

FIRST OF LONG ISLAND CORP

Form 10-K

March 15, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

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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, 2016

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)

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New York 11-2672906  
(State or Other Jurisdiction (I.R.S. Employer  
of Incorporation or Organization) Identification No.)  
10 Glen Head Road, Glen Head, NY 11545  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code (516) 671-4900

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. [ ]

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The aggregate market value of the Corporation’s voting common stock held by nonaffiliates as of June 30, 2016, the last business day of the Corporation’s most recently completed second fiscal quarter, was \$428,876,938. This value was computed by reference to the price at which the stock was last sold on June 30, 2016 and excludes \$18,108,259 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, 2017 |
|-------------------------------|----------------------------|
| Common Stock, \$.10 par value | 23,901,419                 |

#### **DOCUMENTS INCORPORATED BY REFERENCE**

**Portions of the Registrant’s Proxy Statement for the Annual Meeting of Stockholders to be held April 19, 2017 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: The First of Long Island Agency, Inc., a licensed insurance agency under the laws of the State of New York; and FNY Service Corp., an investment company. 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 and income from investment management and trust services.

The Bank did not commence, abandon or significantly change any of its lines of business during 2016.

#### **Markets Served and Products Offered**

The Bank serves the financial needs of privately owned 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 thirty-four other full service branches, including a

branch opened in February 2017, ten commercial banking offices and two select service banking centers. Included in these totals are three 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          | Mobile Banking                              |
| ACH Origination                          | Mobile Capture                              |
| ATM Banking and Deposit Automation       | Mutual Funds, Annuities and Life Insurance  |
| Bank by Mail                             | Night Depository Services                   |
| Bill Payment                             | Online Banking                              |
| Cash Management Services                 | Payroll Services                            |
| Collection Services                      | Personal Money Orders                       |
| Controlled Disbursement Accounts         | Remote Deposit                              |
| Drive-Through Banking                    | Safe Deposit Boxes                          |
| Foreign Currency Sales and Purchases     | Securities Transactions                     |
| Healthcare Remittance Automation         | Signature Guarantee Services                |
| Instant Issue Debit Cards                | Telephone Banking                           |
| Investment Management and Trust Services | Travelers Checks                            |
| Lock Box Services                        | Wire Transfers - Domestic and International |
| Merchant Credit Card Services            | 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 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 2016 and 2015, 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, 2016, \$458.6 million of the Corporation's municipal securities were rated AA or better and \$2.4 million were non-rated bonds issued by local municipalities. The Corporation's pass-through mortgage securities portfolio at December 31, 2016 is comprised of \$218.0 million and \$147.6 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 policies. 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. If there has been no deterioration in risk rating, an existing credit facility over \$15.0 million may be extended for twelve months or less with the approval of two non-management members of the Board Loan Committee.

**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; 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 \$1.5 million of small business credit scored loans outstanding at December 31, 2016. In addition, the Bank had commitments on small business credit scored revolving lines of credit of \$34.5 million, of which \$14.1 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. Many of the residential mortgage loans made by the Bank in recent years 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 \$2.6 million at December 31, 2016.

***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 from the Dividend Reinvestment and Stock Purchase Plan. 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 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, 2016, the Bank had 314 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”), as well as 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) permissible activities; (v) reserve requirements; and (vi) dealings with officers, directors and affiliates.

The Dodd-Frank Act made extensive changes in the regulation of depository institutions and their holding companies. Certain provisions of the Dodd-Frank Act are having an impact on the Corporation and the Bank. 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.

**Payment of Dividends.** The principal source of the Corporation's liquidity is dividends from the Bank. The 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 2017 the Bank could declare dividends to the Corporation of approximately \$46.5 million plus any 2017 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.

On January 1, 2015, the Corporation and the Bank implemented the Basel III regulatory capital standards ("Basel III" or "final rule") 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 as follows: 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, 2016.

The final rule 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<br>Measure (%)            | Tier 1 RBC<br>Measure (%) | Common Equity<br>Tier 1 RBC<br>Measure (%) | Leverage<br>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, 2016.

**Deposit Insurance.** The FDIC imposes an assessment on financial institutions for deposit insurance. The assessment is based on the risk category of the institution, 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 and 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 and 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 plus 0.15% 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. At December 31, 2016, 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.

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 risks faced by the Corporation include, among others, credit risk, allowance for loan loss risk, interest rate risk, liquidity risk, market risk for its common stock, economic conditions risk, operational risk, technology and cybersecurity risk, key personnel risk, regulatory and legislative risk, income tax risk, external events risk and competitive risk. 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.

### Credit Risk

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 and environmental study requirements.

The credit risk within the Bank's loan portfolio primarily stems from factors such as borrower size, geographic concentration, industry concentration, real estate values, local and national 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, 2016, multifamily loans amounted to approximately \$610 million and comprised approximately 56% of the Bank's total commercial mortgage portfolio and approximately 25% 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 are dependent on the strength of the local economy.

Although the economy has improved, national and local economic conditions remain suboptimal. 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 its collection efforts. Environmental impairment of properties securing mortgage loans is also 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.

### **Allowance for Loan Loss Risk**

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, 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 a new accounting standard, ASU 2016-13, that will be effective for reporting periods beginning after December 15, 2019. This new standard changes the accounting methodology used to determine the allowance for loan losses from an incurred loss model to a current expected credit loss model, or CECL. 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.

### **Interest Rate Risk**

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 could adversely affect the Bank's earnings. When interest rates are low, as they currently are, borrowers tend to refinance higher rate loans at lower rates and prepayments on mortgages 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. The positive impact of lower interest rates on the Bank's cost of funds is currently constrained because many of the Bank's deposit products are at historically low rates with little if any room for further reductions, and because the Bank funds a significant portion of its average interest-earning assets with noninterest bearing checking deposits and capital.

Increases in the federal funds target rate could exert upward pressure on non-maturity deposit liability rates. In a period of rising interest rates, the Bank's loans and investment securities could reprice slower than its interest-bearing liabilities, which could initially have a negative effect on net interest income. Over a longer period of time, the effect on the Bank's earnings should be positive primarily because with the passage of time more loans and investment securities will reprice at the higher rates and there will be no offsetting increase in interest expense for those interest-earning assets funded by noninterest-bearing checking deposits and capital.

## **Liquidity Risk**

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 renewed 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, investment securities designated as available-for-sale, maturities and monthly payments on its investment securities and loan portfolios and operations.





The Bank is a member of the Federal Reserve Bank of New York (“FRB”) 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 FRB and FHLB of New York. In addition, the Bank can purchase overnight federal funds under its existing line. However, the Bank’s FRB 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.

### **Market Risk for the Corporation’s Common Stock**

The Corporation’s common stock is included in the Russell 3000 and Russell 2000 Indexes, which are reconstituted annually. Upon reconstitution in May 2016, the average market capitalization of companies in the Russell 2000 Index was \$1.7 billion, the median market capitalization was \$692 million, the capitalization of the largest company in the index was \$2.9 billion and the capitalization of the smallest company in the index was \$133 million. The Corporation’s market capitalization on December 31, 2016 was approximately \$677 million. The Corporation believes that inclusion in the Russell indexes has 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.

### **Economic Conditions Risk**

Although the economy has improved, national and local economic conditions remain suboptimal. 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.

### **Operational Risk**

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.

### **Technology and Cybersecurity Risk**

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.

In addition, 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.

The Bank has established board committee approved policies to prevent or limit the impact of systems failures, interruptions and security breaches and relies 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 Bank’s emergency and disaster recovery policy and its incident response and business continuity plans. In addition, for TPSPs of data processing and other significant services, the Bank obtains and reviews 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.



### **Key Personnel Risk**

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.

### **Regulatory and Legislative Risk**

The Corporation and the Bank are subject to regulation, supervision and examination by, among others, the Federal Reserve Board, OCC and FDIC, which 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 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.

### **Income Tax Risk**

The Corporation is subject to income tax under Federal, New York State, New Jersey, Connecticut and New York City laws and regulations. Changes in such laws and regulations, including laws and regulations associated with having a captive REIT, could increase the Corporation's tax burden and such increase could have a material negative impact on its results of operations.

### **External Events Risk –Weather and Terrorism**

Weather-related events have adversely impacted our market area, especially areas located near coastal waters and flood prone areas. 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.

### **Competitive Risk**

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, 2016, the Bank owns 22 buildings and leases 33 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 PURCHASE 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, 2016, there were 702 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, 2016 and 2015, adjusted to reflect the 2016 stock split.

| Quarter | 2016    |         | Dividends<br>Declared | 2015    |         | Dividends<br>Declared |
|---------|---------|---------|-----------------------|---------|---------|-----------------------|
|         | High    | Low     |                       | High    | Low     |                       |
| First   | \$20.33 | \$17.43 | \$ .13                | \$18.91 | \$15.50 | \$ .13                |
| Second  | 21.29   | 18.06   | .13                   | 19.29   | 15.99   | .13                   |
| Third   | 22.35   | 18.68   | .14                   | 19.16   | 15.21   | .13                   |
| Fourth  | 29.67   | 20.99   | .14                   | 21.28   | 17.36   | .13                   |

**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, 2012, 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 2016.



**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.

|  | 2016  | 2015         | 2014         | 2013         | 2012         |   |   |
|--|---|--------------|--------------|--------------|--------------|---|---|
|  | (dollars in thousands, except per share data) |              |              |              |              |   |   |
| <b>INCOME STATEMENT DATA:</b>                |   |              |              |              |              |   |   |
| Interest Income                              | \$ 104,123                                    | \$ 92,135    | \$ 81,976    | \$ 74,851    | \$ 76,229    |   |   |
| Interest Expense                             | 18,002  | 16,529       | 15,048       | 12,364       | 16,127       |   |   |
| Net Interest Income                          | 86,121  | 75,606       | 66,928       | 62,487       | 60,102       |   |   |
| Provision for Loan Losses                    | 3,480   | 4,317        | 3,189        | 2,997        | 3,628        |   |   |
| Net Income                                   | 30,880  | 25,890       | 23,014       | 21,300       | 20,393       |   |   |
| <b>PER SHARE DATA:</b>                       |   |              |              |              |              |   |   |
| Basic Earnings                               | \$ 1.35                                       | \$ 1.23      | \$ 1.11      | \$ 1.04      | \$ 1.02      |   |   |
| Diluted Earnings                             | 1.34  | 1.22         | 1.10         | 1.03         | 1.01         |   |   |
| Cash Dividends Declared                      | .55   | .52          | .48          | .45          | .43          |   |   |
| Dividend Payout Ratio                        | 41.04   | % 42.62      | % 43.64      | % 43.69      | % 42.57      | % | % |
| Book Value                                   | \$ 12.90                                      | \$ 11.85     | \$ 11.20     | \$ 10.04     | \$ 10.14     |   |   |
| Tangible Book Value                          | 12.90   | 11.84        | 11.19        | 10.03        | 10.13        |   |   |
| <b>BALANCE SHEET DATA AT YEAR END:</b>       |   |              |              |              |              |   |   |
| Total Assets                                 | \$ 3,510,320                                  | \$ 3,130,343 | \$ 2,721,494 | \$ 2,399,892 | \$ 2,108,290 |   |   |
| Loans  | 2,545,421                                     | 2,248,183    | 1,804,819    | 1,477,937    | 1,147,384    |   |   |
| Allowance for Loan Losses                    | 30,057  | 27,256       | 23,221       | 20,848       | 18,624       |   |   |
| Deposits                                     | 2,608,717                                     | 2,284,675    | 1,985,025    | 1,782,128    | 1,633,076    |   |   |
| Borrowed Funds                               | 586,224                                       | 577,214      | 481,486      | 395,463      | 248,634      |   |   |
| Stockholders' Equity                         | 305,830                                       | 250,936      | 233,303      | 206,556      | 205,370      |   |   |
| <b>AVERAGE BALANCE SHEET DATA:</b>           |   |              |              |              |              |   |   |
| Total Assets                                 | \$ 3,329,308                                  | \$ 2,897,548 | \$ 2,515,103 | \$ 2,240,139 | \$ 2,057,608 |   |   |
| Loans  | 2,364,187                                     | 1,990,823    | 1,584,198    | 1,286,227    | 1,073,046    |   |   |
| Allowance for Loan Losses                    | 28,238  | 24,531       | 21,554       | 19,847       | 18,098       |   |   |
| Deposits                                     | 2,590,988                                     | 2,215,883    | 1,922,172    | 1,747,888    | 1,578,233    |   |   |
| Borrowed Funds                               | 432,554                                       | 419,372      | 347,946      | 272,737      | 257,392      |   |   |
| Stockholders' Equity                         | 290,806                                       | 243,330      | 224,585      | 203,125      | 200,137      |   |   |
| <b>FINANCIAL RATIOS:</b>                     |   |              |              |              |              |   |   |
| Return on Average Assets (ROA)               | .93   | % .89        | % .92        | % .95        | % .99        | % | % |
| Return on Average Stockholders' Equity (ROE) | 10.62   | % 10.64      | % 10.25      | % 10.49      | % 10.19      | % | % |
| Average Equity to Average Assets             | 8.73  | % 8.40       | % 8.93       | % 9.07       | % 9.73       | % | % |

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

### Overview – 2016 Versus 2015

**Analysis of 2016 Earnings.** Net income and earnings per share 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 is 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 is 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%, is 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 includes 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 is 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 last year. Earnings per share was \$.31 for the fourth quarter of 2016, unchanged from the fourth quarter of 2015. The increase in net income is 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 is 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 remains excellent. Nonaccrual loans amounted to \$2.6 million, or .10% of total loans outstanding, at December 31, 2016, compared to \$1.4 million, or .06%, at December 31, 2015. 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 are performing in accordance with their modified terms and \$788,000 are 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 is 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 also remains excellent. The Bank's mortgage securities are 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 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's growing branch distribution system currently consists of 47 branches in Nassau and Suffolk Counties, Long Island and the boroughs of Queens, Brooklyn and Manhattan. The Bank expects to open two more branches in 2017 and continues to evaluate sites for further branch expansion. The two new branches will be in East Setauket, Long Island and Marine Park, Brooklyn. 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 acquisition of fee-based businesses.

**Challenges We Face.** The federal funds target rate increased by 25 basis points in December 2016 and December 2015. Further increases could exert upward pressure on non-maturity deposit rates. Intermediate and long-term interest rates also increased during the fourth quarter of 2016. Nevertheless, they remain low and could move lower in the foreseeable future. This could cause investing and lending rates to be suboptimal. There is significant price competition for loans in the Bank's marketplace and little room for the Bank to further reduce its deposit rates. These factors will make it difficult to improve net interest margin and could result in a decline in net interest margin from its current level and inhibit earnings growth for the foreseeable future.

The banking industry continues to be faced with new and complex regulatory requirements and enhanced supervisory oversight. The new President has indicated that regulatory relief will be forthcoming, but the timing, magnitude and impact of any such relief is 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, as of late, predatory sales practices. Regulatory requirements and enhanced oversight are exerting downward pressure on revenues and upward pressure on required capital levels and the cost of doing business.

## Overview – 2015 Versus 2014

**Analysis of 2015 Earnings.** Net income and earnings per share for 2015 were \$25.9 million and \$1.22, respectively, representing increases of 12.5% and 10.9%, respectively, over the comparable 2014 amounts. Dividends per share increased 8.3% from \$.48 for 2014 to \$.52 for 2015. Returns on average assets and average equity for 2015 were .89% and 10.64%, respectively, as compared to .92% and 10.25%, respectively, for 2014.

Net income for 2015 increased \$2.9 million over 2014. The increase was attributable to increases in net interest income of \$8.7 million, or 13.0%, and noninterest income, before securities gains, of \$174,000, or 2.4%. The positive impact of these items on earnings was partially offset by an increase in noninterest expense, before debt extinguishment costs, of \$3.6 million, or 8.5%, and increases in the provision for loan losses and income tax expense of \$1.1 million and \$1.4 million, respectively.

The increase in net interest income was driven by growth in average interest-earning assets of \$365.6 million, or 15.0%, as partially offset by an eight basis point decline in net interest margin. The growth in average interest-earning assets was primarily comprised of growth in the average balances of loans of \$406.6 million, or 25.7%, and nontaxable securities of \$23.9 million, or 5.8%, partially offset by a decrease in the average balance of taxable securities of \$68.8 million, or 16.2%. The growth in the average balance of loans included growth in commercial and industrial loans of \$11.3 million, or 14.8%, a large portion of which resulted from the Bank's small business credit scored loan initiative. The shift from taxable securities to better yielding loans and nontaxable securities partially mitigated the negative impact on net interest income of a low interest rate environment. The growth in loans and nontaxable securities, to the extent not funded by the decline in taxable securities, was funded by growth in the average balances of noninterest-bearing checking deposits of \$99.0 million, or 15.5%, interest-bearing deposits of \$194.7 million, or 15.1%, and long-term debt of \$64.5 million, or 21.5%. The increase in long-term debt resulted from management's desire to reduce the impact that an eventual increase in interest rates could have on the Bank's earnings. Net interest margin declined from 3.04% in 2014 to 2.96% in 2015 as loans were repriced and cash flows were deployed in a low interest rate environment.

The \$174,000 increase in noninterest income before securities gains was primarily attributable to real estate and sales tax refunds in 2015 and increases in merchant services income and cash value accretion on bank-owned life insurance.

The impact of these items was partially offset by a decrease in service charges on deposit accounts and a net gain during 2014 on the sale of loans held-for-sale. The \$3.6 million increase in noninterest expense before debt extinguishment costs was primarily attributable to increases in salaries and employee benefits expense, a growth-related increase in the combined amount of the Bank's FDIC insurance expense and OCC assessment and a one-time charge resulting from the termination of certain network and communication-related contracts. The impact of these items was partially offset by a decrease in occupancy and equipment expense. The increase in income tax expense was attributable to an increase in pretax earnings and changes in New York City income tax law effective January 1, 2015, partially offset by changes in New York State tax law also effective January 1, 2015.

**Analysis of Fourth Quarter 2015 Earnings.** Net income for the fourth quarter of 2015 was \$6.6 million, an increase of 21.2% over \$5.5 million earned in the same quarter of 2014. Earnings per share was \$.31 for the fourth quarter of 2015, an increase of 19.2% over \$.26 for the same quarter of 2014. The increase in net income was primarily attributable to an increase in net interest income of \$3.1 million, or 18.2%, net gains on sales of securities of \$191,000 and a decrease in occupancy and equipment expense of \$274,000. The positive impact on earnings of these items was partially offset by increases in salaries of \$143,000, employee benefits expense of \$395,000, other noninterest expense of \$257,000, the provision for loan losses of \$870,000 and income tax expense of \$751,000. The increases in net interest income, salaries, employee benefits expense, other noninterest expense and income tax expense and the decrease in occupancy and equipment expense occurred for substantially the same reasons discussed with respect to the full year periods. The increase in the provision for loan losses was primarily attributable to the fact that the fourth quarter of 2014 included a decline in average annualized historical losses and an improvement in economic conditions.

**Asset Quality.** The Bank's allowance for loan losses to total loans decreased by eight basis points from 1.29% at year-end 2014 to 1.21% at December 31, 2015. The decrease was primarily due to improved economic conditions, partially offset by an increase in specific reserves on loans individually deemed to be impaired.

