domestic and international; and (2) fixed income of various durations and issuer type. The goal of the equity allocation is to supplement the Bank's contributions to the Plan when the Plan is underfunded and increase surplus when the Plan is overfunded. The fixed income component will include longer-duration bonds designed to match and hedge the characteristics of the Plan's liabilities. Cash equivalents, under normal circumstances, will be temporary holdings for the purpose of paying expenses and monthly benefits.

For fixed income investments: (1) the minimum average credit quality shall be investment grade (Standard & Poor's BBB or Moody's Baa) or higher; and (2) no more than 5% of the portfolio may be invested in securities with ratings below investment grade, and none may be rated below investment grade at the time of purchase.

Reasonable precautions are taken to avoid excessive concentrations to protect the portfolio against unfavorable outcomes within an asset class. Specifically, the following guidelines are in place:

- With the exception of fixed income investments explicitly guaranteed by the U.S. government, no single investment security shall represent more than 5% of total Plan assets; and
- With the exception of passively managed investment vehicles seeking to match the returns of broadly diversified market indices or diversified investment vehicles chosen specifically to hedge the interest rate risk embedded in Plan liabilities, no single investment pool or investment company (mutual fund) shall comprise more than 10% of total plan assets.

The portfolio will be rebalanced to the target asset allocation, if needed, no less often than quarterly. Unless expressly authorized in writing by the Committee, the following investing activities are prohibited:

- Purchasing securities on margin;
- Pledging or hypothecating securities, except for loans of securities that are fully collateralized;
- Purchasing or selling derivative securities for speculation or leverage; and
- Engaging in investment strategies that have the potential to amplify or distort the risk of loss beyond a level that is reasonably expected given the objectives of the portfolio.

The Plan's actual asset allocations, target allocations and expected long-term rates of return by asset category at December 31, 2017 and 2016 are set forth in the tables that follow.

	December 31, 2017		
	Target Allocation	Percentage of Plan Assets	Weighted Average Expected Long-term Rates of Return
Cash equivalents .....	0% - 1%	.2%	<1.00%
Equity mutual funds .....	15% - 25%	20.1%	6.2% to 8.4%
Fixed income mutual funds.....	75% - 85%	79.7%	3.4% to 4.4%
		<u>100.0%</u>	4.5% to 5.5%
	December 31, 2016		
Cash equivalents .....	0% - 1%	.2%	<1.00%
Equity mutual funds .....	15% - 25%	19.8%	5.4% to 11.4%
Fixed income mutual funds.....	75% - 85%	80.0%	3.2% to 4.2%
		<u>100.0%</u>	3.6% to 5.6%

The ranges for the weighted average expected long-term rates of return for equity funds, bond funds and total plan assets set forth in the preceding table represent expected 25<sup>th</sup> to 75<sup>th</sup> percentile returns provided by Vanguard. For these purposes Vanguard utilizes a proprietary capital markets model (the "model") developed and maintained by Vanguard's primary investment research and advice teams. The model forecasts distributions of future returns for a wide array of broad asset classes. The theoretical and empirical foundation of the model is that the returns of various asset classes reflect the compensation investors require for bearing different types of systematic risk. At the core of the model are estimates of the dynamic statistical relationship between risk factors and asset returns, obtained from statistical analysis based on available historical monthly financial and economic data.

At December 31, 2017, the equity and fixed income components of Plan assets consist of the following Vanguard institutional funds:

**Equity**

- Vanguard Total Stock Market Index Fund (VITSX). This fund seeks to track the performance of the Center for Research in Security Prices (CRSP) U.S. Total Market Index. The fund is passively managed using index sampling and consists of large, small and mid-cap equity securities diversified across growth and value styles.
- Vanguard Total International Stock Index Fund (VTSNX). This fund seeks to track the performance of the Financial Times Stock Exchange (FTSE) Global All Cap ex U.S. Index. The fund is passively managed and includes broad exposure across developed and emerging non-U.S. equity markets.

## Fixed Income

- Vanguard Long-Term Investment-Grade Fund (VWETX). This fund seeks high and sustainable current income. Investments are selected using a fundamental, bottom-up credit selection process and consist of long-term, high-quality bonds broadly diversified by issuer and industry sector.
- Vanguard Long-Term Bond Index Fund (VBLLX). This fund seeks high current income with high credit quality and to track the performance of the Barclays U.S. Long Government/Credit Float Adjusted Index. The fund is passively managed using index sampling and includes diversified exposure to long-term, investment-grade U.S. bond market instruments. Obligations of the U.S. government make up a significant portion of the fund's holdings.

**Fair Value of Plan Assets.** The fair value of the Plan assets at December 31, 2017 and 2016, by asset category, is summarized below.

