FIRST OF LONG ISLAND CORP
Form 10-K
March 15, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from to

Commission file number 001-32964

THE FIRST OF LONG ISLAND CORPORATION

(Exact Name Of Registrant As Specified In Its Charter)

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

(516) 671-4900

Registrant's telephone number, including area code

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.10 par value per share	The NASDAQ Stock Market

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

None
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

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

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

The aggregate market value of the Corporation's voting common stock held by nonaffiliates as of June 29, 2018, the last business day of the Corporation's most recently completed second fiscal quarter, was $605.3 million. This value was computed by reference to the price at which the stock was last sold on June 29, 2018 and excludes $24.7 million representing the market value of common stock beneficially owned by directors and executive officers of the registrant.

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

Class	Outstanding, March 1, 2019
Common Stock, $.10 par value	25,153,936

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held April 16, 2019 are incorporated by reference into Part III.

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

General

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

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

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

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

The Bank did not commence, abandon or significantly change any of its lines of business during 2018.

Markets Served and Products Offered

The Bank serves the financial needs of small and medium-sized businesses, professionals, consumers, public bodies and other organizations primarily in Nassau and Suffolk Counties, Long Island, and the boroughs of New York City (“NYC”). The Bank’s head office is located in Glen Head, New York, and the Bank has 51 other branch locations including six full-service branches in Queens, three in Brooklyn and two commercial banking offices in Manhattan. The Bank continues to evaluate potential new branch sites on Long Island and in the NYC boroughs of Brooklyn and

Queens.

The Bank’s loan portfolio is primarily comprised of loans to borrowers on Long Island and in the boroughs of NYC, 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, corporate bonds of large U.S. financial institutions 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 and large regional and community banks located within the Bank’s market area, mortgage brokers, brokerage firms, credit unions and fintech or e-commerce companies. 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 is granted and amended as necessary by the Board of Directors or BALCO.

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

The Bank's investment policy generally limits individual maturities to twenty years and estimated average lives on collateralized mortgage obligations ("CMOs") and other mortgage-backed securities to ten years. At the time of purchase, bonds of states and political subdivisions must generally be rated AA or better, notes of states and political subdivisions must generally be rated MIG-1 (or equivalent), commercial paper must be rated A-1 or P-1, and corporate bonds of large U.S. based financial institutions must have a rating of BBB+ 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 2018 and 2017, 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, 2018, $419.2 million of the Corporation's municipal securities were rated AA or better, $2.1 million were rated A and $3.9 million were non-rated bonds issued by local municipalities. The Corporation's pass-through mortgage securities portfolio at December 31, 2018 is comprised of $167.9 million and $52.9 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 Corporation's corporate bond portfolio is comprised of $117.6 million of senior unsecured fixed-to-floating rate securities issued by large U.S. based financial institutions. The bonds are rated A- to BBB+, have a stated maturity of ten years, a fixed rate for a period of two or three years and then reset quarterly based on the ten-year swap rate.

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

Lending Activities

General. The Bank’s lending is subject to written underwriting standards and loan origination procedures, as approved by the Board Loan Committee and contained in the Bank’s loan policy. The loan policy allows for exceptions and sets 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 NYC. 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 $750,000, home equity and small business credit scored loans in excess of $500,000 and other loans in excess of $750,000 generally require the approval of the Management Loan Committee. Loans in excess of $12.5 million require the additional approval of two non-management members of the Board Loan Committee, while those in excess of $17.5 million require the approval of a majority of the Board of Directors.

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

Small Business Credit Scored Loans. The Bank makes small business credit scored loans and issues VISA® credit cards to businesses that generally have annual sales at the time of application of less than $3.5 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 60 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 $623,000 of small business credit scored term loans outstanding at December 31, 2018. In addition, the Bank had commitments on small business credit scored revolving lines of credit of $52.8 million, of which $20.0 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 30 years and are generally maintained in the Bank's portfolio. The residential mortgage loans made by the Bank in recent years consist of both fixed rate loans with terms ranging from 10 to 30 years and variable rate loans that reprice in five, seven or ten years and then every year thereafter. Commercial mortgage loans generally reprice within five years and home equity lines generally mature within ten years. Depending on the type of property, the Bank will generally not lend more than 75% of appraised value on residential mortgage, home equity and commercial mortgage loans. The lending limitations with regard to appraised value are more stringent for loans on co-ops and condominiums.

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

Construction Loans. From time to time, the Bank makes loans to finance the construction of both residential and commercial properties. The maturity of such loans is generally 18 months or less and advances are made as the construction progresses. The advances can require the submission of bills and lien waivers 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 $6.1 million at December 31, 2018.