The credit quality of the Bank's loan portfolio remained excellent at December 31, 2015. Nonaccrual loans, including loans held-for-sale, amounted to \$1.4 million, or .06% of total loans outstanding, at December 31, 2015, compared to \$1.7 million, or .09%, at December 31, 2014. The decrease in nonaccrual loans was primarily attributable to paydowns and loan sales. Troubled debt restructurings increased \$2.5 million during 2015 to \$4.5 million at year-end. Of this amount, \$3.6 million were performing in accordance with their modified terms and \$900,000 were nonaccrual and included in the aforementioned amount of nonaccrual loans. Loans past due 30 through 89 days amounted to \$1.0 million, or .04% of total loans outstanding, at December 31, 2015, compared to \$2.2 million, or .12%, at December 31, 2014. The increase in troubled debt restructurings during 2015 was attributed to one lending relationship.

The credit quality of the Bank's securities portfolio also remained excellent. The Bank's mortgage securities are backed by mortgages underwritten on conventional terms, with 69% 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.

### **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 median home prices and commercial vacancy rates in the Bank's service area and national and local unemployment levels, (3) trends in the nature and volume of loans, (4) concentrations of credit, (5) changes in lending policies and procedures, (6) experience, ability and depth of lending staff, (7) changes in the quality of the loan review function, (8) environmental risks, and (9) 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.

|  | 2016                   |                        |                 | 2015               |                        |                 | 2014               |                        |                 |  |
|--|------------------------|------------------------|-----------------|--------------------|------------------------|-----------------|--------------------|------------------------|-----------------|--|
|  | Average<br>Balance     | Interest/<br>Dividends | Average<br>Rate | Average<br>Balance | Interest/<br>Dividends | Average<br>Rate | Average<br>Balance | Interest/<br>Dividends | Average<br>Rate |  |
|  | (dollars in thousands) |                        |                 |                    |                        |                 |                    |                        |                 |  |
| <b>Assets:</b>                               |                        |                        |                 |                    |                        |                 |                    |                        |                 |  |
| Interest-bearing bank balances               | \$32,711               | \$168                  | .51 %           | \$20,568           | \$52                   | .25 %           | \$16,675           | \$36                   | .22 %           |  |
| Investment securities:                       |                        |                        |                 |                    |                        |                 |                    |                        |                 |  |
| Taxable                                      | 374,199                | 7,813                  | 2.09            | 355,177            | 7,939                  | 2.24            | 423,929            | 9,323                  | 2.20            |  |
| Nontaxable (1)                               | 465,457                | 21,056                 | 4.52            | 438,835            | 20,902                 | 4.76            | 414,972            | 20,628                 | 4.97            |  |
| Loans (1)                                    | 2,364,187              | 82,469                 | 3.49            | 1,990,823          | 70,573                 | 3.54            | 1,584,198          | 59,225                 | 3.74            |  |
| Total  |                        |                        |                 |                    |                        |                 |                    |                        |                 |  |
| interest-earning assets                      | 3,236,554              | 111,506                | 3.45            | 2,805,403          | 99,466                 | 3.55            | 2,439,774          | 89,212                 | 3.66            |  |
| Allowance for loan losses                    | (28,238 )              |                        |                 | (24,531 )          |                        |                 | (21,554 )          |                        |                 |  |
| Net interest-earning assets                  | 3,208,316              |                        |                 | 2,780,872          |                        |                 | 2,418,220          |                        |                 |  |
| Cash and due from banks                      | 30,450                 |                        |                 | 28,665             |                        |                 | 26,608             |                        |                 |  |
| Premises and equipment, net                  | 31,597                 |                        |                 | 29,011             |                        |                 | 26,429             |                        |                 |  |
| Other assets                                 | 58,945                 |                        |                 | 59,000             |                        |                 | 43,846             |                        |                 |  |
|  | \$3,329,308            |                        |                 | \$2,897,548        |                        |                 | \$2,515,103        |                        |                 |  |
| <b>Liabilities and Stockholders' Equity:</b> |                        |                        |                 |                    |                        |                 |                    |                        |                 |  |
| Savings, NOW and money market deposits       | \$1,501,096            | 5,344                  | .36             | \$1,159,573        | 2,564                  | .22             | \$972,136          | 1,955                  | .20             |  |
| Time deposits                                | 298,194                | 5,107                  | 1.71            | 320,626            | 5,987                  | 1.87            | 313,318            | 6,171                  | 1.97            |  |
| Total interest-bearing deposits              | 1,799,290              | 10,451                 | .58             | 1,480,199          | 8,551                  | .58             | 1,285,454          | 8,126                  | .63             |  |

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|                                    |             |          |        |             |          |        |             |          |        |
|------------------------------------|-------------|----------|--------|-------------|----------|--------|-------------|----------|--------|
| Short-term borrowings              | 57,395      | 296      | .52    | 55,134      | 183      | .33    | 48,220      | 148      | .31    |
| Long-term debt                     | 375,159     | 7,255    | 1.93   | 364,238     | 7,795    | 2.14   | 299,726     | 6,774    | 2.26   |
| Total interest-bearing liabilities | 2,231,844   | 18,002   | .81    | 1,899,571   | 16,529   | .87    | 1,633,400   | 15,048   | .92    |
| Checking deposits                  | 791,698     |          |        | 735,684     |          |        | 636,718     |          |        |
| Other liabilities                  | 14,960      |          |        | 18,963      |          |        | 20,400      |          |        |
|                                    | 3,038,502   |          |        | 2,654,218   |          |        | 2,290,518   |          |        |
| Stockholders' equity               | 290,806     |          |        | 243,330     |          |        | 224,585     |          |        |
|                                    | \$3,329,308 |          |        | \$2,897,548 |          |        | \$2,515,103 |          |        |
| Net interest income (1)            |             | \$93,504 |        |             | \$82,937 |        |             | \$74,164 |        |
| Net interest spread (1)            |             |          | 2.64 % |             |          | 2.68 % |             |          | 2.74 % |
| Net interest margin (1)            |             |          | 2.89 % |             |          | 2.96 % |             |          | 3.04 % |

(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.

|  | 2016 versus 2015                       |           |                        |               | 2015 versus 2014                       |           |                        |               |
|--|--|-----------|------------------------|---------------|--|-----------|------------------------|---------------|
|  | Increase (decrease) due to changes in: |           |                        |               | Increase (decrease) due to changes in: |           |                        |               |
|  | Volume                                 | Rate      | Rate/<br>Volume<br>(1) | Net<br>Change | Volume                                 | Rate      | Rate/<br>Volume<br>(1) | Net<br>Change |
|  | (in thousands)                         |           |                        |               |  |           |                        |               |
| <b>Interest Income:</b>                    |  |           |                        |               |  |           |                        |               |
| Interest-bearing bank balances             | \$31                                   | \$54      | \$31                   | \$116         | \$8                                    | \$6       | \$2                    | \$16          |
| Investment securities:                     |  |           |                        |               |  |           |                        |               |
| Taxable                                    | 425                                    | (523 )    | (28 )                  | (126 )        | (1,512 )                               | 153       | (25 )                  | (1,384 )      |
| Nontaxable                                 | 1,268                                  | (1,050)   | (64 )                  | 154           | 1,186                                  | (863 )    | (49 )                  | 274           |
| Loans                                      | 13,235                                 | (1,128)   | (211 )                 | 11,896        | 15,202                                 | (3,067)   | (787 )                 | 11,348        |
| Total interest income                      | 14,959                                 | (2,647)   | (272 )                 | 12,040        | 14,884                                 | (3,771)   | (859 )                 | 10,254        |
| <b>Interest Expense:</b>                   |  |           |                        |               |  |           |                        |               |
| Savings, NOW & money market deposits       | 755                                    | 1,564     | 461                    | 2,780         | 377                                    | 195       | 37                     | 609           |
| Time deposits                              | (419 )                                 | (495 )    | 34                     | (880 )        | 144                                    | (320 )    | (8 )                   | (184 )        |
| Short-term borrowings                      | 7                                      | 102       | 4                      | 113           | 21                                     | 12        | 2                      | 35            |
| Long-term debt                             | 234                                    | (751 )    | (23 )                  | (540 )        | 1,458                                  | (360 )    | (77 )                  | 1,021         |
| Total interest expense                     | 577                                    | 420       | 476                    | 1,473         | 2,000                                  | (473 )    | (46 )                  | 1,481         |
| Increase (decrease) in net interest income | \$14,382                               | \$(3,067) | \$(748 )               | \$10,567      | \$12,884                               | \$(3,298) | \$(813 )               | \$8,773       |

(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 – 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%. 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 Bank's continued ability to grow loans is attributable to a variety of factors including, among others, competitive pricing, targeted solicitation efforts, the introduction of new loan products, advertising campaigns and broker and correspondent relationships for both

residential and commercial mortgages.

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 Bank's ongoing ability to grow deposits is attributable to, among other things, continued expansion of the Bank's branch distribution system, targeted solicitation of local commercial businesses and municipalities, new and expanded lending relationships, new small business checking and loan products and the expansion of merchant sales relationships. In addition, management believes that the Bank's positive reputation in its marketplace has contributed to both loan and deposit growth. The increase in stockholders' equity is mostly attributable to retained net income and the sale of common stock through an underwritten public offering completed in the second quarter of 2016.

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 is partially offset in a low rate environment by increased prepayment activity accompanied by higher levels of prepayment penalty income. On a going forward basis, if available yields for loans and securities, prepayment penalties and the cost of deposits and borrowings remain at current levels, net interest margin is not expected to meaningfully decline. This expectation is based on the fact that significant portions of the Bank's mortgage loan and securities portfolios were originated or purchased in a low rate environment at yields similar to those currently available.

#### **Net Interest Income – 2015 Versus 2014**

Net interest income on a tax-equivalent basis was \$82.9 million in 2015, an increase of \$8.8 million, or 11.8%, from \$74.2 million in 2014. The increase resulted from an increase in average interest-earning assets of \$365.6 million, or 15.0%, as partially offset by an eight basis point decline in net interest margin.

The increase in average interest-earning assets was primarily attributable to growth in the average balances of loans of \$406.6 million, or 25.7%, and nontaxable securities of \$23.9 million, or 5.8%, partially offset by a decrease in the average balance of taxable securities of \$68.8 million, or 16.2%. The growth in the average balance of loans included growth in commercial and industrial loans of \$11.3 million, or 14.8%, a large portion of which resulted from the Bank's small business credit scored loan initiative. The growth in loans and nontaxable securities of \$406.6 million and \$23.9 million, respectively, to the extent not funded by the decline in taxable securities of \$68.8 million, was funded by growth in the average balances of noninterest-bearing checking deposits of \$99.0 million, or 15.5%, interest-bearing deposits of \$194.7 million, or 15.1%, and long-term debt of \$64.5 million, or 21.5%.

Intermediate and long-term interest rates remained low and volatile in 2015. Because loans repriced and cash flows were deployed in a low interest rate environment, net interest margin declined from 3.04% in 2014 to 2.96% in 2015. The decline in net interest margin explains why strong growth in the average balance of loans of 25.7% was accompanied by lesser growth of 11.8% in net interest income.

### **Noninterest Income**

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

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

Noninterest income before securities gains increased \$174,000, or 2.4%, when comparing 2015 to 2014. The increase was primarily attributable to real estate and sales tax refunds of \$204,000 and \$91,000, respectively, an increase in cash value accretion on bank-owned life insurance of \$359,000 and an increase in merchant services income of \$76,000. The positive impact of these items was partially offset by a decrease in service charges on deposit accounts of \$397,000 resulting largely from a decrease in deposit account overdraft activity in 2015 and a net gain of \$165,000 during 2014 on the sale of loans held-for-sale. Cash value accretion increased primarily because of a fourth quarter 2014 purchase of bank-owned life insurance with an initial cash value of \$16.9 million. The increase in noninterest income also resulted from debit cards and ATM banking, which produced income of \$626,000 in 2015 compared to \$583,000 in 2014.

## 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 \$4.7 million, or 10.4%, when comparing 2016 to 2015. The increase is 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 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 includes 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 is 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 Corporation expects that, based on current transaction volumes, the negotiated cost savings will amount to approximately \$4.5 to \$5.0 million over the seven-year term of the contract. This savings will help to slow the future growth in total operating expenses. The increase in occupancy and equipment expense includes 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 is mainly attributable to a growth-related increase in telecommunications capacity and one-time expenses of approximately \$126,000 in the second quarter of 2016. The Bank's ongoing investment in and spending on technology and telecommunications-related projects should result in continued enhancement of operating efficiency, business continuity controls and cyber security.

Effective July 1, 2016, the FDIC reduced the assessment rate charged to certain depository institutions, including the Bank, for FDIC insurance coverage. The reduction in the assessment rate lowered the Bank's FDIC insurance cost by approximately \$150,000 per quarter commencing in the second half of 2016. The savings resulting from the lower assessment rate is expected to be offset over time by growth-related increases in the assessment base, which is equal to quarterly average total assets less average capital.

Noninterest expense before debt extinguishment costs increased \$3.6 million, or 8.5%, when comparing 2015 to 2014. The increase was primarily comprised of an increase in salaries of \$1.8 million, or 9.5%, an increase in employee benefits expense of \$1.2 million, or 24.6%, a growth-related increase in the combined amount of FDIC insurance expense and the Bank's OCC assessment of \$250,000 and a one-time charge of \$77,000 resulting from the termination of certain network and communication-related contracts. The impact of these items was partially offset by a decrease in occupancy and equipment expense of \$82,000. The increase in salaries was primarily due to new branch openings, additions to staff in the back office and normal annual salary adjustments, partially offset by lower stock-based compensation expense. The decrease in stock-based compensation expense was mainly attributable to the immediate vesting of stock awards granted in the fourth quarter of 2014 with a value of \$358,000. The increase in employee benefits expense was largely due to an increase in incentive compensation cost, an increase in payroll tax expense resulting from additions to staff, an increase in group health insurance expense resulting from increases in staff count and the rates being paid for group health insurance and an increase in supplemental executive retirement expense. The decrease in occupancy and equipment expense was primarily attributable to a \$453,000 decrease in maintenance and repairs expense, mostly offset by increases in rent, real estate taxes and depreciation of newly-opened branches and expanded back-office space.

### **Implementation of ASU 2016-09**

In the fourth quarter of 2016, the Corporation adopted ASU 2016-09 "Improvements to Employee Share-Based Payment Accounting" effective 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 January 1, 2016 adoption of the ASU increased (decreased) quarterly net income for the first through the fourth quarters of 2016 by \$205,000, \$109,000, (\$13,000) and \$84,000, respectively.

### **Income Taxes**

Income tax expense as a percentage of pre-tax book income ("effective tax rate") was 22.7%, 22.4% and 20.9% in 2016, 2015 and 2014, 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.

**2016 Versus 2015.** The Corporation's effective tax rate increased from 22.4% in 2015 to 22.7% in 2016. The increase is 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 .7%, respectively.

**2015 Versus 2014.** The Corporation's effective tax rate increased from 20.9% in 2014 to 22.4% in 2015. As discussed hereinafter, this primarily resulted from the combined impact of changes in New York State and New York City income tax laws, a reduction in tax-exempt income as a percentage of pre-tax book income and the progressive nature of the corporate federal income tax.

Effective January 1, 2015, both New York State and New York City substantially revised their income tax law. The New York State banking corporation franchise tax under Article 32 was repealed and banks became subject to a general corporation franchise tax under a substantially revised Article 9A. New York City made conforming changes to their tax law and replaced the bank franchise tax with a new corporate tax contained in subchapter 3-A of chapter 6 of title 11 of New York City's administrative code.

In response to the changes in New York State and New York City income tax laws, the Corporation adjusted its deferred New York State and New York City income tax liability accounts. The adjustment of the New York State deferred tax liability account was made in 2014 and resulted in a one-time net credit to income tax expense of \$318,000 and a reduction in the effective tax rate for 2014 of 1.1%. The adjustment of the New York City deferred tax liability account was made in the second quarter of 2015 and resulted in a one-time net charge to income tax expense of \$402,000 and an increase in the effective tax rate for 2015 of 1.2%. The timing of these New York State and New York City adjustments was based on the enactment dates of the respective legislation.

Aside from the one-time charges and credits, management estimates that the law changes in combination with additional funding of the Corporation's captive REIT served to reduce the Corporation's 2015 net New York State income tax expense by approximately \$875,000 and increase its net New York City income tax expense by approximately \$41,000. Together, this resulted in a net decrease in the Corporation's 2015 effective tax rate of 2.5%.

Also impacting the Corporation's effective tax rate in 2015 was a decline in the percentage of pre-tax book income represented by tax-exempt income and the progressive nature of the corporate federal income tax. Income on tax-exempt securities, tax-exempt loans and bank-owned life insurance declined from 48% of pre-tax book income in 2014 to 43.4% in 2015. In addition, in 2015 the Corporation's federal taxable income grew to the point that it was taxed at a 35% rate rather than a portion, as in prior years, being taxed at 34%. These two items together resulted in an increase in the Corporation's 2015 effective tax rate of approximately 2.0%.

## **Financial Condition**

Total assets were \$3.5 billion at December 31, 2016, an increase of \$380.0 million, or 12.1%, from the previous year-end. The increase was primarily attributable to growth in loans of \$297.2 million, or 13.2%, and in available-for-sale securities of \$77.6 million, or 10.5%. The growth in loans and securities helped to offset the negative impact of the low interest rate environment on net interest income.





Asset growth during 2016 was largely funded by growth in deposits and stockholders' equity. Total deposits grew \$324.0 million, or 14.2%, to \$2.6 billion at December 31, 2016. The growth in deposits is due to increases in savings, NOW and money market deposits of \$323.8 million, or 27.1%, and noninterest-bearing checking deposits of \$30.3 million, or 3.9%, partially offset by a decrease in time deposits of \$30.1 million, or 9.7%.