(in thousands)	Total	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2017:</b>				
Cash equivalents:				
Vanguard Prime Money Market Mutual Fund .....	\$ 117	\$ —	\$ 117	\$ —
Total cash equivalents .....	117	—	117	—
Equity mutual funds:				
Vanguard Total Stock Market Index Fund (VITSX) .....	6,658	6,658	—	—
Vanguard Total International Stock Index Fund (VTSNX) .....	5,479	5,479	—	—
Total equity mutual funds.....	12,137	12,137	—	—
Fixed income mutual funds:				
Vanguard Long-Term Investment Grade Fund (VWETX) .....	29,065	29,065	—	—
Vanguard Long-Term Bond Index Fund (VBLLX).....	19,217	19,217	—	—
Total fixed income mutual funds.....	48,282	48,282	—	—
Total Plan Assets .....	\$ 60,536	\$ 60,419	\$ 117	\$ —
<b>December 31, 2016:</b>				
Cash equivalents:				
Vanguard Prime Money Market Mutual Fund .....	\$ 107	\$ —	\$ 107	\$ —
Total cash equivalents .....	107	—	107	—
Equity mutual funds:				
Vanguard Total Stock Market Index Fund (VITSX) .....	5,997	5,997	—	—
Vanguard Total International Stock Index Fund (VTSNX) .....	4,777	4,777	—	—
Total equity mutual funds.....	10,774	10,774	—	—
Fixed income mutual funds:				
Vanguard Long-Term Investment Grade Fund (VWETX) .....	26,075	26,075	—	—
Vanguard Long-Term Bond Index Fund (VBLLX).....	17,376	17,376	—	—
Total fixed income mutual funds.....	43,451	43,451	—	—
Total Plan Assets .....	\$ 54,332	\$ 54,225	\$ 107	\$ —

The fair values of the Vanguard mutual funds represent their net asset values (“NAV”) at December 31, 2017 and 2016. On an ongoing basis, the Plan has the ability to readily redeem its investments in these funds at their NAV per share with no advance notification.

An explanation of matrix pricing and the definitions of Level 1, 2 and 3 fair value measurements are included in “Note M – Fair Value of Financial Instruments” to these consolidated financial statements.

At both December 31, 2017 and 2016, the Plan’s cash and cash equivalents amounted to .2% of the Plan’s total assets and represented investments in the Vanguard Prime Money Market Mutual Fund.

**Estimated Future Benefit Payments.** The following benefit payments, which reflect expected future service as appropriate, are expected to be made by the Plan.

<u>Year (dollars in thousands)</u>	<u>Amount</u>
2018 .....	\$ 1,777
2019 .....	1,859
2020 .....	2,036
2021 .....	2,155
2022 .....	2,329
2023 – 2027 .....	13,480

The Bank's Supplemental Executive Retirement Plan ("SERP") currently covers the Bank's Chief Executive Officer ("CEO"). The benefit under the SERP is equal to the additional amount that the CEO would be entitled to under the Pension and 401(k) plans in the absence of Internal Revenue Code limitations. SERP expense was \$31,000, \$197,000 and \$271,000 in 2017, 2016 and 2015, respectively.

**NOTE K – OTHER OPERATING EXPENSES**

Expenses included in other operating expenses that exceed one percent of the aggregate of total interest income and noninterest income in one or more of the years shown are as follows:

<u>(in thousands)</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Computer services.....	\$ 1,888	\$ 2,631	\$ 2,212
Marketing.....	1,442	1,053	877
FDIC assessment.....	1,178	1,379	1,472
Consultants.....	702	1,337	576

**NOTE L – COMMITMENTS AND CONTINGENT LIABILITIES**

**Financial Instruments With Off-Balance-Sheet Risk.** In the normal course of business, the Bank enters into various types of off-balance-sheet arrangements to meet the financing needs of its customers. These off-balance-sheet financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. These instruments involve varying degrees of credit risk in excess of the amount recognized in the consolidated balance sheets and expose the Bank to credit loss in the event of nonperformance by the Bank's customers. The Bank's exposure to credit loss is represented by the contractual notional amount of these instruments. The Bank uses the same credit policies in making commitments to extend credit, and generally uses the same credit policies for letters of credit, as it does for on-balance sheet instruments such as loans.