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

The Bank offers checking and interest-bearing deposit products. In addition to business and small business checking, the Bank has a variety of personal checking products that differ in minimum balance requirements, monthly maintenance fees, and per check charges, if any. The interest-bearing deposit products, which have a wide range of interest rates and terms, consist of checking accounts, which include negotiable order of withdrawal ("NOW") accounts and IOLA, escrow service accounts, rent security accounts, a variety of personal and nonpersonal money market accounts, a variety of personal and nonpersonal savings products, time deposits, holiday club accounts and a variety of individual retirement accounts.

The Bank relies primarily on its branch network, customer service, calling programs, lending relationships, referral sources, competitive pricing, deposit rate promotions 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, 2018, the Bank had 344 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 their interpretation and application by regulatory agencies cannot be predicted and may have a material effect on our business and results of operations.

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

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

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

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

Payment of Dividends. A large source of the Corporation's liquidity is dividends from the Bank. Prior approval of the OCC is required if the total of all dividends declared by a national bank in any calendar year would exceed the sum of the bank's net profits for that year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. Under the foregoing dividend restrictions, and while maintaining its "well-capitalized" status and absent affirmative governmental approvals, during 2019 the Bank could declare dividends to the Corporation of approximately $52.3 million plus any 2019 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.

Stock Repurchases. Current Federal Reserve regulations provide that a bank holding company that is not well capitalized or well managed, as such terms are defined in the regulations, or that is subject to any unresolved supervisory issues, is required to give the Federal Reserve prior written notice of any repurchase or redemption of its outstanding equity securities if the gross consideration for repurchase or redemption, when combined with the net consideration paid for all such repurchases or redemptions during the preceding 12 months, will be equal to 10% or more of the company's consolidated net worth. The Federal Reserve may disapprove such a repurchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice or violate a law or regulation. Federal Reserve guidance generally provides for bank holding company consultation with Federal Reserve Bank ("FRB") staff prior to engaging in a repurchase or redemption of a bank holding company's stock, even if a formal written notice is not required. However, it has recently come to the attention of the Corporation that the Federal Reserve staff is interpreting the capital regulations as requiring a bank holding company to secure Federal Reserve approval prior to redeeming or repurchasing any capital stock that is included in regulatory capital.

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

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

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

The Corporation and the Bank are subject to the Basel III regulatory capital standards (“Basel III”) issued by the Federal Reserve Board and the OCC. Under the Basel III capital requirements, the Corporation and the Bank are required to maintain minimum ratios of Tier 1 capital to average assets of 4.00%, Common equity tier 1 capital to risk weighted assets of 4.50%, Tier 1 capital to risk weighted assets of 6.00% and Total capital to risk weighted assets of 8.00%. 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, 2018.

Basel III also phased-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 conservation buffer of 2.5% is now fully phased in and the capital ratio requirements for 2019, including the capital conservation buffer, for banks with $250 billion or less in total assets are 7.00% for Common equity tier 1 capital to risk weighted assets, 8.50% for Tier 1 capital to risk weighted assets and 10.50% for Total capital to risk weighted assets.

Federal legislation enacted in 2018 requires that the federal banking agencies, including the OCC and FRB, establish an alternative framework that specifies a “community bank leverage ratio” of between 8 and 10% of average total consolidated assets for qualifying banking organizations with less than $10 billion of assets. Institutions and holding companies with tangible equity (subject to certain adjustments) meeting the specified level and electing to follow the alternative framework would be deemed to comply with the applicable regulatory capital requirements, including the risk-based requirements, and be considered to be “well-capitalized” for purposes of the Prompt Corrective Action (“PCA”) regulations, discussed in the following section. The agencies have issued a proposed rule that would set the “community bank leverage ratio” at 9%. Management is evaluating the proposed rule to determine whether or not to elect the alternative framework.

Prompt Corrective Action Regulations. The Federal Deposit Insurance Act, as amended (“FDIA”), requires among other things, that the federal banking agencies 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 PCA regulations: “well-capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” The PCA thresholds established by Basel III for each of the capital tiers is as follows:

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

The Bank was well capitalized under the Basel III PCA thresholds at December 31, 2018.

Deposit Insurance. The FDIC imposes an assessment on financial institutions for deposit insurance. The assessment is based on the FDIC’s statistical model for estimating the institution’s probability of failure over a three-year period and 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.

On September 30, 2018, the Deposit Insurance Fund Reserve Ratio exceeded 1.35%. As a result, small banks such as the Bank will receive assessment credits for the portion of their assessment that contributed to the growth in the reserve ratio from 1.15% to 1.35%, to be applied when the reserve ratio is at least 1.38%. Based on a notice received from the FDIC in January 2019, the Bank would receive approximately $960,000 in credits toward future assessments once the reserve ratio reaches 1.38%.