**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, 2016, 2015 and 2014.

|                                       | 2016      | 2015<br>(in<br>thousands) | 2014      |
|---------------------------------------|-----------|---------------------------|-----------|
| <b>Held-to-Maturity Securities:</b>   |           |                           |           |
| State and municipals                  | \$10,419  | \$12,922                  | \$19,836  |
| Pass-through mortgage securities      | 361       | 576                       | 856       |
| Collateralized mortgage obligations   | 607       | 873                       | 1,141     |
|                                       | \$11,387  | \$14,371                  | \$21,833  |
| <b>Available-for-Sale Securities:</b> |           |                           |           |
| State and municipals                  | \$450,660 | \$435,693                 | \$411,797 |
| Pass-through mortgage securities      | 185,809   | 147,265                   | 131,181   |
| Collateralized mortgage obligations   | 178,830   | 154,742                   | 231,167   |
|                                       | \$815,299 | \$737,700                 | \$774,145 |

The following table presents the maturities and weighted average yields of the Bank's investment securities at December 31, 2016.

|   | Principal Maturing (1)        |        |                                       |        |                                       |        |                    |        |
|---|-------------------------------|--------|---------------------------------------|--------|---------------------------------------|--------|--------------------|--------|
|   | Within<br>One Year            |        | After One But<br>Within Five<br>Years |        | After Five But<br>Within Ten<br>Years |        | After<br>Ten Years |        |
|   | Amount                        | Yield  | Amount                                | Yield  | Amount                                | Yield  | Amount             | Yield  |
|   | <i>(dollars in thousands)</i> |        |                                       |        |                                       |        |                    |        |
| <b>Held-to-Maturity Securities:</b>       |                               |        |                                       |        |                                       |        |                    |        |
| State and municipals (2)                  | \$4,799                       | 5.22 % | \$4,732                               | 6.43 % | \$888                                 | 6.26 % | \$-                | - %    |
| Pass-through mortgage securities          | -                             | -      | -                                     | -      | 103                                   | 9.72   | 258                | 5.14   |
| Collateralized mortgage obligations       | -                             | -      | -                                     | -      | -                                     | -      | 607                | 8.03   |
|   | \$4,799                       | 5.22 % | \$4,732                               | 6.43 % | \$991                                 | 6.62 % | \$865              | 7.17 % |
| <b>Available-for-Sale Securities: (3)</b> |                               |        |                                       |        |                                       |        |                    |        |
| State and municipals (2)                  | \$17,046                      | 5.62 % | \$77,243                              | 4.87 % | \$170,386                             | 4.11 % | \$185,985          | 4.84 % |
| Pass-through mortgage securities          | -                             | -      | -                                     | -      | 45,469                                | 1.54   | 140,340            | 1.83   |
| Collateralized mortgage obligations       | -                             | -      | -                                     | -      | 8,776                                 | 2.76   | 170,054            | 2.09   |

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\$17,046 5.62 % \$77,243 4.87 % \$224,631 3.54 % \$496,379 3.05 %

(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 tax-exempt municipal securities have been computed on a tax-equivalent basis.

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

During 2016, the Bank received cash dividends totaling \$1.1 million on its FRB and FHLB stock, representing an average yield of 4.60%.

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

|                           | December 31,          |             |             |             |             |
|---------------------------|-----------------------|-------------|-------------|-------------|-------------|
|                           | 2016                  | 2015        | 2014        | 2013        | 2012        |
|                           | <i>(in thousands)</i> |             |             |             |             |
| Commercial and industrial | \$ 126,038            | \$ 93,056   | \$ 77,140   | \$ 71,818   | \$ 54,339   |
| Commercial mortgages (1): |                       |             |             |             |             |
| Multifamily               | 610,385               | 572,322     | 529,093     | 469,486     | 278,503     |
| Other                     | 371,142               | 348,909     | 222,537     | 162,874     | 141,986     |
| Owner-occupied            | 103,671               | 115,100     | 107,345     | 83,651      | 83,879      |
| Residential mortgages:    |                       |             |             |             |             |
| Closed end                | 1,238,431             | 1,025,215   | 779,994     | 605,343     | 502,367     |
| Revolving home equity     | 86,461                | 87,848      | 83,109      | 77,581      | 81,975      |
| Consumer and other        | 9,293                 | 5,733       | 5,601       | 7,184       | 4,335       |
|                           | 2,545,421             | 2,248,183   | 1,804,819   | 1,477,937   | 1,147,384   |
| Allowance for loan losses | (30,057 )             | (27,256 )   | (23,221 )   | (20,848 )   | (18,624 )   |
|                           | \$2,515,364           | \$2,220,927 | \$1,781,598 | \$1,457,089 | \$1,128,760 |

(1) Certain loans were reclassified within the various classes of the commercial mortgages segment into multifamily at December 31, 2016.

Maturity and rate information for commercial and industrial loans outstanding at December 31, 2016 is set forth below.

|                                  | Maturity              |                               |                        |                        |       |
|----------------------------------|-----------------------|-------------------------------|------------------------|------------------------|-------|
|                                  | Within                | After<br>One<br>But<br>Within | After<br>Five<br>Years | After<br>Five<br>Years | Total |
|                                  | One<br>Year           | Five<br>Years                 | Five<br>Years          |                        |       |
|                                  | <i>(in thousands)</i> |                               |                        |                        |       |
| Commercial and industrial loans: |                       |                               |                        |                        |       |
| Fixed rate                       | \$ 604                | \$ 20,854                     | \$ 8,920               | \$ 30,378              |       |
| Variable rate                    | 49,561                | 35,121                        | 10,978                 | 95,660                 |       |
|                                  | \$ 50,165             | \$ 55,975                     | \$ 19,898              | \$ 126,038             |       |

**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.

|   | December 31,                  |         |         |         |         |   |     |   |     |   |
|---|-------------------------------|---------|---------|---------|---------|---|-----|---|-----|---|
|   | 2016                          | 2015    | 2014    | 2013    | 2012    |   |     |   |     |   |
|   | <i>(dollars in thousands)</i> |         |         |         |         |   |     |   |     |   |
| Nonaccrual loans (includes loans held-for-sale):                                |                               |         |         |         |         |   |     |   |     |   |
| Troubled debt restructurings  | \$788                         | \$900   | \$1,280 | \$2,548 | \$2,430 |   |     |   |     |   |
| Other   | 1,770                         | 535     | 424     | 1,948   | 1,668   |   |     |   |     |   |
| Total nonaccrual loans  | 2,558                         | 1,435   | 1,704   | 4,496   | 4,098   |   |     |   |     |   |
| Loans past due 90 days or more and still accruing                               | 621                           | -       | -       | -       | -       |   |     |   |     |   |
| Other real estate owned   | -                             | -       | -       | -       | -       |   |     |   |     |   |
| Total nonperforming assets  | 3,179                         | 1,435   | 1,704   | 4,496   | 4,098   |   |     |   |     |   |
| Troubled debt restructurings - performing                                       | 757                           | 3,581   | 704     | 541     | 1,953   |   |     |   |     |   |
| Total risk elements   | \$3,936                       | \$5,016 | \$2,408 | \$5,037 | \$6,051 |   |     |   |     |   |
| Nonaccrual loans as a percentage of total loans                                 | .10                           | %       | .06     | %       | .09     | % | .30 | % | .36 | % |
| Nonperforming assets as a percentage of total loans and other real estate owned | .12                           | %       | .06     | %       | .09     | % | .30 | % | .36 | % |
| Risk elements as a percentage of total loans and other real estate owned        | .15                           | %       | .22     | %       | .13     | % | .34 | % | .53 | % |

The loans in the preceding table that are past due 90 days or more and still accruing are well secured and in the process of collection.

|   | Year Ended December 31, |       |       |       |       |
|---|-------------------------|-------|-------|-------|-------|
|   | 2016                    | 2015  | 2014  | 2013  | 2012  |
|   | <i>(in thousands)</i>   |       |       |       |       |
| Gross interest income on nonaccrual loans and troubled debt restructurings: |                         |       |       |       |       |
| Amount that would have been recorded during the year under original terms   | \$153                   | \$276 | \$127 | \$311 | \$365 |
| Actual amount recorded during the year                                      | 82                      | 171   | 33    | 60    | 134   |

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.

**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.

|                           | December 31, 2016               |          |             |         |                    |             |          |             |
|---------------------------|---------------------------------|----------|-------------|---------|--------------------|-------------|----------|-------------|
|                           | Internally Assigned Risk Rating |          |             |         |                    |             |          |             |
|                           | Pass                            |          | 5 - 6       | Watch   | Special<br>Mention | Substandard | Doubtful | Total       |
|                           | 1 - 2                           | 3 - 4    |             |         |                    |             |          |             |
|                           | <i>(in thousands)</i>           |          |             |         |                    |             |          |             |
| 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     |
|                           | \$2,614                         | \$63,424 | \$1,134,627 | \$2,601 | \$7,282            | \$ 688      | \$ -     | \$1,211,236 |
|                           | December 31, 2015               |          |             |         |                    |             |          |             |
| Commercial and industrial | \$1,882                         | \$1,085  | \$88,983    | \$1,106 | \$-                | \$-         | \$-      | \$93,056    |

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Commercial mortgages:

|                |         |          |             |         |         |         |     |             |
|----------------|---------|----------|-------------|---------|---------|---------|-----|-------------|
| Multifamily    | -       | 42,432   | 525,035     | -       | 4,855   | -       | -   | 572,322     |
| Other          | -       | 7,576    | 338,843     | 900     | -       | 1,590   | -   | 348,909     |
| Owner-occupied | 622     | 2,060    | 107,959     | 3,865   | -       | 594     | -   | 115,100     |
|                | \$2,504 | \$53,153 | \$1,060,820 | \$5,871 | \$4,855 | \$2,184 | \$- | \$1,129,387 |

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.

December 31, 2016

Internally Assigned Risk Rating

|                       |   |   |       |         |             |          |       |  |
|-----------------------|---|---|-------|---------|-------------|----------|-------|--|
| Pass                  |   |   |       |         | Special     |          |       |  |
| 1                     | 2 | 3 | Watch | Mention | Substandard | Doubtful | Total |  |
| <i>(in thousands)</i> |   |   |       |         |             |          |       |  |

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       |
|                       | \$1,260,746 | \$52,146 | \$16,063 | \$982 | \$942 | \$2,627 | \$- | \$1,333,506 |

December 31, 2015

Residential mortgages:

|                       |             |          |          |         |     |         |     |             |
|-----------------------|-------------|----------|----------|---------|-----|---------|-----|-------------|
| Closed end            | \$955,740   | \$49,719 | \$14,934 | \$1,025 | \$- | \$3,797 | \$- | \$1,025,215 |
| Revolving home equity | 76,820      | 5,861    | 4,645    | -       | -   | 522     | -   | 87,848      |
| Consumer and other    | 4,751       | 680      | 12       | -       | -   | -       | -   | 5,443       |
|                       | \$1,037,311 | \$56,260 | \$19,591 | \$1,025 | \$- | \$4,319 | \$- | \$1,118,506 |

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 \$2.8 million during 2016, amounting to \$30.1 million, or 1.18% of total loans, at December 31, 2016, as compared to \$27.3 million, or 1.21% of total loans, at December 31, 2015. The decrease of three basis points in the reserve coverage ratio is primarily due to a continued improvement in economic conditions and a reduction in the historical loss component of the allowance for loan losses.

During 2016, the Bank had loan chargeoffs and recoveries of \$709,000 and \$30,000, respectively, and recorded a \$3.5 million provision for loan losses. 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. The \$4.3 million provision for loan losses for 2015 was primarily attributable to loan growth, \$282,000 of net chargeoffs and a \$368,000 increase in specific reserves on loans individually deemed to be impaired, partially offset by improved economic conditions.

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.

|                                  | Year ended December 31,       |          |          |          |          |
|----------------------------------|-------------------------------|----------|----------|----------|----------|
|                                  | 2016                          | 2015     | 2014     | 2013     | 2012     |
|                                  | <i>(dollars in thousands)</i> |          |          |          |          |
| Balance, beginning of year       | \$27,256                      | \$23,221 | \$20,848 | \$18,624 | \$16,572 |
| Loans charged off:               |                               |          |          |          |          |
| Commercial and industrial        | 445                           | 166      | 96       | -        | 5        |
| Commercial mortgages:            |                               |          |          |          |          |
| Multifamily                      | -                             | 91       | -        | -        | 501      |
| Other                            | -                             | 1        | 37       | -        | -        |
| Owner-occupied                   | -                             | -        | 400      | -        | -        |
| Residential mortgages:           |                               |          |          |          |          |
| Closed end                       | 259                           | 7        | 121      | 914      | 659      |
| Revolving home equity            | -                             | 67       | 173      | -        | 450      |
| Consumer and other               | 5                             | 37       | 7        | 18       | 4        |
|                                  | 709                           | 369      | 834      | 932      | 1,619    |
| Recoveries of loans charged off: |                               |          |          |          |          |
| Commercial and industrial        | 4                             | 7        | 2        | 19       | 4        |



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|  |          |          |          |          |          |
|--|----------|----------|----------|----------|----------|
| Commercial mortgages:                                |          |          |          |          |          |
| Multifamily  | -        | 27       | -        | -        | 4        |
| Other  | -        | 39       | -        | 113      | 19       |
| Residential mortgages:                               |          |          |          |          |          |
| Closed end   | 9        | 9        | 3        | 13       | 10       |
| Revolving home equity                                | 12       | 5        | 4        | -        | -        |
| Consumer and other                                   | 5        | -        | 9        | 14       | 6        |
|  | 30       | 87       | 18       | 159      | 43       |
| Net chargeoffs                                       | 679      | 282      | 816      | 773      | 1,576    |
| Provision for loan losses                            | 3,480    | 4,317    | 3,189    | 2,997    | 3,628    |
| Balance, end of year                                 | \$30,057 | \$27,256 | \$23,221 | \$20,848 | \$18,624 |
| Ratio of net chargeoffs to average loans outstanding | .03      | % .01    | % .05    | % .06    | % .15    |

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

|                                       | December 31,<br>2016          |                                       | 2015     |                                       | 2014     |                                       | 2013     |                                       | 2012     |                                       |  |
|---------------------------------------|-------------------------------|---------------------------------------|----------|---------------------------------------|----------|---------------------------------------|----------|---------------------------------------|----------|---------------------------------------|--|
|                                       | Amount                        | % of<br>Loans<br>to<br>Total<br>Loans | Amount   | % of<br>Loans<br>to<br>Total<br>Loans | Amount   | % of<br>Loans<br>to<br>Total<br>Loans | Amount   | % of<br>Loans<br>to<br>Total<br>Loans | Amount   | % of<br>Loans<br>to<br>Total<br>Loans |  |
|                                       | <i>(dollars in thousands)</i> |                                       |          |                                       |          |                                       |          |                                       |          |                                       |  |
| Commercial and industrial             | \$1,408                       | 4.9 %                                 | \$928    | 4.1 %                                 | \$838    | 4.3 %                                 | \$808    | 4.9 %                                 | \$834    | 4.7 %                                 |  |
| Commercial mortgages:                 |                               |                                       |          |                                       |          |                                       |          |                                       |          |                                       |  |
| Multifamily                           | 6,119                         | 24.0                                  | 6,858    | 25.5                                  | 7,207    | 29.3                                  | 7,348    | 31.8                                  | 5,342    | 24.3                                  |  |
| Other                                 | 4,296                         | 14.6                                  | 3,674    | 15.5                                  | 2,340    | 12.3                                  | 1,501    | 11.0                                  | 1,978    | 12.4                                  |  |
| Owner-occupied Residential mortgages: |                               |                                       |          |                                       |          |                                       |          |                                       |          |                                       |  |
| Closed end                            | 15,740                        | 48.6                                  | 13,639   | 45.6                                  | 10,599   | 43.2                                  | 8,607    | 40.9                                  | 7,729    | 43.8                                  |  |
| Revolving home equity                 | 1,401                         | 3.4                                   | 1,016    | 3.9                                   | 1,121    | 4.6                                   | 1,240    | 5.2                                   | 1,453    | 7.1                                   |  |
| Consumer and other                    | 134                           | .4                                    | 94       | .3                                    | 93       | .3                                    | 153      | .5                                    | 125      | .4                                    |  |
|                                       | \$30,057                      | 100.0%                                | \$27,256 | 100.0%                                | \$23,221 | 100.0%                                | \$20,848 | 100.0%                                | \$18,624 | 100.0%                                |  |

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 95% of the Bank's total loans outstanding at December 31, 2016. 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 \$324.0 million, or 14.2%, to \$2.6 billion at December 31, 2016. The increase was attributable to growth in savings, NOW and money market deposits of \$323.8 million, or 27.1%, and noninterest-bearing checking deposits of \$30.3 million, or 3.9%, partially offset by a decrease in time deposits of \$30.1 million, or 9.7%. The largest segment of the deposit base is savings, NOW and money market deposits, which represent 58.3% of total deposits at December 31, 2016.

The remaining maturities of the Bank's time deposits at December 31, 2016 can be found in "Note E – Deposits" to the Corporation's December 31, 2016 consolidated financial statements.

Borrowings include short-term and long-term FHLB borrowings and borrowings under repurchase agreements. Total borrowings increased \$9.0 million during 2016 to \$586.2 million at year-end. The increase is due to an increase in long-term debt of \$13.5 million, partially offset by a decrease in short-term borrowings of \$4.5 million. The increase in long-term debt includes new fixed rate long-term FHLB borrowings of \$43.5 million, partially offset by the prepayment of borrowings under repurchase agreements of \$30.0 million in the 2016 deleveraging transaction discussed below.

**Deleveraging Transactions.** In the second quarter of 2016, the Bank completed a deleveraging transaction. The primary purpose of the transaction was to eliminate inefficient leverage and thereby provide capital to accommodate growth. The transaction involved the sale of \$40.3 million of mortgage-backed securities at a gain of \$1.8 million and utilization of most of the resulting proceeds to prepay \$30.0 million of long-term debt at a cost of \$1.8 million. 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.

**Capital.** Stockholders' equity totaled \$305.8 million at December 31, 2016, an increase of \$54.9 million from \$250.9 million at December 31, 2015. The most significant reason for the increase was the sale of 1,300,000 shares of common stock (1,950,000 shares post-split) through an underwritten public offering at a price of \$29.00 per share (\$19.33 per share post-split). The capital raised in the offering amounted to \$35.3 million, net of \$2.4 million of issuance costs, and is being used to support continued growth. The other primary reasons for the increase in stockholders' equity were net income of \$30.9 million and the issuance of shares under the Corporation's stock-based compensation and dividend reinvestment and stock purchase plans of \$9.3 million, partially offset by cash dividends declared of \$12.6 million and a decrease in the after-tax amount of unrealized gains on available-for-sale securities of \$10.0 million.

During 2016, 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 Dividend Reinvestment and Stock Purchase Plan from \$20,000 to \$50,000. This change is providing additional capital that is being used to accommodate balance sheet growth.

On October 27, 2016, the Corporation announced a 3-for-2 stock split. The stock split was effected through a 50% stock dividend. The additional shares issued as a result of the stock split were distributed on November 28, 2016 to shareholders of record on November 10, 2016.

The ratio of average stockholders' equity to average total assets increased to 8.73% for 2016 from 8.40% for 2015. The increase occurred because the growth rate in average stockholders' equity of 19.5% during 2016, primarily due to retained net income and the previously discussed capital raise, exceeded the 14.9% growth rate in average assets. The Corporation had returns on average equity of 10.62%, 10.64% and 10.25% and returns on average assets of .93%, .89% and .92%, for the years ended December 31, 2016, 2015 and 2014, respectively. Book value per share increased 8.9% during 2016 to \$12.90 at December 31, 2016. Book value per share was \$11.85 and \$11.20 at December 31, 2015 and 2014, 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, 2016 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 .625% applicable to the Bank for 2016, and the Bank was well capitalized under the PCA provisions at December 31, 2016.

|                                 | Corporation | Bank   |
|---------------------------------|-------------|--------|
| Tier 1 leverage                 | 8.89%       | 8.90%  |
| Common Equity Tier 1 risk-based | 14.70%      | 14.72% |
| Tier 1 risk-based               | 14.70%      | 14.72% |
| Total risk-based                | 15.95%      | 15.97% |

**Basel III Regulatory Capital Standards.** On January 1, 2015, the Corporation and the Bank implemented the Basel III regulatory capital standards issued by the Federal Reserve Board and the OCC. Basel III implements for U.S. banks the regulatory capital reforms of the Basel Committee on Banking Supervision, revises PCA categories to incorporate the revised regulatory capital requirements and implements certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Basel III includes guidelines with respect to the calculation of risk weighted assets for both on and off-balance-sheet positions. For some asset and off-balance-sheet exposures, such as residential mortgage loans and long-term unfunded

commitments, the final rule retains the capital requirements contained in the former regulatory capital rule. For other exposures, however, such as high volatility commercial real estate loans, as defined, loans that are more than 90 days past due or in nonaccrual status, unfunded loan commitments with an original maturity of one year or less and repurchase agreements, Basel III either increases the capital requirements or establishes new capital requirements that were not mandated in the former regulatory capital rule. The Corporation and the Bank made a one-time election upon implementation of the final rule to exclude accumulated other comprehensive income (“AOCI”) components from regulatory capital.