At December 31, 2017 and 2016, financial instruments whose contract amounts represent credit risk are as follows:

<u>(in thousands)</u>	<u>2017</u>		<u>2016</u>	
	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>
Commitments to extend credit .....	\$ 90,635	\$ 227,385	\$ 67,289	\$ 264,404
Standby letters of credit .....	4,244	—	5,596	—

A commitment to extend credit is a legally binding agreement to lend to a customer as long as there is no violation of any condition established in the contract. Unused home equity, small business and commercial lines of credit are a large component of the Bank's variable rate loan commitments. Since some of the commitments to extend credit and letters of credit are expected to expire without being drawn upon and, with respect to unused lines of credit, can be frozen, reduced or terminated by the Bank based on the financial condition of the borrower, the total commitment amounts do not necessarily represent future cash requirements. Home equity lines generally expire ten years from their date of origination and small business lines generally have a three-year term. Other real estate loan commitments generally expire within 60 days and commercial loan commitments generally expire within one year. At December 31, 2017, the Bank's fixed rate loan commitments are to make loans with interest rates ranging from 3.50% to 4.75% and maturities of ten years or more. The amount of collateral obtained, if any, by the Bank upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include mortgages on commercial and residential real estate, security interests in business assets, equipment, deposit accounts with the Bank or other financial institutions and securities.

Standby letters of credit are conditional commitments issued by the Bank to assure the performance or financial obligations of a customer to a third party. The Bank's standby letters of credit extend through April 2019. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The Bank generally holds collateral and/or obtains personal guarantees supporting these commitments. The extent of collateral held for these commitments at December 31, 2017 varied from 0% to 100% of the contractual notional amount of each instrument, with the average amount of collateral totaling 96% of the aggregate outstanding notional amount. Standby letters of credit are considered financial guarantees and are recorded at fair value.

**Employment Agreements.** At December 31, 2017, the chief executive officer, senior executive vice president and the Corporation's other executive vice presidents, collectively referred to as the senior executives, had employment agreements with the Corporation under which they are entitled to severance compensation in the event that their employment is terminated without cause or they terminate their employment following an event constituting Good Reason, as defined. The chief executive officer's contract has a term of three (3) years beginning January 1, 2017 and can be extended at the option of the Board of Directors of the Corporation (the "Board") for an additional period of one year. The other senior executives have contracts with a term of two (2) years beginning January 1, 2017. Except for one of these two-year contracts, these contracts automatically renew for an additional period of one year on each anniversary date unless the Corporation gives written notice of non-renewal at least thirty (30) days prior to such date. The one two-year contract that does not automatically renew, can be extended at the option of the Board for an additional period of one year. Notwithstanding the foregoing, each of the automatically renewing two-year contracts will expire on December 31 of the calendar year in which the senior executive attains normal retirement age, which for these purposes is age 65. Pursuant to their terms, the Corporation can elect to extend these agreements for an additional period of two years. The current aggregate annual salaries provided for in these contracts is \$2,398,000.

**Lease Commitments.** At December 31, 2017, minimum annual rental commitments under non-cancelable operating leases are as follows:

<u>Year (dollars in thousands)</u>	<u>Amount</u>
2018.....	\$ 2,763
2019.....	2,749
2020.....	2,615
2021.....	2,500
2022.....	2,447
Thereafter.....	8,046
	<u>\$ 21,120</u>

The Bank has various renewal options on the above leases. Rent expense, including amounts paid for real estate taxes and common area maintenance, was \$2,466,000, \$2,085,000 and \$1,885,000 in 2017, 2016 and 2015, respectively.

**Related Party Leases.** Buildings occupied by two of the Bank's branch offices are leased from a director of the Corporation and the Bank. The leases expire on October 31, 2022 and December 31, 2019 with options to renew. The Bank expects to renew both leases prior to their expiration. Aggregate base rent expense for these leases, plus a proportionate share of real estate taxes on one of the leased properties, amounted to approximately \$78,000 for each of the years ending December 31, 2017, 2016 and 2015. The Corporation believes that the terms of the leases are comparable to competitive terms that could have been obtained from an unrelated third party.

**Litigation.** The Corporation is a named defendant in several legal actions incidental to the business. For some of these actions there is a possibility that the Corporation will sustain a financial loss. Management believes that none of the possible losses are material.

**NOTE M – FAIR VALUE OF FINANCIAL INSTRUMENTS**

**Financial Instruments Recorded at Fair Value.** When measuring fair value, the Corporation uses a fair value hierarchy, which is designed to maximize the use of observable inputs and minimize the use of unobservable inputs. The hierarchy involves three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect the Corporation's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation deems transfers between levels of the fair value hierarchy to have occurred on the date of the event or change in circumstance that caused the transfer. There were no transfers between levels of the fair value hierarchy in either 2017 or 2016.

The fair values of the Corporation's investment securities designated as available-for-sale at December 31, 2017 and 2016 are set forth in the tables that follow. These values are determined on a recurring basis using matrix pricing (Level 2 inputs). Matrix pricing, which is a mathematical technique widely used in the industry to value debt securities, does not rely exclusively on quoted prices for the specific securities but rather on the relationship of such securities to other benchmark quoted securities.