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

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

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank System ("FHLB System"), which consists of 11 regional Federal Home Loan Banks (each a "FHLB"). The FHLB System provides a central credit facility primarily for member banks. As a member of the FHLB of New York, the Bank is required to acquire and hold shares of capital stock in the FHLB in an amount equal to 4.5% of its borrowings from the FHLB (transaction-based stock) plus .125% of the total principal amount at the beginning of the year of the Bank's unpaid residential real estate loans, commercial real estate loans, home equity loans, CMOs, and other similar obligations (membership stock). At December 31, 2018, 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 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. The Corporation's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed with or furnished to the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through the Bank's website as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. To access these reports go to the homepage of the Bank's website and click on "Investor Relations," then click on "SEC Filings," and then click on "Corporate SEC Filings." This will bring you to a listing of the Corporation's reports maintained on the SEC's EDGAR website. You can then click on any report to view its contents. Information on our website shall not be considered a part of this Annual Report on Form 10-K. Our SEC filings are also available on the SEC's website at www.sec.gov.

ITEM 1A. RISK FACTORS

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

The inability to realize the full carrying value of the Bank's investment securities, loans and BOLI could negatively impact our financial condition and results of operations.

For investment securities, loans and BOLI, 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 BOLI portfolios has been addressed by adopting board committee approved investment and BOLI 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 BOLI 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 of large U.S. based financial institutions must be rated BBB+ or better. BOLI 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 BOLI carriers. Any significant deterioration in the creditworthiness of an issuer or carrier will be analyzed and action taken if deemed appropriate.

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

The credit risk within the Bank's loan portfolio primarily stems from factors such as changes in the borrower's financial condition, credit concentrations, changes in collateral values, economic conditions and environmental contamination. The Bank's commercial loans, including those secured by mortgages, are primarily made to small and medium-sized businesses. Such loans sometimes involve a higher degree of risk than those to larger companies because such businesses may have shorter operating histories, higher debt-to-equity ratios and may lack sophistication in internal record keeping and financial and operational controls. In addition, most of the Bank's loans are made to businesses and consumers on Long Island and in the boroughs of NYC, and a large percentage of these loans are mortgage loans secured by properties located in those areas. At December 31, 2018, residential mortgage loans, including home equity lines of credit, amounted to approximately $1.9 billion and comprised approximately 59% of loans secured by real estate. The primary source of repayment for residential mortgage loans is cash flows from individual borrowers and co-borrowers. Also, at December 31, 2018, multifamily loans amounted to approximately $757 million and comprised approximately 59% of the Bank's total commercial mortgage portfolio and approximately 24% of the Bank's total loans secured by real estate. The primary source of repayment for multifamily loans is cash flows from the underlying properties, a substantial portion of which are rent stabilized or rent controlled. Such cash flows for both residential mortgage and multifamily loans are dependent on the strength of the local economy.

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

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

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

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

Changes in interest rates and the shape of the yield curve could negatively impact our earnings.

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

A sustained period of low interest rates and a flattening yield curve over the past several years have resulted in significant downward pressure on our net interest margin. The curve significantly flattened as the FRB slowly changed from an accommodative monetary policy to a tightening monetary policy with increases in the federal funds target rate of 225 basis points since December 2015.

Increases in the federal funds target rate have exerted upward pressure on non-maturity deposit liability rates and the cost of overnight borrowings. Net interest margin is expected to be negatively impacted by further upward deposit repricing and increases in the federal funds target rate. To date, increases in the federal funds target rate have not been met with and in the future may not be met with corresponding increases in lending and investing yields. Adding to the downward pressure on net interest margin are timing differences between the repricing of interest-earning assets and interest-bearing liabilities in a rising rate environment. While the Bank's non-maturity deposits and short-term borrowings are subject to immediate repricing with changes in market interest rates, most of its investment securities and loans are not. The impact of these interest rate changes and timing differences is expected to continue to exert downward pressure on net interest income and earnings. However, over a longer period of time, the Bank's earnings could be positively impacted if the yield curve steepens and results in higher lending and investment yields with no offsetting increase in interest expense from those interest-earning assets funded by noninterest-bearing checking deposits and capital.

If interest rates decline, borrowers may refinance higher rate loans at lower rates causing prepayments on mortgage loans and mortgage-backed securities to be 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 that prepaid. In addition, subject to the floors contained in many of the Bank's loan agreements, the Bank's loans at variable interest rates may adjust to lower rates at their reset dates. While lower rates may reduce the Bank's cost of funds on non-maturity deposits, certificates of deposits and FHLB advances, the cost savings could be somewhat constrained because decreases in the Bank's funding rates may occur more slowly than decreases in yields earned on the Bank's assets and a significant portion of the Bank's funding already comes from noninterest bearing checking deposits and capital.