Implementation of the Basel III regulatory capital standards on January 1, 2015 did not have a material impact on the Corporation’s or the Bank’s regulatory capital position, lines of business or profitability.

### **Cash Flows and Liquidity**

**Cash Flows.** During 2016, the Corporation’s cash and cash equivalent position decreased by \$2.7 million, from \$39.6 million at December 31, 2015 to \$36.9 million at December 31, 2016. The decrease occurred primarily because cash used to originate loans, purchase investment securities, pay cash dividends and expand and improve physical facilities exceeded the cash provided by the growth in deposits and borrowings, maturities and paydowns of loans and securities, operations and the issuance of common stock.

**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, 2016, the Bank had approximately \$400 million of unencumbered available-for-sale securities. In addition, based on securities and loan collateral in place at the FRB and FHLB of New York, the Bank had borrowing capacity of approximately \$1.3 billion at December 31, 2016.

**Off-Balance-Sheet Arrangements and Contractual Obligations**

The Corporation's off-balance-sheet arrangements and contractual obligations at December 31, 2016 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 to the Corporation's December 31, 2016 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, 2016 pursuant to off-balance-sheet arrangements and contractual obligations.

|                              | Amount of Commitment Expiration Per Period             |                        |   |  |                       |
|------------------------------|--|------------------------|---|--|-----------------------|
|                              | Total<br>Amounts<br>Committed<br><i>(in thousands)</i> | One<br>Year<br>or Less | Over<br>One Year<br>Through<br>Three<br>Years | Over<br>Three<br>Years<br>Through<br>Five<br>Years | Over<br>Five<br>Years |
| Commitments to extend credit | \$331,693  | \$212,084              | \$55,856                                      | \$10,787   | \$52,966              |
| Standby letters of credit    | 5,596  | 5,596                  | -   | -  | -                     |
| Long-term debt               | 379,212  | 27,050                 | 174,950                                       | 104,475  | 72,737                |
| Operating lease obligations  | 13,223   | 2,139                  | 3,666   | 3,043  | 4,375                 |
| Purchase obligations         | 12,331   | 1,895                  | 3,563   | 3,316  | 3,557                 |
| Time deposits                | 280,657  | 55,090                 | 128,730                                       | 68,803   | 28,034                |
|                              | \$1,022,712  | \$303,854              | \$366,765                                     | \$190,424  | \$161,669             |

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 ("EVE") 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. Gap analysis also assumes that cash flows from maturing assets and liabilities will be reinvested in or refinanced by assets and liabilities of the same type, and 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, 2016, 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 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                          | \$29,915             | \$26,502                             | \$39,905                 | \$96,322              | \$255,201                        | \$472,538       | \$2,625                | \$826,686 |
| Loans  | 229,046              | 43,970                               | 91,025                   | 364,041               | 1,101,668                        | 1,077,154       | (27,499)               | 2,515,364 |
| Other assets                                   | 31,986               | -                                    | 33,303                   | 65,289                | -                                | -               | 102,981                | 168,270   |
|  | 290,947              | 70,472                               | 164,233                  | 525,652               | 1,356,869                        | 1,549,692       | 78,107                 | 3,510,320 |
| <b>Liabilities &amp; Stockholders' Equity:</b> |                      |                                      |                          |                       |                                  |                 |                        |           |
| Checking deposits                              | -                    | -                                    | -                        | -                     | -                                | -               | 808,311                | 808,311   |
| Savings, NOW and money market deposits         | 284,797              | 90,242                               | 180,483                  | 555,522               | 806,243                          | 157,984         | -                      | 1,519,749 |
| Time deposits, \$100,000 and                   | 26,408               | 2,795                                | 9,179                    | 38,382                | 124,557                          | 15,979          | -                      | 178,918   |

|  |             |             |             |             |              |             |               |           |
|--|-------------|-------------|-------------|-------------|--------------|-------------|---------------|-----------|
| over   |             |             |             |             |              |             |               |           |
| Time deposits,<br>other                        | 7,960       | 5,947       | 2,801       | 16,708      | 72,976       | 12,055      | -             | 101,739   |
| Borrowed<br>funds                              | 207,012     | 8,900       | 18,150      | 234,062     | 279,425      | 72,737      | -             | 586,224   |
| Other<br>liabilities                           | -           | -           | -           | -           | -            | -           | 9,549         | 9,549     |
| Stockholders'<br>equity                        | -           | -           | -           | -           | -            | -           | 305,830       | 305,830   |
|  | 526,177     | 107,884     | 210,613     | 844,674     | 1,283,201    | 258,755     | 1,123,690     | 3,510,320 |
| Interest-rate<br>sensitivity gap               | \$(235,230) | \$(37,412 ) | \$(46,380 ) | \$(319,022) | \$73,668     | \$1,290,937 | \$(1,045,583) | \$-       |
| Cumulative<br>interest-rate<br>sensitivity gap | \$(235,230) | \$(272,642) | \$(319,022) | \$(319,022) | \$(245,354 ) | \$1,045,583 | \$-           | \$-       |

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. Nonetheless, 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. Conversely, net interest income in the near-term could be negatively impacted if the rates paid on the Bank's deposit accounts are increased at the same time and in the same amount as increases in the rates earned on the Bank's interest-earning assets. Furthermore, a decrease in short-term interest rates would likely have a negative impact on the Bank's net interest income in the near term because interest rates are currently very low and there is little if any room to reduce the rates being paid on the Bank's deposit accounts below current levels.

**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 (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, 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 during 2015 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, 2016 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 on a tax-equivalent basis for the year ending December 31, 2017 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 conducted in 2015 and the current mix of deposits.

The rate change information in the table shows estimates of net interest income on a tax-equivalent basis for the year ending December 31, 2017 and calculations of EVE at December 31, 2016 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 (dollars in thousands) | Economic Value of Equity at December 31, 2016 |                               | Net Interest Income for 2017 |                               |
|---|---|-------------------------------|------------------------------|-------------------------------|
|   | Amount  | Percent Change From Base Case | Amount                       | Percent Change From Base Case |
| + 300 basis point rate shock                | \$336,355                                     | -19.2%                        | \$89,840                     | -10.6%                        |
| + 200 basis point rate shock                | 400,617                                       | -3.8%                         | 94,568                       | -5.9%                         |
| + 100 basis point rate shock                | 414,357                                       | -0.5%                         | 97,731                       | -2.7%                         |
| Base case (no rate change)                  | 416,366                                       | -                             | 100,480                      | -                             |
| - 100 basis point rate shock                | 368,742                                       | -11.4%                        | 97,748                       | -2.7%                         |

Any of the rate shock scenarios shown in the preceding table could negatively impact the Bank's net interest income for the year ended December 31, 2017. The Bank's net interest income could be negatively impacted in a shock down 100 basis point scenario because, among other things, the rates currently being paid on many of the Bank's deposit products are approaching zero and there is little room to reduce them further. In the shock up 100, 200 or 300 basis point scenarios 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. 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 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 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)  | 2016               | 2015        |
|---|--------------------|-------------|
| <b>Assets:</b>  |                    |             |
| Cash and cash equivalents   | <b>\$36,929</b>    | \$39,635    |
| Investment securities:  |                    |             |
| Held-to-maturity, at amortized cost (fair value of \$11,637 and \$14,910) | <b>11,387</b>      | 14,371      |
| Available-for-sale, at fair value   | <b>815,299</b>     | 737,700     |
|   | <b>826,686</b>     | 752,071     |
| Loans held-for-sale   | -                  | 105         |
| Loans:  |                    |             |
| Commercial and industrial   | <b>126,038</b>     | 93,056      |
| Secured by real estate:   |                    |             |
| Commercial mortgages  | <b>1,085,198</b>   | 1,036,331   |
| Residential mortgages   | <b>1,238,431</b>   | 1,025,215   |
| Home equity lines   | <b>86,461</b>      | 87,848      |
| Consumer and other  | <b>9,293</b>       | 5,733       |
|   | <b>2,545,421</b>   | 2,248,183   |
| Allowance for loan losses   | <b>(30,057 )</b>   | (27,256 )   |
|   | <b>2,515,364</b>   | 2,220,927   |
| Restricted stock, at cost   | <b>31,763</b>      | 28,435      |
| Bank premises and equipment, net  | <b>34,361</b>      | 30,330      |
| Bank-owned life insurance   | <b>33,097</b>      | 32,447      |
| Pension plan assets, net  | <b>17,316</b>      | 14,337      |
| Other assets  | <b>14,804</b>      | 12,056      |
|   | <b>\$3,510,320</b> | \$3,130,343 |
| <b>Liabilities:</b>   |                    |             |
| Deposits:   |                    |             |
| Checking  | <b>\$808,311</b>   | \$777,994   |
| Savings, NOW and money market   | <b>1,519,749</b>   | 1,195,968   |
| Time, \$100,000 and over  | <b>178,918</b>     | 198,147     |
| Time, other   | <b>101,739</b>     | 112,566     |
|   | <b>2,608,717</b>   | 2,284,675   |
| Short-term borrowings   | <b>207,012</b>     | 211,502     |
| Long-term debt  | <b>379,212</b>     | 365,712     |
| Accrued expenses and other liabilities                                    | <b>9,481</b>       | 12,313      |
| Deferred income taxes payable   | <b>68</b>          | 5,205       |
|   | <b>3,204,490</b>   | 2,879,407   |
| <b>Commitments and Contingent Liabilities (Note L)</b>                    |                    |             |

**Stockholders' Equity:**

Common stock, par value \$.10 per share:

|   |                    |             |
|---|--------------------|-------------|
| Authorized, 40,000,000 shares; Issued and outstanding, 23,699,107 and 14,116,677 shares | <b>2,370</b>       | 1,412       |
| Surplus   | <b>101,738</b>     | 56,931      |
| Retained earnings   | <b>203,326</b>     | 185,069     |
|   | <b>307,434</b>     | 243,412     |
| Accumulated other comprehensive income (loss), net of tax                               | <b>(1,604 )</b>    | 7,524       |
|   | <b>305,830</b>     | 250,936     |
|   | <b>\$3,510,320</b> | \$3,130,343 |

*See notes to consolidated financial statements*

**CONSOLIDATED STATEMENTS OF INCOME**

| Year Ended December 31 (dollars in thousands, except per share data) | 2016            | 2015     | 2014     |
|--|-----------------|----------|----------|
| <b>Interest and dividend income:</b>                                 |                 |          |          |
| Loans  | <b>\$82,456</b> | \$70,558 | \$59,209 |
| Investment securities:   |                 |          |          |
| Taxable  | <b>7,981</b>    | 7,991    | 9,359    |
| Nontaxable   | <b>13,686</b>   | 13,586   | 13,408   |
|  | <b>104,123</b>  | 92,135   | 81,976   |
| <b>Interest expense:</b>   |                 |          |          |
| Savings, NOW and money market deposits                               | <b>5,344</b>    | 2,564    | 1,955    |
| Time deposits  | <b>5,107</b>    | 5,987    | 6,171    |
| Short-term borrowings  | <b>296</b>      | 183      | 148      |
| Long-term debt   | <b>7,255</b>    | 7,795    | 6,774    |
|  | <b>18,002</b>   | 16,529   | 15,048   |
| Net interest income  | <b>86,121</b>   | 75,606   | 66,928   |
| <b>Provision for loan losses</b>                                     | <b>3,480</b>    | 4,317    | 3,189    |
| Net interest income after provision for loan losses                  | <b>82,641</b>   | 71,289   | 63,739   |
| <b>Noninterest income:</b>   |                 |          |          |
| Investment Management Division income                                | <b>2,000</b>    | 2,044    | 2,058    |
| Service charges on deposit accounts                                  | <b>2,666</b>    | 2,577    | 2,974    |
| Net gains on sales of securities                                     | <b>1,868</b>    | 1,324    | 141      |
| Other  | <b>2,845</b>    | 2,813    | 2,228    |
|  | <b>9,379</b>    | 8,758    | 7,401    |
| <b>Noninterest expense:</b>  |                 |          |          |
| Salaries   | <b>22,116</b>   | 20,680   | 18,885   |
| Employee benefits  | <b>6,889</b>    | 6,021    | 4,833    |
| Occupancy and equipment  | <b>9,264</b>    | 8,798    | 8,880    |
| Debt extinguishment  | <b>1,756</b>    | 1,084    | -        |
| Other  | <b>12,066</b>   | 10,108   | 9,433    |
|  | <b>52,091</b>   | 46,691   | 42,031   |
| Income before income taxes   | <b>39,929</b>   | 33,356   | 29,109   |
| <b>Income tax expense</b>  | <b>9,049</b>    | 7,466    | 6,095    |
| <b>Net income</b>  | <b>\$30,880</b> | \$25,890 | \$23,014 |
| <b>Earnings per share:</b>   |                 |          |          |
| Basic  | <b>\$1.35</b>   | \$1.23   | \$1.11   |
| Diluted  | <b>\$1.34</b>   | \$1.22   | \$1.10   |
| <b>Cash dividends declared per share</b>                             | <b>\$0.55</b>   | \$0.52   | \$0.48   |



*See notes to consolidated financial statements*

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**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| Year Ended December 31 (in thousands)                                   | <b>2016</b>     | 2015     | 2014     |
|---|-----------------|----------|----------|
| <b>Net income</b>   | <b>\$30,880</b> | \$25,890 | \$23,014 |
| <b>Other comprehensive income (loss):</b>                               |                 |          |          |
| Change in net unrealized holding gains on available-for-sale securities | <b>(17,004)</b> | (3,034 ) | 18,046   |
| Change in funded status of pension plan                                 | <b>1,443</b>    | (2,573 ) | (2,581 ) |
| Other comprehensive income (loss) before income taxes                   | <b>(15,561)</b> | (5,607 ) | 15,465   |
| <b>Income tax expense (benefit)</b>                                     | <b>(6,433 )</b> | (2,346 ) | 6,342    |
| <b>Other comprehensive income (loss)</b>                                | <b>(9,128 )</b> | (3,261 ) | 9,123    |
| <b>Comprehensive income</b>   | <b>\$21,752</b> | \$22,629 | \$32,137 |

*See notes to consolidated financial statements*

### CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

| (dollars in thousands)  | Common Stock      |                 |                  | Retained Earnings | Accumulated Other Comprehensive | Total            |
|---|-------------------|-----------------|------------------|-------------------|---------------------------------|------------------|
|   | Shares            | Amount          | Surplus          |                   | Income (Loss)                   |                  |
| Balance, January 1, 2014  | 9,141,767         | \$ 914          | \$46,873         | \$157,107         | \$ 1,662                        | \$206,556        |
| Net income  |                   |                 |                  | 23,014            |                                 | 23,014           |
| Other comprehensive income  |                   |                 |                  |                   | 9,123                           | 9,123            |
| Repurchase of common stock  | (9,243 )          | (1 )            | (285 )           |                   |                                 | (286 )           |
| Common stock issued under stock compensation plans, including tax benefit | 74,671            | 8               | 1,193            |                   |                                 | 1,201            |
| Common stock issued under dividend reinvestment and stock purchase plan   | 67,139            | 7               | 2,224            |                   |                                 | 2,231            |
| 3-for-2 stock split   | 4,612,800         | 461             | (507 )           |                   |                                 | (46 )            |
| Stock-based compensation  |                   |                 | 1,511            |                   |                                 | 1,511            |
| Cash dividends declared   |                   |                 |                  | (10,001 )         |                                 | (10,001 )        |
| Balance, December 31, 2014  | 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 )         |
| Repurchase of common stock  | (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  | <b>14,116,677</b> | <b>1,412</b>    | <b>56,931</b>    | <b>185,069</b>    | <b>7,524</b>                    | <b>250,936</b>   |
| Net income  |                   |                 |                  | <b>30,880</b>     |                                 | <b>30,880</b>    |
| Other comprehensive loss  |                   |                 |                  |                   | <b>(9,128 )</b>                 | <b>(9,128 )</b>  |
| Common stock issued in public offering, net of issuance costs             | <b>1,300,000</b>  | <b>130</b>      | <b>35,140</b>    |                   |                                 | <b>35,270</b>    |
| Repurchase of common stock  | (13,393 )         | (1 )            | (369 )           |                   |                                 | (370 )           |
| Common stock issued under stock compensation plans                        | <b>109,409</b>    | <b>11</b>       | <b>895</b>       |                   |                                 | <b>906</b>       |
| Common stock issued under dividend reinvestment and stock purchase plan   | <b>287,498</b>    | <b>28</b>       | <b>8,414</b>     |                   |                                 | <b>8,442</b>     |
| 3-for-2 stock split   | <b>7,898,916</b>  | <b>790</b>      | <b>(790 )</b>    |                   |                                 | -                |
| Stock-based compensation  |                   |                 | <b>1,517</b>     |                   |                                 | <b>1,517</b>     |
| Cash dividends declared   |                   |                 |                  | <b>(12,623 )</b>  |                                 | <b>(12,623 )</b> |
| 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> |