<i>(in thousands)</i>	Total	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Available-for-Sale Securities:</b>				
December 31, 2017:				
State and municipals.....	\$ 461,323	\$ —	\$ 461,323	\$ —
Pass-through mortgage securities.....	71,391	—	71,391	—
Collateralized mortgage obligations.....	187,414	—	187,414	—
	<u>\$ 720,128</u>	<u>\$ —</u>	<u>\$ 720,128</u>	<u>\$ —</u>
December 31, 2016:				
State and municipals.....	\$ 450,660	\$ —	\$ 450,660	\$ —
Pass-through mortgage securities.....	185,809	—	185,809	—
Collateralized mortgage obligations.....	178,830	—	178,830	—
	<u>\$ 815,299</u>	<u>\$ —</u>	<u>\$ 815,299</u>	<u>\$ —</u>

Assets measured at fair value on a nonrecurring basis at December 31, 2017 and 2016, are set forth in the table that follows. Real estate appraisals utilized in measuring the fair value of other real estate and impaired loans may employ a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. In arriving at fair value, the Corporation adjusts the value set forth in the appraisal by deducting costs to sell and a distressed sale adjustment when appropriate. The adjustments made by the appraisers and the Corporation are deemed to be significant unobservable inputs and therefore result in a Level 3 classification of the inputs used for determining the fair value of impaired loans and other real estate owned. Because the Corporation has a small amount of impaired loans and other real estate owned measured at fair value, the impact of unobservable inputs on the Corporation's financial statements is not material.

<i>(in thousands)</i>	Total	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017:				
Other real estate owned.....	<u>\$ 5,125</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 5,125</u>
December 31, 2016:				
Impaired loans:				
Residential mortgages - closed end.....	<u>\$ 1,009</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,009</u>

The other real estate owned in the preceding table is one commercial real estate property acquired by deed-in-lieu of foreclosure at a fair value of \$5,850,000 in the fourth quarter of 2017. A valuation allowance of \$725,000 was subsequently recorded and is included in other noninterest expense in the consolidated statements of income for the year ended December 31, 2017. The Bank sold the property for its carrying value in the first quarter of 2018.

The impaired loan set forth in the preceding table had a principal balance of \$1,491,000 at December 31, 2016 and a valuation allowance of \$482,000. During the years ended December 31, 2017, 2016 and 2015, the Corporation recorded provisions (credit) for loan losses of (\$482,000), \$449,000 and \$27,000, respectively, for impaired loans measured at fair value.

**Financial Instruments Not Recorded at Fair Value.** Fair value estimates are made at a specific point in time. Such estimates are generally subjective in nature and dependent upon a number of significant assumptions associated with each financial instrument or group of similar financial instruments, including estimates of discount rates, risks associated with specific financial instruments, estimates of future cash flows, and relevant available market information. Changes in assumptions could significantly affect the estimates. In addition, fair value estimates do not reflect the value of anticipated future business, premiums or discounts that could result from offering for sale at one time the Corporation's entire holdings of a particular financial instrument, or the tax consequences of realizing gains or losses on the sale of financial instruments.

The following table sets forth the carrying amounts and estimated fair values of financial instruments that are not recorded at fair value in the Corporation's financial statements at December 31, 2017 and 2016.

<i>(in thousands)</i>	Level of Fair Value Hierarchy	December 31, 2017		December 31, 2016	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial Assets:</b>					
Cash and cash equivalents .....	Level 1	\$ 69,672	\$ 69,672	\$ 36,929	\$ 36,929
Held-to-maturity securities .....	Level 2	5,030	5,143	9,904	10,154
Held-to-maturity securities .....	Level 3	2,606	2,606	1,483	1,483
Loans.....	Level 3	2,916,568	2,855,812	2,514,355	2,472,849
Restricted stock.....	Level 1	37,314	37,314	31,763	31,763
Accrued interest receivable:					
Investment securities .....	Level 2	4,189	4,189	4,564	4,564
Loans .....	Level 3	7,386	7,386	6,418	6,418
<b>Financial Liabilities:</b>					
Checking deposits .....	Level 1	896,129	896,129	808,311	808,311
Savings, NOW and money market deposits .....	Level 1	1,602,460	1,602,460	1,519,749	1,519,749
Time deposits .....	Level 2	323,408	323,108	280,657	282,024
Short-term borrowings.....	Level 1	281,141	281,141	207,012	207,012
Long-term debt .....	Level 2	423,797	418,465	379,212	375,003
Accrued interest payable:					
Checking, savings, NOW and money market deposits .....	Level 1	176	176	160	160
Time deposits.....	Level 2	59	59	25	25
Short-term borrowings.....	Level 1	34	34	8	8
Long-term debt .....	Level 2	677	677	590	590

The following methods and assumptions are used by the Corporation in measuring the fair value of financial instruments disclosed in the preceding table.