See notes to consolidated financial statements



## CONSOLIDATED STATEMENTS OF CASH FLOWS

| Year Ended December 31 (in thousands)   | 2016             | 2015      | 2014      |
|---|------------------|-----------|-----------|
| <b>Cash Flows From Operating Activities:</b>                                      |                  |           |           |
| Net income  | <b>\$30,880</b>  | \$25,890  | \$23,014  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |           |           |
| Provision for loan losses   | <b>3,480</b>     | 4,317     | 3,189     |
| Net loss (gain) on sales of loans held-for-sale                                   | <b>5</b>         | -         | (165 )    |
| Deferred income tax provision (credit)  | <b>1,233</b>     | (881 )    | (594 )    |
| Tax benefit of stock-based compensation   | -                | 336       | 224       |
| Depreciation and amortization   | <b>3,219</b>     | 3,013     | 2,855     |
| Premium amortization on investment securities, net                                | <b>4,002</b>     | 4,632     | 6,435     |
| Net gains on sales of securities  | <b>(1,868 )</b>  | (1,324 )  | (141 )    |
| Loss on extinguishment of debt  | <b>1,756</b>     | 1,084     | -         |
| Stock-based compensation expense  | <b>1,517</b>     | 1,319     | 1,511     |
| Accretion of cash surrender value on bank-owned life insurance                    | <b>(932 )</b>    | (879 )    | (520 )    |
| Excess of proceeds over cash surrender value of bank-owned life insurance         | <b>(106 )</b>    | -         | -         |
| Pension expense (credit) less contribution  | <b>(1,536 )</b>  | (489 )    | (471 )    |
| (Increase) decrease in other assets   | <b>(2,748 )</b>  | (229 )    | 626       |
| Decrease in accrued expenses and other liabilities                                | <b>(3,313 )</b>  | (1,117 )  | (155 )    |
| Net cash provided by operating activities   | <b>35,589</b>    | 35,672    | 35,808    |
| <b>Cash Flows From Investing Activities:</b>                                      |                  |           |           |
| Proceeds from sales of investment securities:                                     |                  |           |           |
| Held-to-maturity  | <b>123</b>       | 4,203     | 2,423     |
| Available-for-sale  | <b>62,047</b>    | 69,649    | 3,390     |
| Proceeds from maturities and redemptions of investment securities:                |                  |           |           |
| Held-to-maturity  | <b>4,322</b>     | 5,479     | 8,840     |
| Available-for-sale  | <b>108,486</b>   | 106,900   | 101,991   |
| Purchase of investment securities:  |                  |           |           |
| Held-to-maturity  | <b>(1,403 )</b>  | (2,005 )  | (814 )    |
| Available-for-sale  | <b>(267,329)</b> | (146,661) | (83,159 ) |
| Proceeds from sales of loans and loans held-for-sale                              | <b>544</b>       | 1,176     | 3,265     |
| Net increase in loans to customers  | <b>(298,361)</b> | (444,927) | (329,898) |
| Net increase in restricted stock  | <b>(3,328 )</b>  | (5,131 )  | (3,435 )  |
| Purchases of bank premises and equipment, net                                     | <b>(7,250 )</b>  | (5,489 )  | (6,239 )  |
| Proceeds from bank-owned life insurance   | <b>388</b>       | -         | -         |
| Purchase of bank-owned life insurance   | -                | -         | (16,863 ) |
| Net cash used in investing activities   | <b>(401,761)</b> | (416,806) | (320,499) |
| <b>Cash Flows From Financing Activities:</b>                                      |                  |           |           |
| Net increase in total deposits  | <b>324,042</b>   | 299,650   | 202,897   |
| Net increase (decrease) in short-term borrowings                                  | <b>(4,490 )</b>  | 75,016    | 26,023    |
| Proceeds from long-term debt  | <b>43,500</b>    | 94,212    | 60,000    |
| Repayment of long-term debt   | <b>(31,756 )</b> | (74,584 ) | -         |
| Proceeds from issuance of common stock, net                                       | <b>43,712</b>    | 3,870     | 2,185     |
| Proceeds from exercise of stock options   | <b>906</b>       | 707       | 1,055     |
| Repurchase and retirement of common stock   | <b>(370 )</b>    | (287 )    | (286 )    |

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|  |           |           |          |
|--|-----------|-----------|----------|
| Cash dividends paid                                  | (12,078 ) | (10,759 ) | (9,736 ) |
| Net cash provided by financing activities            | 363,466   | 387,825   | 282,138  |
| Net increase (decrease) in cash and cash equivalents | (2,706 )  | 6,691     | (2,553 ) |
| Cash and cash equivalents, beginning of year         | 39,635    | 32,944    | 35,497   |
| Cash and cash equivalents, end of year               | \$36,929  | \$39,635  | \$32,944 |
| <b>Supplemental Information:</b>                     |           |           |          |
| Cash paid for:                                       |           |           |          |
| Interest   | \$21,158  | \$18,361  | \$15,683 |
| Income taxes   | 9,006     | 8,065     | 6,200    |
| Noncash investing and financing activities:          |           |           |          |
| Cash dividends payable                               | 3,368     | 2,823     | 2,642    |
| Loans transferred from portfolio to held-for-sale    | -         | 105       | 2,200    |

*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 accounted for on the cash basis or cost-recovery method until the loans qualify for return to an accrual status. Return to an accrual status occurs when all the principal and interest amounts contractually 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 median home prices and commercial vacancy rates in the Bank's service area and national and local unemployment levels, (3) trends in the

nature and volume of loans, (4) concentrations of credit, (5) changes in lending policies and procedures, (6) experience, ability and depth of lending staff, (7) changes in the quality of the loan review function, (8) environmental risks, and (9) 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.

### **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**

Each of the Bank's commercial checking accounts has 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 prior service costs and 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, 2016 or 2014. Anti-dilutive stock options and RSUs at December 31, 2015 were de minimis. Other than the stock options and RSUs described in Note I, 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.

|   |            |            |            |
|---|------------|------------|------------|
| (dollars in thousands, except per share data)         | 2016       | 2015       | 2014       |
| Net income  | \$30,880   | \$25,890   | \$23,014   |
| Income allocated to participating securities (1)      | 127        | -          | -          |
| Income allocated to common stockholders               | \$30,753   | \$25,890   | \$23,014   |
| Weighted average:                                     |            |            |            |
| Common shares   | 22,745,967 | 21,017,808 | 20,711,223 |
| Dilutive stock options and restricted stock units (1) | 271,929    | 244,452    | 220,658    |
|   | 23,017,896 | 21,262,260 | 20,931,881 |
| Earnings per share:                                   |            |            |            |
| Basic   | \$1.35     | \$1.23     | \$1.11     |
| Diluted   | 1.34       | 1.22       | 1.10       |

(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 is required to calculate 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 for additional details on the RSUs awarded in 2016.

**Shares Tendered Upon the Exercise of Stock Options and Withheld Upon the Vesting of RSUs.** The amounts shown for 2016 and 2015 on the line captioned "Repurchase of common stock" in the Consolidated Statement of Changes in Stockholders' Equity represents 13,393 and 12,227 shares, respectively, with a value of \$370,000 and \$287,000, respectively, withheld upon the conversion of RSUs. The amount shown for 2014 represents 518 shares with a value of \$21,000 tendered upon the exercise of stock options and 8,725 shares with a value of \$265,000 withheld upon the conversion of RSUs.

**Stock Splits.** 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.

On September 16, 2014, 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 October 15, 2014 to stockholders of record on October 1, 2014, and are shown for 2014 on the line captioned "3-for-2 stock split" in the Consolidated Statement of Changes in Stockholders' Equity. Issuance costs of \$46,000 were charged to Surplus. 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 its common stock (1,950,000 shares post-split) in an underwritten public offering at a price of \$29.00 per share (\$19.33 per share post-split). The net proceeds of the offering, after the underwriting discount and offering expenses paid by the Corporation, were \$35,270,000.

**Shareholder Protection Rights Plan.** The Corporation's Shareholder Protection Rights Plan expired on August 1, 2016 and was not renewed by the Board of Directors.

### **Stock-based Compensation**

The Corporation's stock-based compensation plans are described in Note I. 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.

For stock options, compensation expense 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.

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 of \$358,000 for RSUs awarded in 2014 with immediate vesting was recognized in full on the grant date. The Corporation accounts for forfeitures as they occur.



## Comprehensive Income

Comprehensive income includes net income and other comprehensive income. Other comprehensive income 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 is recognized as a separate component of stockholders' equity.

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

|  | 2016                  | 2015      | 2014     |
|--|-----------------------|-----------|----------|
|  | <i>(in thousands)</i> |           |          |
| Change in net unrealized holding gains on available-for-sale securities: |                       |           |          |
| Change arising during the period   | \$(15,153)            | \$(1,851) | \$18,068 |
| Reclassification adjustment for gains included in net income (1)         | (1,851 )              | (1,183)   | (22 )    |
| Change in net unrealized holding gains on available-for-sale securities  | (17,004)              | (3,034)   | 18,046   |
| Tax effect   | (6,983 )              | (1,249)   | 7,369    |
|  | (10,021)              | (1,785)   | 10,677   |
| Change in funded status of pension plan:                                 |                       |           |          |
| Unrecognized net gain (loss) arising during the period                   | 1,199                 | (2,573)   | (2,597 ) |
| Amortization of prior service cost included in pension expense (2)       | -                     | -         | 16       |
| Amortization of net actuarial loss included in pension expense (2)       | 244                   | -         | -        |
|  | 1,443                 | (2,573)   | (2,581 ) |
| Tax effect   | 550                   | (1,097)   | (1,027 ) |
|  | 893                   | (1,476)   | (1,554 ) |
| Other comprehensive income (loss)  | \$(9,128 )            | \$(3,261) | \$9,123  |

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

(2) Represents the amortization into expense of prior service cost and net actuarial loss relating to the Corporation's defined benefit pension plan. These items are 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 these costs 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:

|   | Balance<br>12/31/15   | Current<br>Period<br>Change | Balance<br>12/31/16 |
|---|-----------------------|-----------------------------|---------------------|
|   | <i>(in thousands)</i> |                             |                     |
| Unrealized holding gains on available-for-sale securities       | \$11,675              | \$(10,021)                  | \$1,654             |
| Unrealized actuarial losses on pension plan                     | (4,151)               | 893                         | (3,258)             |
| Total accumulated other comprehensive income (loss), net of tax | \$7,524               | \$(9,128)                   | \$(1,604)           |

## 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

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-12 "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." ASU 2014-12 provides guidance on the accounting for share-based payments in which the terms of an award provide that an employee can cease rendering service before the end of the period in which a performance target could be achieved and still be eligible to vest in the award if and when

the performance target is achieved. The amendments in ASU 2014-12 were effective for interim and annual reporting periods beginning after December 15, 2015. Early adoption was permitted. The adoption of ASU 2014-12 on January 1, 2016 did not have a material impact on the Corporation's financial position, results of operations or disclosures.

In March 2016, the FASB issued ASU 2016-09 “Improvements to Employee Share-Based Payment Accounting.” ASU 2016-09 affects any entity that issues share-based payment awards to its employees. The ASU involves the simplification of several aspects of the accounting for employee share-based payment transactions including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The Corporation adopted ASU 2016-09 in the fourth quarter of 2016 effective 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 credit to income tax expense represents excess tax benefits arising from exercises of stock options and conversions of RSUs during 2016. Adoption of the ASU also impacted certain reporting practices and accounting policies of the Corporation. In particular, ASU 2016-09 allows an entity to either estimate the number of awards that are expected to vest or account for forfeitures as they occur. The Corporation has elected to account for forfeitures when they occur, which had an immaterial impact on our 2016 financial statements. In addition, the tax benefit of stock-based compensation transactions on the statement of cash flows is now classified as cash flows from operating activities rather than cash flows from financing activities. The Corporation elected to apply this change in cash flow classification guidance retrospectively and, therefore, prior period amounts of \$336,000 and \$224,000 for the years ended December 31, 2015 and 2014, respectively, have been reclassified to conform to the current period presentation.

### **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 FASB issued 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. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2016. Management continues to evaluate the impact that the amendments in ASU 2014-09 could have on the Corporation’s financial position, results of operations and disclosures. Management currently believes that implementation of ASU 2014-09 in 2018 will result in enhancements to certain revenue recognition disclosures, but that the amendments in the ASU will not have a material impact on the Corporation’s financial position or results of operations.

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 would require equity securities to be measured at fair value with changes in fair value

recognized through net income, but would allow 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 would simplify the impairment assessment of such equity securities and would require enhanced disclosure about these investments. ASU 2016-01 would also require separate presentation of financial assets and liabilities by measurement category and type of instrument, such as securities or loans, on the balance sheet or in the notes, and would eliminate certain other 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. Early adoption is not permitted. ASU 2016-01 is not expected to have a material impact on the Corporation's financial position, results of operations or 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. Early adoption is permitted. 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 is currently 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 basis 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 is currently evaluating the impact that ASU 2016-13 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 Topic 230, Statement of Cash Flows, and other 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. Early adoption is permitted, including adoption in an interim period. ASU 2016-15 is not expected to have a material impact on the Corporation's financial position, results of operations or disclosures.

### **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, 2016 and 2015.

|                                       | <b>2016</b>           |                              |                               |               |
|---------------------------------------|-----------------------|------------------------------|-------------------------------|---------------|
|                                       | Amortized<br>Cost     | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|                                       | <i>(in thousands)</i> |                              |                               |               |
| <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           |
|                                       | \$11,387              | \$250                        | \$ -                          | \$11,637      |
| <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       |
|                                       | \$812,674             | \$11,155                     | \$ (8,530 )                   | \$815,299     |
| <b>2015</b>                           |                       |                              |                               |               |
| <b>Held-to-Maturity Securities:</b>   |                       |                              |                               |               |
| State and municipals                  | \$12,922              | \$410                        | \$-                           | \$13,332      |
| Pass-through mortgage securities      | 576                   | 67                           | -                             | 643           |
| Collateralized mortgage obligations   | 873                   | 62                           | -                             | 935           |
|                                       | \$14,371              | \$539                        | \$-                           | \$14,910      |
| <b>Available-for-Sale Securities:</b> |                       |                              |                               |               |
| State and municipals                  | \$416,957             | \$18,892                     | \$ (156 )                     | \$435,693     |
| Pass-through mortgage securities      | 148,402               | 810                          | (1,947)                       | 147,265       |
| Collateralized mortgage obligations   | 152,712               | 2,720                        | (690 )                        | 154,742       |
|                                       | \$718,071             | \$22,422                     | \$ (2,793 )                   | \$737,700     |

At December 31, 2016 and 2015, investment securities with a carrying value of \$415,419,000 and \$405,769,000, 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, 2016 and 2015.

**Securities With Unrealized Losses.** The following tables set forth securities with unrealized losses at December 31, 2016 and 2015 presented by length of time the securities had been in a continuous unrealized loss position.

|                                     | <b>2016</b>                             |                    | 12 Months     |                    | Total         |                    |
|-------------------------------------|---|--------------------|---------------|--------------------|---------------|--------------------|
|                                     | Less than<br>12 Months<br>Fair<br>Value | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
|                                     | <i>(in thousands)</i>                   |                    |               |                    |               |                    |
| 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          | \$417,605                               | \$ (8,325 )        | \$7,737       | \$ (205 )          | \$425,342     | \$ (8,530 )        |
|                                     | <b>2015</b>                             |                    |               |                    |               |                    |
| State and municipals                | \$13,148                                | \$ (78 )           | \$5,837       | \$ (78 )           | \$18,985      | \$ (156 )          |
| Pass-through mortgage securities    | 98,504                                  | (1,348 )           | 27,365        | (599 )             | 125,869       | (1,947 )           |
| Collateralized mortgage obligations | 39,133                                  | (305 )             | 12,743        | (385 )             | 51,876        | (690 )             |
| Total temporarily impaired          | \$150,785                               | \$ (1,731 )        | \$45,945      | \$ (1,062 )        | \$196,730     | \$ (2,793 )        |

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, 2016.

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

|          | 2016                  | 2015     | 2014    |
|----------|-----------------------|----------|---------|
|          | <i>(in thousands)</i> |          |         |
| Proceeds | \$62,047              | \$69,649 | \$3,390 |
| Gains    | \$1,869               | \$1,560  | \$42    |
| Losses   | (18 )                 | (377 )   | (20 )   |
| Net gain | \$1,851               | \$1,183  | \$22    |

The income tax expense related to these net realized gains was \$772,000, \$487,000 and \$9,000 in 2016, 2015 and 2014, respectively, and is included in the consolidated statements of income in the line item, "Income tax expense."



***Sales of Held-to-Maturity Securities.*** 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 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.

During 2014, the Bank sold municipal and mortgage-backed securities that were classified as held-to-maturity securities. The sales of municipal securities were in response to a significant deterioration in the creditworthiness of the issuers. The sales of mortgage-backed securities occurred after the Bank had collected at least 85% of the principal balance outstanding at acquisition of each security. The securities sold had a carrying value of \$2,304,000 at the time of sale and the Bank realized a gain upon sale of \$119,000.

**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, 2016 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.

|                                     | Amortized Fair<br>Cost Value<br>(in thousands) |          |
|-------------------------------------|--|----------|
| <b>Held-to-Maturity Securities:</b> |  |          |
| Within one year                     | \$4,799  | \$4,833  |
| After 1 through 5 years             | 4,732  | 4,865    |
| After 5 through 10 years            | 888  | 898      |
| After 10 years                      | -  | -        |
| Mortgage-backed securities          | 968  | 1,041    |
|                                     | \$11,387                                       | \$11,637 |

|                                       |           |           |
|---------------------------------------|-----------|-----------|
| <b>Available-for-Sale Securities:</b> |           |           |
| Within one year                       | \$16,882  | \$17,046  |
| After 1 through 5 years               | 74,756    | 77,243    |
| After 5 through 10 years              | 167,981   | 170,386   |
| After 10 years                        | 184,535   | 185,985   |
| Mortgage-backed securities            | 368,520   | 364,639   |
|                                       | \$812,674 | \$815,299 |

**NOTE C – LOANS**

The following tables set forth by class of loans as of December 31, 2016 and 2015 the amount of loans individually and collectively evaluated for impairment and the portion of the allowance for loan losses allocable to such loans.

|  | December 31, 2016              |                                |                   | Allowance for Loan Losses      |                                |                   |
|--|--------------------------------|--------------------------------|-------------------|--------------------------------|--------------------------------|-------------------|
|  | Loans<br>Individually          | Collectively                   | Ending<br>Balance | Individually                   | Collectively                   | Ending<br>Balance |
|  | Evaluated<br>for<br>Impairment | Evaluated<br>for<br>Impairment |                   | Evaluated<br>for<br>Impairment | Evaluated<br>for<br>Impairment |                   |
|  | (in thousands)                 |                                |                   |                                |                                |                   |
| Commercial and industrial<br>Commercial mortgages (1): | \$131                          | \$125,907                      | \$126,038         | \$-                            | \$1,408                        | \$1,408           |

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|                        |         |             |             |       |          |          |
|------------------------|---------|-------------|-------------|-------|----------|----------|
| 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      |
|                        | \$3,315 | \$2,542,106 | \$2,545,421 | \$527 | \$29,530 | \$30,057 |

**December 31, 2015**

|                           |         |             |             |       |          |          |
|---------------------------|---------|-------------|-------------|-------|----------|----------|
| Commercial and industrial | \$-     | \$93,056    | \$93,056    | \$-   | \$928    | \$928    |
| Commercial mortgages (1): |         |             |             |       |          |          |
| Multifamily               | -       | 572,322     | 572,322     | -     | 6,858    | 6,858    |
| Other                     | -       | 348,909     | 348,909     | -     | 3,674    | 3,674    |
| Owner-occupied            | 594     | 114,506     | 115,100     | -     | 1,047    | 1,047    |
| Residential mortgages:    |         |             |             |       |          |          |
| Closed end                | 3,797   | 1,021,418   | 1,025,215   | 428   | 13,211   | 13,639   |
| Revolving home equity     | 522     | 87,326      | 87,848      | -     | 1,016    | 1,016    |
| Consumer and other        | -       | 5,733       | 5,733       | -     | 94       | 94       |
|                           | \$4,913 | \$2,243,270 | \$2,248,183 | \$428 | \$26,828 | \$27,256 |

(1) Certain loans were reclassified within the various classes of the commercial mortgages segment into multifamily at December 31, 2016.