*Cash and cash equivalents.* The recorded book value of cash and cash equivalents is their fair value.

*Investment securities.* Fair values are based on quoted prices for similar assets in active markets or derived principally from observable market data.

*Loans.* The total loan portfolio is divided into three segments: (1) residential mortgages; (2) commercial mortgages and commercial loans; and (3) consumer loans. Each segment is further divided into pools of loans with similar financial characteristics (i.e. product type, fixed versus variable rate, time to rate reset, length of term, conforming versus nonconforming). Cash flows for each pool, including estimated prepayments if applicable, are discounted utilizing market or internal benchmarks which management believes are reflective of current market rates for similar loan products. The discounted value of the cash flows is reduced by the related allowance for loan losses to arrive at an estimate of fair value.

*Restricted stock.* The recorded book value of FHLB stock and FRB stock is their fair value because the stock is redeemable at cost.

*Deposit liabilities.* The fair value of deposits with no stated maturity, such as checking deposits, money market deposits, NOW accounts and savings deposits, is equal to their recorded book value. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is equivalent to the rate at which the Bank could currently replace these deposits with wholesale borrowings from the FHLB.

*Borrowed funds.* For short-term borrowings maturing within ninety days, the recorded book value is a reasonable estimate of fair value. The fair value of long-term debt is based on the discounted value of contractual cash flows. The discount rate is equivalent to the rate at which the Bank could currently replace these borrowings with wholesale borrowings from the FHLB.

*Accrued interest receivable and payable.* For these short-term instruments, the recorded book value is a reasonable estimate of fair value.

*Off-balance-sheet Items.* The fair value of off-balance-sheet items is not considered to be material.

#### **NOTE N – PARENT COMPANY FINANCIAL INFORMATION**

Condensed financial information for the Corporation (parent company only) is as follows:

#### **CONDENSED BALANCE SHEETS**

<i>(in thousands)</i>	December 31,	
	2017	2016
<b>Assets:</b>		
Cash and due from banks .....	\$ 925	\$ 1,372
Investment in subsidiary bank, at equity .....	354,334	306,107
Prepaid income taxes.....	1,552	123
Deferred income tax benefits .....	1,381	1,548
Other assets .....	81	68
	<u>\$ 358,273</u>	<u>\$ 309,218</u>
<b>Liabilities:</b>		
Other liabilities.....	\$ 25	\$ 20
Cash dividends payable .....	3,798	3,368
	<u>3,823</u>	<u>3,388</u>
<b>Stockholders' equity:</b>		
Common stock .....	2,467	2,370
Surplus .....	127,122	101,738
Retained earnings .....	224,315	203,326
	<u>353,904</u>	<u>307,434</u>
Accumulated other comprehensive income (loss), net of tax .....	546	(1,604)
	<u>354,450</u>	<u>305,830</u>
	<u>\$ 358,273</u>	<u>\$ 309,218</u>

#### **CONDENSED STATEMENTS OF INCOME**

<i>(in thousands)</i>	Year ended December 31,		
	2017	2016	2015
<b>Income:</b>			
Dividends from subsidiary bank .....	\$ 11,150	\$ 4,500	\$ 7,500
<b>Expenses:</b>			
Salaries.....	2,434	1,517	1,319
Other operating expenses .....	406	376	541
	<u>2,840</u>	<u>1,893</u>	<u>1,860</u>
Income before income taxes.....	8,310	2,607	5,640
Income tax benefit.....	(1,235)	(1,181)	(832)
Income before undistributed earnings of subsidiary bank.....	9,545	3,788	6,472
Equity in undistributed earnings .....	25,577	27,092	19,418
<b>Net income</b> .....	<u>\$ 35,122</u>	<u>\$ 30,880</u>	<u>\$ 25,890</u>
Comprehensive income.....	<u>\$ 37,272</u>	<u>\$ 21,752</u>	<u>\$ 22,629</u>