The following tables present the activity in the allowance for loan losses for the years ended December 31, 2016, 2015 and 2014.

|                           | Balance<br>at<br>1/1/16 | Chargeoffs | Recoveries | Provision<br>for<br>Loan<br>Losses<br>(Credit) | Balance<br>at<br>12/31/16 |
|---------------------------|-------------------------|------------|------------|--|---------------------------|
|                           | <i>(in thousands)</i>   |            |            |  |                           |
| 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                       |
|                           | \$27,256                | \$ 709     | \$ 30      | \$ 3,480                                       | \$ 30,057                 |

|                           | Balance<br>at<br>1/1/15 | Chargeoffs | Recoveries | Provision<br>for<br>Loan<br>Losses<br>(Credit) | Balance<br>at<br>12/31/15 |
|---------------------------|-------------------------|------------|------------|--|---------------------------|
|                           | <i>(in thousands)</i>   |            |            |  |                           |
| 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                        |
|                           | \$23,221                | \$ 369     | \$ 87      | \$ 4,317                                       | \$ 27,256                 |

|  | Balance<br>at<br>1/1/14 | Chargeoffs | Recoveries | Provision<br>for<br>Loan<br>Losses | Balance<br>at<br>12/31/14 |
|--|-------------------------|------------|------------|------------------------------------|---------------------------|
|  |                         |            |            |                                    |                           |

(Credit)

*(in  
thousands)*

|                           |          |        |       |          |          |
|---------------------------|----------|--------|-------|----------|----------|
| Commercial and industrial | \$ 808   | \$ 96  | \$ 2  | \$ 124   | \$ 838   |
| Commercial mortgages:     |          |        |       |          |          |
| Multifamily               | 7,348    | -      | -     | (141 )   | 7,207    |
| Other                     | 1,501    | 37     | -     | 876      | 2,340    |
| Owner-occupied            | 1,191    | 400    | -     | 232      | 1,023    |
| Residential mortgages:    |          |        |       |          |          |
| Closed end                | 8,607    | 121    | 3     | 2,110    | 10,599   |
| Revolving home equity     | 1,240    | 173    | 4     | 50       | 1,121    |
| Consumer and other        | 153      | 7      | 9     | (62 )    | 93       |
|                           | \$20,848 | \$ 834 | \$ 18 | \$ 3,189 | \$23,221 |

For individually impaired loans, the following tables set forth by class of loans at December 31, 2016, 2015 and 2014 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, 2016, 2015 and 2014. 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.

|  | 2016                  |           |           | Average    | Interest   |
|--|-----------------------|-----------|-----------|------------|------------|
|  | Recorded              | Unpaid    | Related   | Recorded   | Income     |
|  | Investment            | Principal | Allowance | Investment | Recognized |
|  | <i>(in thousands)</i> |           |           |            |            |
| <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      | -          |
|  | \$ 3,315              | \$ 3,484  | \$ 527    | \$ 3,368   | \$ 30      |

|  | <b>2015</b>            |                                |                      |                                   |                                  |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|  | <i>(in thousands)</i>  |                                |                      |                                   |                                  |
| <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                                |
|  | \$ 4,913               | \$ 5,074                       | \$ 428               | \$ 5,222                          | \$ 95                            |

|  | <b>2014</b> |          |       |          |       |
|--|-------------|----------|-------|----------|-------|
| <b>With no related allowance recorded:</b> |             |          |       |          |       |
| Commercial and industrial                  | \$ 16       | \$ 16    | \$ -  | \$ 25    | \$ 2  |
| Commercial mortgages:                      |             |          |       |          |       |
| Multifamily                                | 303         | 368      | -     | 321      | -     |
| Owner-occupied                             | 630         | 663      | -     | 641      | -     |
| Residential mortgages:                     |             |          |       |          |       |
| Closed end                                 | 216         | 270      | -     | 230      | -     |
| Revolving home equity                      | 376         | 372      | -     | 376      | -     |
| <b>With an allowance recorded:</b>         |             |          |       |          |       |
| Residential mortgages - closed end         | 867         | 893      | 60    | 891      | 27    |
| <b>Total:</b>                              |             |          |       |          |       |
| Commercial and industrial                  | 16          | 16       | -     | 25       | 2     |
| Commercial mortgages:                      |             |          |       |          |       |
| Multifamily                                | 303         | 368      | -     | 321      | -     |
| Owner-occupied                             | 630         | 663      | -     | 641      | -     |
| Residential mortgages:                     |             |          |       |          |       |
| Closed end                                 | 1,083       | 1,163    | 60    | 1,121    | 27    |
| Revolving home equity                      | 376         | 372      | -     | 376      | -     |
|  | \$ 2,408    | \$ 2,582 | \$ 60 | \$ 2,484 | \$ 29 |

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

|                           | December 31, 2016   |                     |                         |                  | Total Past Due Loans & Nonaccrual |             | Total Loans |
|---------------------------|---------------------|---------------------|-------------------------|------------------|-----------------------------------|-------------|-------------|
|                           | 30-59 Days Past Due | 60-89 Days Past Due | More and Still Accruing | Nonaccrual Loans | Nonaccrual Loans                  | Current     |             |
| 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       |
|                           | \$1,106             | \$ -                | \$ 621                  | \$ 2,558         | \$ 4,285                          | \$2,541,136 | \$2,545,421 |

  

|                           | December 31, 2015   |                     |                         |                  | Total Past Due Loans & Nonaccrual |             | Total Loans |
|---------------------------|---------------------|---------------------|-------------------------|------------------|-----------------------------------|-------------|-------------|
|                           | 30-59 Days Past Due | 60-89 Days Past Due | More and Still Accruing | Nonaccrual Loans | Nonaccrual Loans                  | Current     |             |
| Commercial and industrial | \$-                 | \$-                 | \$-                     | \$-              | \$-                               | \$93,056    | \$93,056    |
| Commercial mortgages:     |                     |                     |                         |                  |                                   |             |             |
| Multifamily               | -                   | -                   | -                       | -                | -                                 | 572,322     | 572,322     |
| Other                     | -                   | -                   | -                       | -                | -                                 | 348,909     | 348,909     |
| Owner-occupied            | -                   | -                   | 594                     | 594              | 1,145,506                         | 115,100     | 1,145,506   |
| Residential mortgages:    |                     |                     |                         |                  |                                   |             |             |
| Closed end                | 991                 | -                   | 456                     | 1,447            | 1,023,768                         | 1,025,215   | 1,025,215   |
| Revolving home equity     | -                   | -                   | 280                     | 280              | 87,568                            | 87,848      | 87,848      |
| Consumer and other        | 12                  | -                   | -                       | 12               | 5,721                             | 5,733       | 5,733       |
|                           | \$1,003             | \$-                 | \$1,330                 | \$2,333          | \$2,245,850                       | \$2,248,183 | \$2,248,183 |

The loans in the preceding table that are past due 90 days or more and still accruing are well secured and in the process of collection. There were no loans in the process of foreclosure nor did the Bank hold any foreclosed residential real estate property at December 31, 2016 or 2015.

**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 years ended December 31, 2016 and 2015. The Bank did not modify any loans in troubled debt restructurings during 2014.

|                                    | Number<br>of<br>Loans | Outstanding<br>Recorded Investment |                       | Interest Rates       |                       |
|------------------------------------|-----------------------|------------------------------------|-----------------------|----------------------|-----------------------|
|                                    |                       | Pre-<br>Modification               | Post-<br>Modification | Pre-<br>Modification | Post-<br>Modification |
| <i>(in thousands)</i>              |                       |                                    |                       |                      |                       |
| 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%                 |
|                                    | 3                     | \$ 1,240                           | \$ 1,240              |                      |                       |
| 2015:                              |                       |                                    |                       |                      |                       |
| Residential mortgages:             |                       |                                    |                       |                      |                       |
| Closed end                         | 1                     | \$ 2,713                           | \$ 2,713              | 5.25%                | 4.00%                 |
| Revolving home equity              | 1                     | 245                                | 245                   | 5.25%                | 4.00%                 |
|                                    | 2                     | \$ 2,958                           | \$ 2,958              |                      |                       |

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, 2016, 2015 and 2014, the Bank had an allowance for loan losses of \$45,000, \$395,000 and \$60,000, 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 2016 and 2015 that were modified during the twelve-month period prior to default. There were two troubled debt restructurings for which there were payment defaults during 2014 that were modified during the twelve-month period prior to default. The restructured loans were owner-occupied commercial mortgage loans with an aggregate outstanding recorded investment of \$630,000 at December 31, 2014 and no specifically allocated allowance for loan losses. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

**Loans Held-for-Sale.** The December 31, 2015 consolidated balance sheet includes loans held-for-sale at their estimated fair value of \$105,000. The Bank recorded chargeoffs totaling \$74,000 against the allowance for loan losses at the time the loans were transferred to held-for-sale. These loans were sold in 2016 at a loss of \$5,000. There were no loans held-for-sale at December 31, 2016.

**Risk Characteristics.** Credit risk within the Bank's loan portfolio primarily stems from factors such as borrower size, geographic concentration, industry concentration, real estate values, local and national economic conditions and environmental impairment of properties securing mortgage loans. 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. 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 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 for the borrower and any guarantors, payment experience, credit underwriting documentation, public records 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 by the lending officer together with any necessary approval authority. 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 60% of the recorded investment of commercial real estate loans as of December 31 of the prior year must be reviewed annually. 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.

|                           | December 31, 2016               |         |                    |             |          | Total       |
|---------------------------|---------------------------------|---------|--------------------|-------------|----------|-------------|
|                           | Internally Assigned Risk Rating |         |                    |             |          |             |
|                           | Pass                            | Watch   | Special<br>Mention | Substandard | Doubtful |             |
|                           | <i>(in thousands)</i>           |         |                    |             |          |             |
| 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     |
|                           | \$1,200,665                     | \$2,601 | \$7,282            | \$ 688      | \$ -     | \$1,211,236 |

|                           | December 31, 2015 |         |         |         |     |             |
|---------------------------|-------------------|---------|---------|---------|-----|-------------|
| Commercial and industrial | \$91,950          | \$1,106 | \$-     | \$-     | \$- | \$93,056    |
| Commercial mortgages:     |                   |         |         |         |     |             |
| Multifamily               | 567,467           | -       | 4,855   | -       | -   | 572,322     |
| Other                     | 346,419           | 900     | -       | 1,590   | -   | 348,909     |
| Owner-occupied            | 110,641           | 3,865   | -       | 594     | -   | 115,100     |
|                           | \$1,116,477       | \$5,871 | \$4,855 | \$2,184 | \$- | \$1,129,387 |

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.

December 31, 2016

Internally Assigned Risk Rating

Special

Pass Watch Mention Substandard Doubtful Total

(in thousands)

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       |
|                       | \$1,328,955 | \$ 982 | \$ 942 | \$ 2,627 | \$ - | \$1,333,506 |

December 31, 2015

Residential mortgages:

|                       |             |         |     |         |     |             |
|-----------------------|-------------|---------|-----|---------|-----|-------------|
| Closed end            | \$1,020,393 | \$1,025 | \$- | \$3,797 | \$- | \$1,025,215 |
| Revolving home equity | 87,326      | -       | -   | 522     | -   | 87,848      |
| Consumer and other    | 5,443       | -       | -   | -       | -   | 5,443       |
|                       | \$1,113,162 | \$1,025 | \$- | \$4,319 | \$- | \$1,118,506 |

Deposit account overdrafts were \$679,000 and \$290,000 at December 31, 2016 and 2015, 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 2016 and 2015. The aggregate outstanding amount of these loans was \$99,000 and \$187,000 at December 31, 2016 and 2015, respectively. During 2016, no new loans were made to such persons. Repayments totaled \$88,000 in 2016. There were no loans to directors or executive officers that were nonaccrual at December 31, 2016 or 2015.

#### **NOTE D – PREMISES AND EQUIPMENT**

Bank premises and equipment consist of the following:

|   | December 31,          |          |
|---|-----------------------|----------|
|   | 2016                  | 2015     |
|   | <i>(in thousands)</i> |          |
| Land                                      | \$8,466               | \$6,352  |
| Buildings and improvements                | 21,660                | 20,894   |
| Leasehold improvements                    | 11,808                | 10,263   |
| Furniture and equipment                   | 29,016                | 26,196   |
| Construction in process                   | 1,911                 | 2,208    |
|   | 72,861                | 65,913   |
| Accumulated depreciation and amortization | (38,500)              | (35,583) |
|   | \$34,361              | \$30,330 |

#### **NOTE E – DEPOSITS**

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

|            | Less than<br>\$100,000 | \$100,000<br>or<br>More | Total     |
|------------|------------------------|-------------------------|-----------|
|            | <i>(in thousands)</i>  |                         |           |
| 2017       | \$16,708               | \$38,382                | \$55,090  |
| 2018       | 12,457                 | 27,442                  | 39,899    |
| 2019       | 35,070                 | 53,761                  | 88,831    |
| 2020       | 6,330                  | 9,987                   | 16,317    |
| 2021       | 19,119                 | 33,367                  | 52,486    |
| Thereafter | 12,055                 | 15,979                  | 28,034    |
|            | \$101,739              | \$178,918               | \$280,657 |

The total amount of time deposits that meet or exceed the FDIC insurance limit of \$250,000 at December 31, 2016 and 2015 was \$63.3 million and \$74.3 million, respectively. Deposits from executive officers, directors and their affiliates at December 31, 2016 and 2015 were approximately \$4.9 million and \$8.5 million, respectively.

**NOTE F – BORROWED FUNDS**

The following table summarizes borrowed funds at December 31, 2016 and 2015.

|   | December 31,          |           |
|---|-----------------------|-----------|
|   | 2016                  | 2015      |
|   | <i>(in thousands)</i> |           |
| Short-term borrowings:                      |                       |           |
| Securities sold under repurchase agreements | \$7,012               | \$11,502  |
| Federal Home Loan Bank advances             | 200,000               | 200,000   |
|   | 207,012               | 211,502   |
| Long-term debt:                             |                       |           |
| Securities sold under repurchase agreements | 5,000                 | 35,000    |
| Federal Home Loan Bank advances             | 374,212               | 330,712   |
|   | 379,212               | 365,712   |
|   | \$586,224             | \$577,214 |

Accrued interest payable on borrowed funds is included in “accrued expenses and other liabilities” in the Consolidated Balance Sheets and amounted to \$598,000 and \$672,000 at December 31, 2016 and 2015, respectively.

**Securities Sold Under Repurchase Agreements.** Securities sold under repurchase agreements are fixed rate financing arrangements with remaining contractual maturities of up to two years as of December 31, 2016. At maturity, the securities underlying the agreements will be returned to the Bank. These agreements are 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 following table sets forth information concerning securities sold under repurchase agreements.

|  | 2016                          | 2015     |
|--|-------------------------------|----------|
|  | <i>(dollars in thousands)</i> |          |
| Average daily balance during the year      | \$24,403                      | \$51,297 |
| Average interest rate during the year      | 2.58 %                        | 3.44 %   |
| Maximum month-end balance during the year  | \$47,938                      | \$56,903 |
| Weighted average interest rate at year-end | 2.30 %                        | 3.40 %   |

The following table sets forth as of December 31, 2016 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. All of the repurchase agreements are callable as of December 31, 2016.

| Contractual Maturity (dollars in thousands) | Amount   | Weighted Average Rate |
|---|----------|-----------------------|
| Overnight                                   | \$7,012  | .05 %                 |
| 2018  | 5,000    | 5.45                  |
|   | \$12,012 | 2.30 %                |

Overnight repurchase agreements at December 31, 2016 are collateralized by \$3.5 million of municipal securities and repurchase agreements due in 2018 are collateralized by \$6.2 million of mortgage-backed securities.

**Federal Home Loan Bank Advances.** FHLB advances are collateralized by a blanket lien on residential and commercial mortgages with a lendable value of \$1.7 billion at December 31, 2016 and residential and commercial mortgages with a lendable value of \$1.5 billion at December 31, 2015. 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.

|                                       | 2016                          | 2015      |
|---------------------------------------|-------------------------------|-----------|
|                                       | <i>(dollars in thousands)</i> |           |
| Average daily balance during the year | \$408,151                     | \$367,897 |



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|  |           |   |           |   |
|--|-----------|---|-----------|---|
| Average interest rate during the year      | 1.70      | % | 1.69      | % |
| Maximum month-end balance during the year  | \$574,212 |   | \$530,712 |   |
| Weighted average interest rate at year-end | 1.45      | % | 1.33      | % |

The following table sets forth as of December 31, 2016 the contractual maturities and weighted average interest rates of FHLB advances for each of the next five years and the period thereafter.

| Contractual Maturity (dollars in thousands) | Amount    | Weighted<br>Average<br>Rate |   |
|---|-----------|-----------------------------|---|
| Overnight                                   | \$200,000 | .74                         | % |
| 2017  | 27,050    | 1.51                        |   |
| 2018  | 96,450    | 1.71                        |   |
| 2019  | 73,500    | 1.91                        |   |
| 2020  | 70,250    | 1.85                        |   |
| 2021  | 34,225    | 1.85                        |   |
| After 2021                                  | 72,737    | 2.04                        |   |
|   | 374,212   | 1.84                        |   |
|   | \$574,212 | 1.45                        | % |

**Other Borrowings.** The Bank had no other borrowings at December 31, 2016 or 2015, or at any time during 2016. In 2015, the average balance of other borrowings amounted to \$178,000, with an average interest rate of .43%. The funds were borrowed to test the Bank's credit lines at the FRB discount window and a commercial bank.

**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 2016, 2015 and 2014 had effective tax rates of 22.7%, 22.4% and 20.9%, respectively. The following table sets forth a reconciliation of the statutory Federal income tax rate to the Corporation's effective tax rate.

|   | Year Ended December |        |        |
|---|---------------------|--------|--------|
|   | 31,                 |        |        |
|   | 2016                | 2015   | 2014   |
| Statutory federal income tax rate                               | 35.0 %              | 35.0 % | 35.0 % |
| State and local income taxes, net of federal income tax benefit | .9                  | 2.1    | 2.4    |
| Tax-exempt income, net of disallowed cost of funding            | (12.7)              | (14.9) | (16.4) |
| Excess tax benefit of stock-based compensation (1)              | (.7 )               | -      | -      |
| Other   | .2                  | .2     | (.1 )  |
|   | 22.7 %              | 22.4 % | 20.9 % |

(1) Reflects the adoption of ASU 2016-09 effective January 1, 2016.

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

|                 | Year Ended December   |         |         |
|-----------------|-----------------------|---------|---------|
|                 | 31,                   |         |         |
|                 | 2016                  | 2015    | 2014    |
|                 | <i>(in thousands)</i> |         |         |
| Current:        |                       |         |         |
| Federal         | \$7,407               | \$7,473 | \$4,943 |
| State and local | 409                   | 874     | 1,746   |
|                 | 7,816                 | 8,347   | 6,689   |
| Deferred:       |                       |         |         |
| Federal         | 1,114                 | (1,059) | 61      |
| State and local | 119                   | 178     | (655 )  |
|                 | 1,233                 | (881 )  | (594 )  |
|                 | \$9,049               | \$7,466 | \$6,095 |

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

December 31,  
2016    2015  
*(in thousands)*

|   |          |          |
|---|----------|----------|
| Deferred tax assets:  |          |          |
| Allowance for loan losses and off-balance-sheet credit exposure | \$12,613 | \$11,301 |
| Interest on nonperforming loans                                 | 75       | 109      |
| Accrued bonuses   | 622      | 414      |
| Accrued legal settlement  | 21       | -        |
| Stock-based compensation  | 1,548    | 1,465    |
| Supplemental executive retirement expense                       | 24       | 36       |
| Directors' retirement expense                                   | 66       | 65       |
| Accrued rent expense  | 277      | 240      |
| Depreciation  | 567      | 442      |
| Asset writedown   | 70       | -        |
|   | 15,883   | 14,072   |
| Valuation allowance   | -        | -        |
|   | 15,883   | 14,072   |
| Deferred tax liabilities:                                       |          |          |
| Prepaid pension   | 7,144    | 5,785    |
| Unrealized gains on available-for-sale securities               | 1,101    | 8,084    |
| Deferred loan costs   | 6,840    | 5,186    |
| Prepaid expenses  | 141      | 84       |
| REIT spillover dividend and other                               | 725      | 138      |
|   | 15,951   | 19,277   |
| Net deferred tax liability                                      | \$68     | \$5,205  |

The Corporation had no unrecognized tax benefits at December 31, 2016, 2015 and 2014, and 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 U.S. federal, New York State, Connecticut, New Jersey and New York City income taxes. The Corporation's federal, state and local income tax returns are subject to examination by the taxing authorities for years after 2012. In 2012, New York State completed an examination of the Corporation's and FNY's tax returns for calendar years 2007, 2008 and 2009 and proposed no changes to the returns. In 2011, New York City completed an examination of the Corporation's tax returns for calendar years 2007 and 2008 and proposed no changes to the returns. The Corporation did not incur any amounts for interest and penalties due taxing authorities for calendar years 2016, 2015 or 2014.

**NOTE H – REGULATORY MATTERS**

**Minimum Regulatory Capital Requirements.** On January 1, 2015, the Corporation and the Bank became 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. As part of the initial adoption of Basel III, the Corporation and the Bank elected to exclude accumulated other comprehensive income components from Tier 1 and Total regulatory capital.

Basel III sets forth new 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 .625% applicable to the Bank for 2016, and the Bank was well capitalized under the PCA provisions at December 31, 2016. The Corporation’s and the Bank’s actual capital amounts and ratios under the Basel III rules at December 31, 2016 and 2015 are presented in the table below.

|   | 2016           |        | Minimum Capital Adequacy Requirement |        | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|---|----------------|--------|--------------------------------------|--------|--|--------|
|   | Actual Capital |        | Requirement                          |        |  |        |
|   | Amount         | Ratio  | Amount                               | Ratio  | Amount   | Ratio  |
| <i>(dollars in thousands)</i>                 |                |        |                                      |        |  |        |
| 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 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:        |                |        |                                      |        |  |        |

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|              |         |       |         |      |         |       |
|--------------|---------|-------|---------|------|---------|-------|
| 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 |

2015

Tier 1 Capital to Average Assets:

|              |           |        |           |       |           |        |
|--------------|-----------|--------|-----------|-------|-----------|--------|
| Consolidated | \$243,192 | 7.98 % | \$121,940 | 4.00% | N/A       | N/A    |
| Bank         | 241,516   | 7.92   | 121,938   | 4.00  | \$152,422 | 5.00 % |

Common Equity Tier 1 to Risk Weighted Assets:

|              |         |       |        |      |         |      |
|--------------|---------|-------|--------|------|---------|------|
| Consolidated | 243,192 | 12.92 | 84,673 | 4.50 | N/A     | N/A  |
| Bank         | 241,516 | 12.84 | 84,660 | 4.50 | 122,286 | 6.50 |

Tier 1 Capital to Risk Weighted Assets:

|              |         |       |         |      |         |      |
|--------------|---------|-------|---------|------|---------|------|
| Consolidated | 243,192 | 12.92 | 112,897 | 6.00 | N/A     | N/A  |
| Bank         | 241,516 | 12.84 | 112,880 | 6.00 | 150,506 | 8.00 |

Total Capital to Risk Weighted Assets:

|              |         |       |         |      |         |       |
|--------------|---------|-------|---------|------|---------|-------|
| Consolidated | 266,760 | 14.18 | 150,530 | 8.00 | N/A     | N/A   |
| Bank         | 265,080 | 14.09 | 150,506 | 8.00 | 188,133 | 10.00 |

**Other Matters.** A principal 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 2017, the Bank could, without prior approval, declare dividends of approximately \$46,510,000 plus any 2017 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 2016 was approximately \$24,536,000.

**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 ISOs and NQSOs 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, 2016, 2,030,208 shares of common stock remain available for issuance of awards under the 2014 Plan of which 548,778 shares remain available for issuance as restricted stock awards or RSUs.

**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.

**Vesting of RSUs Granted Under the 2014 Plan.** In the fourth quarter of 2014, the Board of Directors awarded 20,735 RSUs under the 2014 Plan with immediate vesting.

During 2015, 112,868 RSUs were awarded under the 2014 Plan of which 4,486 shares vested upon the retirement of two non-employee directors, 13,076 were forfeited and 95,306 remain outstanding at December 31, 2016. The outstanding awards include 88,775 performance-based RSUs with vesting based on the financial performance of the Corporation in 2017 and 6,531 RSUs that will vest at the end of a three-year service-based vesting period.

During 2016, 107,274 RSUs were awarded under the 2014 Plan of which 3,286 shares vested upon the retirement of two non-employee directors, 9,732 shares were forfeited and 94,256 remain outstanding at December 31, 2016. All 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. The accrued dividends are payable upon vesting of the awards. The outstanding awards include 73,732 performance-based RSUs with vesting based on the financial performance of the Corporation in 2018, 15,274 RSUs that will vest in equal annual installments at the end of one, two and three years of service and 5,250 RSUs that will vest at the end of a three-year service-based vesting period.

In January 2017, the Board of Directors awarded 91,079 RSUs under the 2014 Plan, including 59,083 performance-based RSUs with vesting based on the financial performance of the Corporation in 2019, 31,696 RSUs that will vest in equal annual installments at the end of one, two and three years of service and 300 RSUs that will vest at the end of a three-year service-based vesting period.

***Vesting of RSUs Granted Under the 2006 Plan.*** All awards granted under the 2006 Plan immediately vest in the event of a change in control, retirement, total and permanent disability, as defined, or death. In January and February 2014, the Board of Directors awarded 75,221 RSUs under the 2006 Plan of which 55,448 remain outstanding at December 31, 2016. The outstanding RSUs include 52,635 performance-based RSUs that vested based on the financial performance of the Corporation in 2016 and were convertible into common stock of the Corporation on December 31, 2016 and 2,813 RSUs that will vest in 2017 at the end of a three year service-based vesting period.

***Vesting of Stock Options.*** Stock options granted under both the 2014 and 2006 Plans have a five year vesting period and a ten year term. Stock options immediately vest in the event of a change in control, retirement, total and permanent disability, as defined, or death.

**Fair Value of RSUs.** 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 through December 31, 2015 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 2016, 2015 and 2014, as well as the assumptions utilized in determining such values, is presented below.

|                            | <b>2016</b>               |                       |                   |         |
|----------------------------|---------------------------|-----------------------|-------------------|---------|
|                            | Performance-Based Vesting | Service-Based Vesting | Immediate Vesting |         |
| 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   | \$0.51                    | \$0.51 to \$0.53      |                   | -       |
| Expected term (in years)   | 3.0                       | 3.0                   |                   | -       |
| Risk-free interest rate    | .21 %                     | .28% to .38%          |                   | -       |
|                            | <b>2014</b>               |                       |                   |         |
| Grant date fair value      | \$17.33                   | \$17.33 to \$17.79    | \$17.27           | \$17.27 |
| Market price on grant date | \$18.71                   | \$18.71               |                   | \$17.27 |
| Expected annual dividend   | \$0.46                    | \$0.46                |                   | -       |
| Expected term (in years)   | 3.0                       | 2.0 to 3.0            |                   | -       |
| Risk-free interest rate    | .13 %                     | .13%                  |                   | -       |

**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.

**Compensation Expense.** The Corporation recorded compensation expense for share-based payments of \$1,517,000, \$1,319,000 and \$1,511,000 in 2016, 2015 and 2014, respectively, and related income tax benefits of \$637,000, \$543,000 and \$614,000, respectively.

**Stock Option Activity.** The following table presents a summary of options outstanding under the Corporation's stock-based compensation plans as of December 31, 2016 and changes during the year then ended.



|                                  | Number<br>of<br>Options | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (yrs.) | Aggregate<br>Intrinsic<br>Value<br>(in<br>thousands) |
|----------------------------------|-------------------------|---|---|--|
| Outstanding at January 1, 2016   | 347,179                 | \$ 10.64                                  |   |  |
| Exercised                        | (84,102 )               | 10.76                                     |   |  |
| Forfeited or expired             | (5,815 )                | 10.08                                     |   |  |
| Outstanding at December 31, 2016 | 257,262                 | \$ 10.61                                  | 2.36  | \$ 4,615   |
| Exercisable at December 31, 2016 | 256,662                 | \$ 10.60                                  | 2.35  | \$ 4,608   |

All options outstanding at December 31, 2016 are either fully vested or expected to vest. The total intrinsic value of options exercised in 2016, 2015 and 2014 was \$853,000, \$602,000 and \$723,000, respectively.

**RSU Activity.** The following table presents a summary of RSUs outstanding under the Corporation's stock-based compensation plans as of December 31, 2016 and changes during the year then ended.

|   | Number<br>of<br>RSUs | Weighted-<br>Average<br>Grant-Date<br>Fair Value | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (yrs.) | Aggregate<br>Intrinsic<br>Value<br>(in<br>thousands) |
|---|----------------------|--|---|--|
| Outstanding at January 1, 2016              | 236,037              | \$ 14.55   |   |  |
| Granted                                     | 107,274              | 18.29  |   |  |
| Converted                                   | (77,629 )            | 13.12  |   |  |
| Forfeited                                   | (20,672 )            | 16.03  |   |  |
| Outstanding at December 31, 2016            | 245,010              | \$ 16.52   | 1.19  | \$ 6,995   |
| Vested and Convertible at December 31, 2016 | 52,635               | \$ 17.33   | -   | \$ 1,503   |

The number of RSUs in the table represents the maximum number of shares of common stock of the Corporation into which the RSUs can be converted. RSUs outstanding at December 31, 2016 include 52,635 RSUs that were vested and convertible into common stock at year-end and 192,375 RSUs that are currently expected to vest and become convertible in the future. The total intrinsic value of RSUs converted in 2016, 2015 and 2014 was \$1,445,000, \$965,000 and \$706,000, respectively.

**Unrecognized Compensation Cost.** As of December 31, 2016, there was \$1,366,000 of total unrecognized compensation cost related to non-vested equity awards comprised of \$3,000 for options and \$1,363,000 for RSUs. The total cost is expected to be recognized over a weighted-average period of 1.57 years which is based on weighted average periods of 3.43 years and 1.57 years for options and RSUs, respectively.

**Cash Received and Tax Benefits Realized.** Cash received from option exercises in 2016, 2015 and 2014, was \$906,000, \$707,000 and \$1,055,000, respectively. Tax benefits from stock option exercises were \$356,000, \$240,000 and \$232,000 in 2016, 2015 and 2014, respectively.

**Other.** No cash was used to settle stock options in 2016, 2015 or 2014. The Corporation uses newly issued shares to settle stock option exercises and for the conversion of RSUs.

#### **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 \$396,000, \$397,000 and \$349,000 for 2016, 2015 and 2014, respectively.

The Bank has a defined benefit pension plan ("Pension Plan" or "Plan"). Through December 20, 2013, the provisions of the Plan were governed by the rules and regulations contained in the Prototype Plan of the New York State Bankers' Retirement System ("Retirement System") and the Retirement System Adoption Agreement executed by the Bank. On December 20, 2013, the Bank withdrew from the New York State Bankers' Retirement System and simultaneously formed an internal management committee (the "Committee") to oversee the affairs of the Plan and act as named fiduciary. The Committee retained Vanguard Group, Inc., including its subsidiaries and affiliates ("Vanguard"), to act as discretionary investment agent, trustee and custodian for the Plan. Vanguard formulated investment recommendations customized to meet the Committee's objectives and, after approval by the Committee, such investment recommendations were incorporated into the investment guidelines and policies contained in the investment management agreement between the Bank and Vanguard (the "Investment Management Agreement"). Subsequently, 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, 2016, 2015 and 2014 and the benefit cost for each of the Plan years then ended.

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. 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, 2016, the mortality table previously utilized, RP-2014 Healthy Annuitant/Employee Mortality Table with Projection Scale MP-2015, was updated to reflect Projection 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 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. In calculating the benefit obligation at December 31, 2015, the mortality table was updated from RP-2014 Healthy Annuitant/Employee Mortality Table with Projection Scale MP-2014 to reflect Projection Scale MP-2015. The updated mortality table decreased the projected benefit obligation at December 31, 2015 by approximately \$270,000.

| <b>Weighted average assumptions used to determine the benefit obligation at year end</b> | 2016  | 2015  | 2014  |
|--|-------|-------|-------|
| Discount rate  | 4.40% | 4.54% | 4.02% |
| Rate of increase in compensation levels  | 3.50% | 3.50% | 3.50% |
| <b>Weighted average assumptions used to determine net pension cost</b>                   |       |       |       |
| Discount rate  | 4.54% | 4.02% | 5.07% |
| Rate of increase in compensation levels  | 3.50% | 3.50% | 3.50% |
| Expected long-term rate of return on plan assets   | 6.00% | 6.00% | 6.50% |

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

|  | 2016                  | 2015            | 2014            |
|--|-----------------------|-----------------|-----------------|
|  | <i>(in thousands)</i> |                 |                 |
| Service cost plus expected expenses and net of expected plan participant contributions | \$1,142               | \$1,189         | \$1,115         |
| Interest cost  | 1,584                 | 1,408           | 1,407           |
| Expected return on plan assets   | (2,953)               | (3,086)         | (3,009)         |
| Amortization of net actuarial loss   | 244                   | -               | -               |
| Amortization of prior service cost   | -                     | -               | 16              |
| <b>Net pension cost (credit)</b>   | <b>\$17</b>           | <b>\$(489 )</b> | <b>\$(471 )</b> |

The net actuarial loss for the defined benefit plan that will be amortized from accumulated other comprehensive income into net periodic pension cost in 2017 is \$18,000. Prior service cost had been 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.

| 2016 | 2015 | 2014 |
|------|------|------|
|------|------|------|

*(in thousands)***Change in projected benefit obligation:**

|  |               |               |               |
|--|---------------|---------------|---------------|
| Projected benefit obligation at beginning of year  | \$35,684      | \$35,787      | \$28,650      |
| Service cost                                       | 1,283         | 1,267         | 1,051         |
| Interest cost                                      | 1,584         | 1,408         | 1,407         |
| Benefits paid                                      | (1,364 )      | (1,288 )      | (1,160 )      |
| Assumption changes                                 | (50 )         | (3,185 )      | 6,302         |
| Experience loss (gain) and other                   | (121 )        | 1,695         | (463 )        |
| <b>Projected benefit obligation at end of year</b> | <b>37,016</b> | <b>35,684</b> | <b>35,787</b> |

**Change in fair value of plan assets:**

|   |                 |                 |                 |
|---|-----------------|-----------------|-----------------|
| Fair value of plan assets at beginning of year  | 50,021          | 52,208          | 47,182          |
| Actual return on plan assets                    | 3,919           | (1,071 )        | 6,009           |
| Employer contributions                          | 1,553           | -               | -               |
| Plan participant contributions                  | 301             | 270             | 251             |
| Benefits paid                                   | (1,365 )        | (1,288 )        | (1,160 )        |
| Expenses  | (97 )           | (98 )           | (74 )           |
| <b>Fair value of plan assets at end of year</b> | <b>54,332</b>   | <b>50,021</b>   | <b>52,208</b>   |
| <b>Funded status at end of year</b>             | <b>\$17,316</b> | <b>\$14,337</b> | <b>\$16,421</b> |
| <b>Accumulated Benefit Obligation</b>           | <b>\$34,451</b> | <b>\$32,716</b> | <b>\$33,403</b> |

During 2016, the Bank made a contribution into the Plan of \$1,553,000 representing the maximum tax-deductible contribution allowable under the Internal Revenue Code. The Bank has no minimum required pension contribution for the Plan year ending September 30, 2017 and it cannot make a tax-deductible contribution for the tax year beginning January 1, 2017.

**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, 2016 and 2015 are set forth in the tables that follow.

|                           | December 31, 2016    |                                    | Weighted<br>Average Expected |                 |
|---------------------------|----------------------|------------------------------------|------------------------------|-----------------|
|                           | Target<br>Allocation | Percentage<br>of<br>Plan<br>Assets | Long-term<br>Rates of Return |                 |
| Cash equivalents          | 0% -1%               | .2                                 | %                            | <1.00%          |
| Equity mutual funds       | 15%-25%              | 19.8                               | %                            | 5.35% to 11.40% |
| Fixed income mutual funds | 75%-85%              | 80.0                               | %                            | 3.15% to 4.20%  |
|                           |                      | 100.0                              | %                            | 3.55% to 5.60%  |

|                           | December 31, 2015 |       |   |                 |
|---------------------------|-------------------|-------|---|-----------------|
| Cash equivalents          | 0% - 1%           | .2    | % | <1.00%          |
| Equity mutual funds       | 15% - 25%         | 19.6  | % | 5.80% to 11.70% |
| Fixed income mutual funds | 75% - 85%         | 80.2  | % | 3.55% to 4.55%  |
|                           |                   | 100.0 | % | 3.95% to 5.95%  |

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, 2016, 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, 2016 and 2015, by asset category, is summarized below.

|   | 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) |
| <i>(in thousands)</i>                                 |          |  |   |   |
| <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 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  | \$ -                                      |
| <b>December 31, 2015:</b>                             |          |  |   |   |
| Cash equivalents:                                     |          |  |   |   |
| Vanguard Prime Money Market Mutual Fund               | \$98     | \$-  | \$98  | \$-                                       |
| Total cash equivalents                                | 98       | -  | 98  | -   |
| Equity mutual funds:                                  |          |  |   |   |
| Vanguard Total Stock Market Index Fund (VITSX)        | 5,392    | 5,392  | -   | -   |
| Vanguard Total International Stock Index Fund (VTSNX) | 4,416    | 4,416  | -   | -   |
| Total equity funds                                    | 9,808    | 9,808  | -   | -   |
| Fixed income mutual funds:                            |          |  |   |   |
| Vanguard Long-Term Investment Grade Fund (VWETX)      | 24,053   | 24,053   | -   | -   |
| Vanguard Long-Term Bond Index Fund (VBLLX)            | 16,062   | 16,062   | -   | -   |
| Total fixed income mutual funds                       | 40,115   | 40,115   | -   | -   |
| Total Plan Assets                                     | \$50,021 | \$49,923   | \$98  | \$-                                       |



The fair values of the Vanguard mutual funds represent their net asset values (“NAV”) at December 31, 2016 and 2015. 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.

The definitions of Level 1, 2 and 3 fair value measurements are included in Note M to these consolidated financial statements.