## CONDENSED STATEMENTS OF CASH FLOWS

<i>(in thousands)</i>	Year ended December 31,		
	2017	2016	2015
<b>Cash Flows From Operating Activities:</b>			
Net income .....	\$ 35,122	\$ 30,880	\$ 25,890
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed earnings of subsidiary bank .....	(25,577)	(27,092)	(19,418)
Deferred income tax provision (credit).....	167	(84)	(278)
Tax benefit of stock-based compensation.....	—	—	336
Stock-based compensation expense.....	2,434	1,517	1,319
(Increase) decrease in prepaid income taxes.....	(1,429)	596	(362)
(Increase) decrease in other assets .....	46	(64)	38
Increase (decrease) in other liabilities .....	5	(19)	39
Net cash provided by operating activities.....	<u>10,768</u>	<u>5,734</u>	<u>7,564</u>
<b>Cash Flows From Investing Activities:</b>			
Capital contributions to Bank subsidiary .....	(20,500)	(38,883)	—
<b>Cash Flows From Financing Activities:</b>			
Shares withheld upon the vesting and conversion of RSUs .....	(527)	(370)	(287)
Proceeds from exercise of stock options .....	917	906	707
Proceeds from issuance of common stock, net.....	22,598	43,712	3,870
Cash dividends paid .....	(13,703)	(12,078)	(10,759)
Net cash provided by (used in) financing activities.....	<u>9,285</u>	<u>32,170</u>	<u>(6,469)</u>
Net increase (decrease) in cash and cash equivalents* .....	(447)	(979)	1,095
Cash and cash equivalents, beginning of year.....	1,372	2,351	1,256
Cash and cash equivalents, end of year.....	<u>\$ 925</u>	<u>\$ 1,372</u>	<u>\$ 2,351</u>
<b>Supplemental Schedule of Noncash Financing Activities:</b>			
Cash dividends payable.....	\$ 3,798	\$ 3,368	\$ 2,823

\* Cash and cash equivalents is defined as cash and due from banks and includes, among other things, the checking and money market accounts with the Corporation's wholly-owned bank subsidiary.

**NOTE O – QUARTERLY FINANCIAL DATA (Unaudited)**

<i>(in thousands, except per share data)</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
<b>2017</b>					
Interest income .....	\$ 28,498	\$ 28,970	\$ 30,337	\$ 30,460	\$ 118,265
Interest expense .....	4,838	5,177	5,634	6,060	21,709
Net interest income .....	23,660	23,793	24,703	24,400	96,556
Provision for loan losses .....	788	1,293	1,122	1,651	4,854
Noninterest income before net securities gains (losses).....	2,063	2,348	2,151	2,133	8,695
Net gains (losses) on sales of securities .....	57	1	16	(1,940)	(1,866)
Noninterest expense .....	13,014	13,135	13,061	14,310	53,520
Income before income taxes .....	11,978	11,714	12,687	8,632	45,011
Income tax expense (1) .....	2,897	2,581	3,345	1,066	9,889
Net income .....	9,081	9,133	9,342	7,566	35,122
Earnings per share:					
Basic .....	.38	.38	.38	.31	1.44
Diluted .....	.38	.37	.38	.30	1.43
Comprehensive income.....	9,705	11,619	9,009	6,939	37,272
<b>2016</b>					
Interest income .....	\$ 25,107	\$ 25,681	\$ 26,232	\$ 27,103	\$ 104,123
Interest expense .....	4,406	4,408	4,541	4,647	18,002
Net interest income .....	20,701	21,273	21,691	22,456	86,121
Provision for loan losses .....	253	139	1,118	1,970	3,480
Noninterest income before net securities gains.....	1,754	1,887	1,990	1,880	7,511
Net gains on sales of securities .....	—	1,844	24	—	1,868
Noninterest expense before debt extinguishment costs .....	12,431	13,116	11,974	12,814	50,335
Debt extinguishment costs .....	—	1,756	—	—	1,756
Income before income taxes .....	9,771	9,993	10,613	9,552	39,929
Income tax expense .....	2,136	2,264	2,615	2,034	9,049
Net income .....	7,635	7,729	7,998	7,518	30,880
Earnings per share:					
Basic .....	.36	.34	.34	.32	1.35
Diluted .....	.35	.34	.34	.31	1.34
Comprehensive income (loss).....	10,566	10,966	5,012	(4,792)	21,752

(1) The fourth quarter of 2017 includes a \$909,000 credit to income tax expense resulting from a reduction in the Corporation's net deferred tax liability to reflect the recent changes in federal tax law.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and the Board of Directors of  
The First of Long Island Corporation  
Glen Head, New York

### Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of The First of Long Island Corporation (“the Company”) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework:(2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework:(2013)* issued by COSO.

### Basis for Opinions

The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management’s Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company’s financial statements and an opinion on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risk of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ CROWE HORWATH LLP  
Crowe Horwath LLP

We have served as the Company’s auditor since 2003.

New York, New York  
March 16, 2018

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

The Corporation's Principal Executive Officer, Michael N. Vittorio, and Principal Financial Officer, Mark D. Curtis, have evaluated the Corporation's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report. Based upon that evaluation, they have concluded that the Corporation's disclosure controls and procedures are effective as of the end of the period covered by this report.