At both December 31, 2016 and 2015, 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.

| Year       | Amount<br>(in<br>thousands) |
|------------|-----------------------------|
| 2017       | \$ 1,576                    |
| 2018       | 1,702                       |
| 2019       | 1,798                       |
| 2020       | 2,034                       |
| 2021       | 2,145                       |
| 2022- 2026 | 12,699                      |

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 \$197,000, \$271,000 and \$133,000 in 2016, 2015 and 2014, 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:

|                   | 2016                  | 2015    | 2014    |
|-------------------|-----------------------|---------|---------|
|                   | <i>(in thousands)</i> |         |         |
| Computer services | \$2,631               | \$2,212 | \$1,970 |
| FDIC assessment   | 1,379                 | 1,472   | 1,278   |
| Consultants       | 1,337                 | 576     | 498     |
| Marketing         | 1,053                 | 877     | 927     |

#### **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, 2016 and 2015, financial instruments whose contract amounts represent credit risk are as follows:

|                              | 2016                  |           | 2015     |           |
|------------------------------|-----------------------|-----------|----------|-----------|
|                              | Fixed                 | Variable  | Fixed    | Variable  |
|                              | Rate                  | Rate      | Rate     | Rate      |
|                              | <i>(in thousands)</i> |           |          |           |
| Commitments to extend credit | \$67,289              | \$264,404 | \$13,092 | \$235,368 |

|                           |       |   |       |   |
|---------------------------|-------|---|-------|---|
| Standby letters of credit | 5,596 | - | 5,758 | - |
|---------------------------|-------|---|-------|---|

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 lines are the largest 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 home equity lines, 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, other real estate loan commitments generally expire within 60 days and commercial loan commitments generally expire within one year. At December 31, 2016, the Bank's fixed rate loan commitments are to make loans with interest rates ranging from 3.00% to 4.75% and maturities of five 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 December 2017. 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, 2016 varied from 0% to 100% of the contractual notional amount of each instrument, with the average amount of collateral totaling 80% of the aggregate outstanding notional amount. Standby letters of credit are considered financial guarantees and are recorded at fair value.

**Employment Contracts.** At December 31, 2016, the chief executive officer, senior executive vice president and certain of the Bank's executive vice presidents had employment contracts with the Corporation under which they are entitled to severance compensation in the event of an involuntary termination of employment or resignation of employment following a change in control. The terms of these contracts currently range from eighteen months to three years. Unless the Corporation gives written notice of non-extension within the time frames set forth in the contracts, the contracts are automatically extended at the expiration of each year for a new period ranging from eighteen months to three years. The current aggregate annual salaries provided for in these contracts is \$1,655,500.

**Lease Commitments.** At December 31, 2016, minimum annual rental commitments under non-cancelable operating leases are as follows:

| Year       | Amount<br>(in<br>thousands) |
|------------|-----------------------------|
| 2017       | \$ 2,139                    |
| 2018       | 1,916                       |
| 2019       | 1,750                       |
| 2020       | 1,611                       |
| 2021       | 1,432                       |
| Thereafter | 4,375                       |
|            | \$ 13,223                   |

The Bank has various renewal options on the above leases. Rent expense, including amounts paid for real estate taxes and common area maintenance, was \$2,085,000, \$1,885,000 and \$1,733,000 in 2016, 2015 and 2014, 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, 2017 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, 2016, 2015 and 2014. 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 2016 or 2015.

The fair values of the Corporation's investment securities designated as available-for-sale at December 31, 2016 and 2015 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.

|                                     | Fair Value Measurements |             |              |
|-------------------------------------|-------------------------|-------------|--------------|
|                                     | Using:                  |             |              |
|                                     | Quoted                  | Significant |              |
|                                     | Prices                  | Inputs      |              |
|                                     | in                      | Other       | Significant  |
|                                     | Active                  | Markets     | Unobservable |
|                                     | Markets                 | Observable  | Inputs       |
|                                     | for                     | Inputs      | (Level 3)    |
|                                     | Identical               | (Level 2)   | (Level 3)    |
|                                     | Assets                  | (Level 2)   | (Level 3)    |
|                                     | (Level 1)               | (Level 2)   | (Level 3)    |
| Total                               | (Level 1)               | (Level 2)   | (Level 3)    |
|                                     | <i>(in thousands)</i>   |             |              |
| Available-for-Sale Securities:      |                         |             |              |
| 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      |
|                                     | \$815,299               | \$-         | \$ 815,299   |
|                                     |                         |             | \$ -         |
| December 31, 2015:                  |                         |             |              |
| State and municipals                | \$435,693               | \$-         | \$ 435,693   |
| Pass-through mortgage securities    | 147,265                 | -           | 147,265      |
| Collateralized mortgage obligations | 154,742                 | -           | 154,742      |
|                                     | \$737,700               | \$-         | \$ 737,700   |
|                                     |                         |             | \$ -         |

Assets measured at fair value on a nonrecurring basis at December 31, 2016 and 2015, are set forth in the table that follows. Real estate appraisals utilized in measuring the fair value of 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. Because the Corporation has a small amount of impaired loans measured at fair value, the impact of unobservable inputs on the Corporation's financial statements is not material.

|                                      | Fair Value Measurements |             |              |           |
|--------------------------------------|-------------------------|-------------|--------------|-----------|
|                                      | Using:                  |             |              |           |
|                                      | Quoted                  | Significant |              |           |
|                                      | Prices                  |             |              |           |
|                                      | in                      | Other       | Significant  |           |
|                                      | Active                  | Markets     | Unobservable |           |
|                                      | Markets                 | Observable  | Unobservable |           |
|                                      | for                     | Inputs      | Inputs       |           |
|                                      | Identical               | Inputs      | Inputs       |           |
|                                      | Assets                  | (Level 1)   | (Level 2)    | (Level 3) |
| Total                                | (Level 1)               | (Level 2)   | (Level 3)    |           |
|                                      | <i>(in thousands)</i>   |             |              |           |
| December 31, 2016:                   |                         |             |              |           |
| Impaired loans:                      |                         |             |              |           |
| Residential mortgages - closed end   | \$1,009                 | \$-         | \$-          | \$ 1,009  |
| December 31, 2015:                   |                         |             |              |           |
| Residential mortgages held-for-sale: |                         |             |              |           |
| Closed end                           | \$25                    | \$-         | \$-          | \$ 25     |
| Revolving home equity                | 80                      | -           | -            | 80        |
|                                      | \$105                   | \$-         | \$-          | \$ 105    |
| Impaired loans:                      |                         |             |              |           |
| Residential mortgages - closed end   | \$119                   | \$-         | \$-          | \$ 119    |

The impaired loans set forth in the preceding table had principal balances of \$1,491,000 and \$152,000 at December 31, 2016 and 2015, respectively, and valuation allowances of \$482,000 and \$33,000, respectively. During the years ended December 31, 2016, 2015 and 2014, the Corporation recorded provisions (credit) for loan losses of \$449,000, \$27,000 and \$(14,000), respectively, for impaired loans measured at fair value.

The residential mortgage loans held-for-sale at December 31, 2015 in the preceding table were accounted for on a nonaccrual basis and carried at fair value. These loans were sold in 2016 at a loss of \$5,000.

**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, 2016 and 2015.

|  | Level of<br>Fair<br>Value<br>Hierarchy | December 31, 2016  |            | December 31, 2015  |            |
|--|--|--------------------|------------|--------------------|------------|
|  |  | Carrying<br>Amount | Fair Value | Carrying<br>Amount | Fair Value |
| <i>(in thousands)</i>                            |  |                    |            |                    |            |
| <b>Financial Assets:</b>                         |  |                    |            |                    |            |
| Cash and cash equivalents                        | Level 1                                | \$36,929           | \$36,929   | \$39,635           | \$39,635   |
| Held-to-maturity securities                      | Level 2                                | 9,904              | 10,154     | 12,366             | 12,905     |
| Held-to-maturity securities                      | Level 3                                | 1,483              | 1,483      | 2,005              | 2,005      |
| Loans  | Level 3                                | 2,514,355          | 2,472,849  | 2,220,808          | 2,203,418  |
| Restricted stock                                 | Level 1                                | 31,763             | 31,763     | 28,435             | 28,435     |
| Accrued interest receivable:                     |  |                    |            |                    |            |
| Investment securities                            | Level 2                                | 4,564              | 4,564      | 4,403              | 4,403      |
| Loans  | Level 3                                | 6,418              | 6,418      | 5,501              | 5,501      |
| <b>Financial Liabilities:</b>                    |  |                    |            |                    |            |
| Checking deposits                                | Level 1                                | 808,311            | 808,311    | 777,994            | 777,994    |
| Savings, NOW and money market deposits           | Level 1                                | 1,519,749          | 1,519,749  | 1,195,968          | 1,195,968  |
| Time deposits                                    | Level 2                                | 280,657            | 282,024    | 310,713            | 313,331    |
| Short-term borrowings                            | Level 1                                | 207,012            | 207,012    | 211,502            | 211,502    |
| Long-term debt                                   | Level 2                                | 379,212            | 375,003    | 365,712            | 364,935    |
| Accrued interest payable:                        |  |                    |            |                    |            |
| Checking, savings, NOW and money market deposits | Level 1                                | 160                | 160        | 43                 | 43         |
| Time deposits                                    | Level 2                                | 25                 | 25         | 3,224              | 3,224      |
| Short-term borrowings                            | Level 1                                | 8                  | 8          | 3                  | 3          |
| Long-term debt                                   | Level 2                                | 590                | 590        | 669                | 669        |

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) and 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**

|   | December 31,          |           |
|---|-----------------------|-----------|
|   | 2016                  | 2015      |
|   | <i>(in thousands)</i> |           |
| <b>Assets:</b>  |                       |           |
| Cash and due from banks                                   | \$1,372               | \$2,351   |
| Investment in subsidiary bank, at equity                  | 306,107               | 249,260   |
| Prepaid income taxes                                      | 123                   | 719       |
| Deferred income tax benefits                              | 1,548                 | 1,464     |
| Other assets  | 68                    | 4         |
|   | \$309,218             | \$253,798 |
| <b>Liabilities:</b>                                       |                       |           |
| Other liabilities   | \$20                  | \$39      |
| Cash dividends payable                                    | 3,368                 | 2,823     |
|   | 3,388                 | 2,862     |
| <b>Stockholders' equity:</b>                              |                       |           |
| Common stock  | 2,370                 | 1,412     |
| Surplus   | 101,738               | 56,931    |
| Retained earnings   | 203,326               | 185,069   |
|   | 307,434               | 243,412   |
| Accumulated other comprehensive income (loss), net of tax | (1,604 )              | 7,524     |
|   | 305,830               | 250,936   |
|   | \$309,218             | \$253,798 |

**CONDENSED STATEMENTS OF INCOME**

|   | Year ended December 31, |                 |                 |
|---|-------------------------|-----------------|-----------------|
|   | 2016                    | 2015            | 2014            |
|   | <i>(in thousands)</i>   |                 |                 |
| <b>Income:</b>  |                         |                 |                 |
| Dividends from subsidiary bank                          | \$4,500                 | \$7,500         | \$6,000         |
| <b>Expenses:</b>  |                         |                 |                 |
| Salaries  | 1,517                   | 1,319           | 1,511           |
| Other operating expenses                                | 376                     | 541             | 409             |
|   | 1,893                   | 1,860           | 1,920           |
| Income before income taxes                              | 2,607                   | 5,640           | 4,080           |
| Income tax benefit                                      | (1,181 )                | (832 )          | (759 )          |
| Income before undistributed earnings of subsidiary bank | 3,788                   | 6,472           | 4,839           |
| Equity in undistributed earnings                        | 27,092                  | 19,418          | 18,175          |
| <b>Net income</b>                                       | <b>\$30,880</b>         | <b>\$25,890</b> | <b>\$23,014</b> |
| Comprehensive income                                    | \$21,752                | \$22,629        | \$32,137        |

**CONDENSED STATEMENTS OF CASH FLOWS**

|   | Year ended December 31, |          |          |
|---|-------------------------|----------|----------|
|   | 2016                    | 2015     | 2014     |
|   | <i>(in thousands)</i>   |          |          |
| <b>Cash Flows From Operating Activities:</b>                                      |                         |          |          |
| Net income  | \$30,880                | \$25,890 | \$23,014 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |          |          |
| Undistributed earnings of subsidiary bank   | (27,092)                | (19,418) | (18,175) |
| Deferred income tax credit  | (84 )                   | (278 )   | (289 )   |
| Tax benefit of stock-based compensation   | -                       | 336      | 224      |
| Stock-based compensation expense  | 1,517                   | 1,319    | 1,511    |
| (Increase) decrease in prepaid income taxes                                       | 596                     | (362 )   | 139      |
| (Increase) decrease in other assets   | (64 )                   | 38       | (41 )    |
| Increase (decrease) in other liabilities  | (19 )                   | 39       | (12 )    |
| Net cash provided by operating activities   | 5,734                   | 7,564    | 6,371    |
| <b>Cash Flows From Investing Activities:</b>                                      |                         |          |          |
| Payments for investments in and advances to subsidiaries                          | (38,883)                | -        | -        |
| <b>Cash Flows From Financing Activities:</b>                                      |                         |          |          |
| Repurchase and retirement of common stock   | (370 )                  | (287 )   | (286 )   |
| Proceeds from exercise of stock options   | 906                     | 707      | 1,055    |
| Proceeds from issuance of common stock, net                                       | 43,712                  | 3,870    | 2,185    |

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|   |          |          |          |
|---|----------|----------|----------|
| Cash dividends paid                                   | (12,078) | (10,759) | (9,736 ) |
| Net cash provided by (used in) financing activities   | 32,170   | (6,469 ) | (6,782 ) |
| Net increase (decrease) in cash and cash equivalents* | (979 )   | 1,095    | (411 )   |
| Cash and cash equivalents, beginning of year          | 2,351    | 1,256    | 1,667    |
| Cash and cash equivalents, end of year                | \$1,372  | \$2,351  | \$1,256  |

**Supplemental Schedule of Noncash Financing Activities:**

|                        |         |         |         |
|------------------------|---------|---------|---------|
| Cash dividends payable | \$3,368 | \$2,823 | \$2,642 |
|------------------------|---------|---------|---------|

\* 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)**

|  | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter | Total     |
|--|------------------|-------------------|------------------|-------------------|-----------|
| <i>(in thousands, except per share data)</i>         |                  |                   |                  |                   |           |
| <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    |
| <b>2015</b>  |                  |                   |                  |                   |           |
| Interest income                                      | \$22,058         | \$22,667          | \$22,903         | \$24,507          | \$92,135  |
| Interest expense                                     | 4,252            | 4,173             | 3,970            | 4,134             | 16,529    |
| Net interest income                                  | 17,806           | 18,494            | 18,933           | 20,373            | 75,606    |
| Provision for loan losses                            | 411              | 942               | 1,049            | 1,915             | 4,317     |
| Noninterest income before net securities gains       | 1,956            | 1,950             | 1,819            | 1,709             | 7,434     |
| Net gains on sales of securities                     | -                | 1,133             | -                | 191               | 1,324     |
| Noninterest expense before debt extinguishment costs | 11,147           | 10,958            | 11,382           | 12,120            | 45,607    |
| Debt extinguishment costs                            | -                | 1,084             | -                | -                 | 1,084     |
| Income before income taxes                           | 8,204            | 8,593             | 8,321            | 8,238             | 33,356    |
| Income tax expense                                   | 1,719            | 2,317             | 1,810            | 1,620             | 7,466     |
| Net income   | 6,485            | 6,276             | 6,511            | 6,618             | 25,890    |
| Earnings per share:                                  |                  |                   |                  |                   |           |
| Basic  | .31              | .30               | .31              | .31               | 1.23      |
| Diluted  | .31              | .30               | .31              | .31               | 1.22      |
| Comprehensive income                                 | 8,092            | 670               | 9,536            | 4,331             | 22,629    |

Adoption of ASU 2016-09 effective January 1, 2016 increased (decreased) quarterly net income for the first through the fourth quarters of 2016 by \$205,000, \$109,000, (\$13,000) and \$84,000, respectively.



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The First of Long Island Corporation

Glen Head, New York

We have audited the accompanying consolidated balance sheets of The First of Long Island Corporation as of December 31, 2016 and 2015, and 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, 2016. We also have audited The First of Long Island Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The First of Long Island Corporation'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 these consolidated financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. 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.

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 consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The First of Long Island Corporation as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, The First of Long Island Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Crowe Horwath LLP

New York, New York

March 15, 2017



## **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 the 2013 *Internal Control - Integrated Framework* 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, 2016, based on the criteria established in the 2013 *Internal Control - Integrated Framework* issued by COSO. Based on the assessment, management determined that, as of December 31, 2016, 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, 2016 in their report which appears on page 66.

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

There were no changes in internal control over financial reporting that occurred during the fourth quarter of 2016 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 19, 2017 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 19, 2017 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 19, 2017 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 19, 2017 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 19, 2017 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 August 21, 2015)   |
| 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 15, 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, as amended (incorporated by reference to Exhibit 10.1 of Registrant’s Form 8-K filed January 20, 2005 and Exhibit 10.1 of Registrant’s Form 8-K filed December 19, 2008)   |
| 10.4               | Employment Agreement between Registrant and Donald L. Manfredonia, as amended (incorporated by reference to Exhibit 10.7 of Registrant’s Form 10-K filed March 29, 2002, Exhibit 10.5 of Registrant’s Form 8-K filed March 3, 2005 and Exhibit 10.3 of Registrant’s Form 8-K filed December 19, 2008)   |
| 10.5               | Employment Agreement between Registrant and Richard Kick, as amended (incorporated by reference to Exhibit 10.3 of Registrant’s Form 8-K filed March 3, 2005 and Exhibit 10.5 of Registrant’s Form 8-K filed December 19, 2008)   |
| 10.6               | Employment Agreement between Registrant and Mark D. Curtis, as amended (incorporated by reference to Exhibit 10.1 of Registrant’s Form 8-K filed March 3, 2005, Exhibit 10.4 of Registrant’s Form 8-K filed December 19, 2008 and Exhibit 10.10 of Registrant’s Form 8-K filed October 21, 2009)  |
| 10.7               | Amendment to Supplemental Executive Retirement Program (incorporated by reference to Exhibit 10.10 of Registrant’s Form 8-K filed December 19, 2008)  |
| 10.8               | Special Severance Agreement dated as of February 17, 2014 between The First of Long Island Corporation and Richard P. Perro, Executive Vice President (incorporated by reference to Exhibit 10.1 of Registrant’s Form 10-Q filed May 12, 2014)  |
| 10.9               | Special Severance Agreement dated as of February 14, 2011 between The First of Long Island Corporation and Christopher Becker, Executive Vice President (incorporated by reference to Exhibit 10.11 of Registrant’s Form 10-K filed March 16, 2015)   |
| 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, 2016, 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.

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## 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 15, 2017 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><br>Walter C. Teagle III | Non-executive Chairman of the Board | <u>March 15, 2017</u> |
| <u>/s/ PAUL T. CANARICK</u>                             | Director                            | <u>March 15, 2017</u> |



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Paul T. Canarick

/s/ ALEXANDER L. COVER Director March 15, 2017  
Alexander L. Cover

/s/ JOHN J. DESMOND Director March 15, 2017  
John J. Desmond

/s/ HOWARD THOMAS HOGAN JR. Director March 15, 2017  
Howard Thomas Hogan Jr.

/s/ JOHN T. LANE Director March 15, 2017  
John T. Lane

/s/ STEPHEN V. MURPHY Director March 15, 2017  
Stephen V. Murphy

/s/ PETER QUICK Director March 15, 2017  
Peter Quick

/s/ MILBREY RENNIE TAYLOR Director March 15, 2017  
Milbrey Rennie Taylor

/s/ ERIC TVETER Director March 15, 2017  
Eric Tveter

/s/ MICHAEL N. VITTORIO Director March 15, 2017  
Michael N. Vittorio