### **Management's Report on Internal Control Over Financial Reporting**

The management of The First of Long Island Corporation is responsible for establishing and maintaining adequate internal control over financial reporting, based on the criteria established in *Internal Control - Integrated Framework:(2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The First of Long Island Corporation's system of internal control over financial reporting was designed by or under the supervision of the Corporation's Principal Executive Officer and Principal Financial Officer to provide reasonable assurance regarding the reliability of the preparation of the Corporation's financial statements for external and regulatory reporting purposes, in accordance with U.S. generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The First of Long Island Corporation's management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2017, based on the criteria established in *Internal Control - Integrated Framework:(2013)* issued by COSO. Based on the assessment, management determined that, as of December 31, 2017, the Corporation's internal control over financial reporting is effective.

### **Report of Independent Registered Public Accounting Firm**

Crowe Horwath LLP, an independent registered public accounting firm, has expressed an opinion on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2017 in their report which appears on page 71.

### **Changes in Internal Control Over Financial Reporting**

There were no changes in internal control over financial reporting that occurred during the fourth quarter of 2017 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## **ITEM 9B. OTHER INFORMATION**

None.

## **PART III**

## **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information regarding directors, executive officers and corporate governance is incorporated herein by reference to the Registrant's Proxy Statement for its Annual Meeting of Stockholders to be held April 17, 2018 that was filed with the SEC.

The Corporation has adopted a code of ethics that applies to its principal executive officer, principal financial officer, chief risk officer, chief accounting officer, controller and persons performing similar functions. The Corporation's Code of Ethics and amendments to and waivers from the Code of Ethics are posted on the Bank's website. To access the Code of Ethics for Senior Financial Officers go to the homepage of the Bank's Internet website at [www.fnbli.com](http://www.fnbli.com) and click on "Investor Relations," and then click on "Code of Ethics."

## **ITEM 11. EXECUTIVE COMPENSATION**

The information regarding executive compensation is incorporated herein by reference to the Registrant's Proxy Statement for its Annual Meeting of Stockholders to be held April 17, 2018 that was filed with the SEC.

## **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information regarding security ownership of certain beneficial owners and management and related stockholder matters is incorporated herein by reference to the Registrant's Proxy Statement for its Annual Meeting of Stockholders to be held April 17, 2018 that was filed with the SEC.

## **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information regarding certain relationships and related transactions and director independence is incorporated herein by reference to the Registrant's Proxy Statement for its Annual Meeting of Stockholders to be held April 17, 2018 that was filed with the SEC.

## **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information regarding principal accountant fees and services is incorporated herein by reference to the Registrant's Proxy Statement for its Annual Meeting of Stockholders to be held April 17, 2018 that was filed with the SEC.

### **PART IV**

## **ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

### **(a) 1. Consolidated Financial Statements**

The following consolidated financial statements of the Corporation and its subsidiary and report of independent registered public accounting firm thereon as required by this Item are included in Part II, Item 8.

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Comprehensive Income

Consolidated Statement of Changes in Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

### **(a) 2. Financial Statement Schedules**

None applicable.

### **(a) 3. Listing of Exhibits**

See Index of Exhibits that follows.

## **ITEM 16. FORM 10-K SUMMARY**

Not applicable.

## INDEX OF EXHIBITS

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
3(i)	Certificate of Incorporation, as amended (incorporated by reference to Exhibit 3(i) of Registrant's Form 10-K filed March 29, 1999)
3(ii)	By-laws, as amended (incorporated by reference to Exhibit 3(ii) of Registrant's Form 8-K filed April 25, 2017)
3(iii)	Certificate of Amendment of Certificate of Incorporation dated May 1, 2014
10.1	Incentive Compensation Plan for Directors and Executive Officers, as amended (incorporated by reference to Items 1.01 of Registrant's Form 8-K filed March 7, 2012 and Item 5.02 of Registrant's Form 8-K filed January 28, 2013)
10.2	The First of Long Island Corporation 2006 Stock Compensation Plan, as amended (incorporated by reference to Appendix A of Registrant's Proxy Statement filed March 16, 2006, Exhibit 10.9 of Registrant's Form 8-K filed December 19, 2008, part of Item 5.02 of Registrant's Form 8-K filed June 21, 2010 and Item 5.02 and Exhibit 10.15 of Registrant's Form 8-K filed September 27, 2010)
10.3	Employment Agreement between Registrant and Michael N. Vittorio (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed April 7, 2017)
10.4	Employment Agreement between Registrant and Donald L. Manfredonia (incorporated by reference to Exhibit 10.3 of Registrant's Form 8-K filed September 11, 2017)
10.5	Employment Agreement between Registrant and Richard Kick (incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed September 11, 2017)
10.6	Employment Agreement between Registrant and Mark D. Curtis (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed September 11, 2017)
10.7	Employment Agreement between Registrant and Christopher Becker, Executive Vice President
10.8	Employment Agreement between Registrant and Paul Daley, Executive Vice President
10.9	Amendment to Supplemental Executive Retirement Program (incorporated by reference to Exhibit 10.10 of Registrant's Form 8-K filed December 19, 2008)
10.10	The First of Long Island Corporation 2014 Equity Incentive Plan (incorporated by reference to Appendix A of Registrant's Proxy Statement filed March 17, 2014)
10.11	The First of Long Island Corporation 2016 Cash Incentive Plan (incorporated by reference to Appendix A of Registrant's Proxy Statement filed March 15, 2016)
21	Subsidiary information included in Part 1, "Business" of this Form 10-K
23	Consent of Crowe Horwath LLP, Independent Registered Public Accounting Firm
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)
32	Certification of Chief Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(b) and U.S.C. Section 1350
101	The following materials from the Corporation's Annual Report on Form 10-K for the year ended December 31, 2017, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statement of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE FIRST OF LONG ISLAND CORPORATION  
(Registrant)

Dated: March 16, 2018

By /s/ MICHAEL N. VITTORIO

\_\_\_\_\_  
MICHAEL N. VITTORIO, President & Chief Executive Officer  
(principal executive officer)

By /s/ MARK D. CURTIS

\_\_\_\_\_  
MARK D. CURTIS, Senior Executive Vice President, Chief Financial Officer & Treasurer  
(principal financial officer)

By /s/ WILLIAM APRIGLIANO

\_\_\_\_\_  
WILLIAM APRIGLIANO, Senior Vice President & Chief Accounting Officer  
(principal accounting officer)

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

<u>Signatures</u>	<u>Titles</u>	<u>Date</u>
<u>/s/ WALTER C. TEAGLE III</u> Walter C. Teagle III	Non-executive Chairman of the Board	<u>March 16, 2018</u>
<u>/s/ PAUL T. CANARICK</u> Paul T. Canarick	Director	<u>March 16, 2018</u>
<u>/s/ ALEXANDER L. COVER</u> Alexander L. Cover	Director	<u>March 16, 2018</u>
<u>/s/ JOHN J. DESMOND</u> John J. Desmond	Director	<u>March 16, 2018</u>
<u>/s/ HOWARD THOMAS HOGAN JR.</u> Howard Thomas Hogan Jr.	Director	<u>March 16, 2018</u>
<u>/s/ STEPHEN V. MURPHY</u> Stephen V. Murphy	Director	<u>March 16, 2018</u>
<u>/s/ PETER QUICK</u> Peter Quick	Director	<u>March 16, 2018</u>
<u>/s/ DENISE STRAIN</u> Denise Strain	Director	<u>March 16, 2018</u>
<u>/s/ MILBREY RENNIE TAYLOR</u> Milbrey Rennie Taylor	Director	<u>March 16, 2018</u>
<u>/s/ ERIC TVETER</u> Eric Tveter	Director	<u>March 16, 2018</u>
<u>/s/ MICHAEL N. VITTORIO</u> Michael N. Vittorio	Director	<u>March 16, 2018</u>

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO RULE 13a-14(a)**

I, Michael N. Vittorio, certify that:

- 1) I have reviewed this Form 10-K of The First of Long Island Corporation (“Registrant”);
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
- 4) The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
- 5) The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: March 16, 2018

By /s/ MICHAEL N. VITTORIO  
\_\_\_\_\_  
MICHAEL N. VITTORIO  
PRESIDENT & CHIEF EXECUTIVE OFFICER  
(principal executive officer)



**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO RULE 13a-14(a)**

I, Mark D. Curtis, certify that:

- 1) I have reviewed this Form 10-K of The First of Long Island Corporation (“Registrant”);
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
- 4) The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
- 5) The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: March 16, 2018

By /s/ MARK D. CURTIS

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MARK D. CURTIS  
SENIOR EXECUTIVE VICE PRESIDENT,  
CHIEF FINANCIAL OFFICER & TREASURER  
(principal financial officer)

**CERTIFICATION PURSUANT TO RULE 13a-14(b)  
AND 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of The First of Long Island Corporation (“Corporation”) on Form 10-K for the year ended December 31, 2017 as filed with the Securities and Exchange Commission on March 16, 2018, (“Report”), we, Michael N. Vittorio, President and Chief Executive Officer of the Corporation and Mark D. Curtis, Senior Executive Vice President, Chief Financial Officer and Treasurer of the Corporation, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

Date: March 16, 2018

By /s/ MICHAEL N. VITTORIO  
\_\_\_\_\_  
MICHAEL N. VITTORIO  
PRESIDENT & CHIEF EXECUTIVE OFFICER  
(principal executive officer)

By /s/ MARK D. CURTIS  
\_\_\_\_\_  
MARK D. CURTIS  
SENIOR EXECUTIVE VICE PRESIDENT,  
CHIEF FINANCIAL OFFICER & TREASURER  
(principal financial officer)