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

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

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

The Bank is a member of the FRB of New York and the FHLB of New York, and has a federal funds line with a commercial bank. In addition to customer deposits, the Bank's primary external sources of liquidity are secured borrowings from the FHLB of New York and FRB of New York. In addition, the Bank can purchase overnight federal funds under its existing line and the Corporation can raise funds through its DRIP. However, the Bank's FRB of New York membership, FHLB of New York membership and federal funds line do not represent legal commitments to extend credit to the Bank. The amount that the Bank can potentially borrow is currently dependent on, among other things, the amount of unencumbered eligible securities and loans that the Bank can use as collateral and the collateral margins required by the lenders. In addition, the Corporation may not be successful in raising funds from the issuance of its stock under the DRIP or otherwise.

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

The Corporation's market capitalization on December 31, 2018 was approximately $507 million, exceeding the $500 million market capitalization which may make the Corporation's common stock more attractive to certain investors. In addition, the Corporation's common stock is included in the Russell 3000 and Russell 2000 Indexes, which are reconstituted annually. Upon reconstitution in May 2018, the average market capitalization of companies in the Russell 2000 Index was $2.1 billion, the median market capitalization was $900 million, the capitalization of the largest company in the index was $3.7 billion and the capitalization of the smallest company in the index was $159 million. The Corporation believes that a market capitalization in excess of $500 million and inclusion in the Russell indexes have positively impacted the price, trading volume and liquidity of its common stock. Conversely, if the Corporation's market capitalization falls below the minimum necessary to be included in the indexes at any future reconstitution date, the opposite could occur. The Corporation also believes that the current activity under its Stock Repurchase Program is positively impacting the price and trading volume of its common stock. Conversely, discontinuance of the Stock Repurchase Program could have the opposite effect.

A concentration of loans in our primary market area may increase the risk of higher nonperforming assets.

Our success depends primarily on the general economic conditions in Nassau and Suffolk counties, Long Island, and the boroughs of NYC as nearly all of our loans are to customers in these markets. Accordingly, the local economic conditions in these market areas have a significant impact on the ability of our borrowers to repay loans as well as our ability to originate new loans. A decline in real estate values in these market areas would also lower the value of the collateral securing loans on properties in these market areas.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Tax Cuts and Jobs Act ("Tax Act"), which was enacted in December 2017, placed limitations on certain deductions that may have a negative impact on the banking industry, borrowers and the market for single-family residential real estate. These limitations include: (1) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans; (2) the elimination of interest deductions for home equity loans; (3) a limitation on the deductibility of business interest expense; and (4) a limitation on the deductibility of property taxes and state and local income taxes.

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

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

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

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

Competition in the banking and financial services industry is intense. In our market area, we compete with numerous commercial banks, savings institutions, mortgage brokers, credit unions, finance companies, mutual funds, fintech or e-commerce companies, 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. Furthermore, fintech developments such as peer-to-peer platforms, blockchain and other distributed ledger technologies have the potential to disrupt the financial services industry and change the way banks do business. 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, 2018, the Bank owns 23 buildings and leases 40 other facilities, all of which are in Nassau and Suffolk Counties, Long Island and the NYC boroughs of Queens, Brooklyn and Manhattan. The Corporation believes that the physical facilities of the Bank are suitable and adequate at present and are being fully utilized.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

The Corporation’s common stock trades on the NASDAQ Capital Market tier of the NASDAQ Stock Market under the symbol “FLIC.” At December 31, 2018, there were 580 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 Corporation declared cash dividends of $.64 per share for the year ended December 31, 2018, compared to cash dividends declared in 2017 of $.58 per share. The Corporation currently expects that comparable cash dividends will continue to be paid in the future.

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 five-year measurement period assuming $100 invested on January 1, 2014, and dividends reinvested in the Corporation’s stock.

Issuer Purchase of Equity Securities

The following table sets forth shares repurchased during the quarter ended December 31, 2018 under the Stock Repurchase Program approved by the Corporation’s Board of Directors in October 2018.

	Total Number	Average	Total Number of Shares Purchased as Part of	Maximum Value of Shares that may yet

Month Purchased	of Shares Purchased	Price Paid Per Share	Its Publicly Announced Program	be Purchased Under Its Program
December 2018	77,300	$19.94	77,300	$18,459,000

13

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.

(dollars in thousands, except per share data)	2018	2017	2016	2015	2014
INCOME STATEMENT DATA:					
Interest Income	$ 138,237	$ 118,265	$ 104,123	$ 92,135	$ 81,976
Interest Expense	35,730	21,709	18,002	16,529	15,048
Net Interest Income	102,507	96,556	86,121	75,606	66,928
Provision (Credit) for Loan Losses	(1,755)	4,854	3,480	4,317	3,189
Net Income	41,573	35,122	30,880	25,890	23,014
PER SHARE DATA:					
Basic Earnings	$ 1.64	$ 1.44	$ 1.35	$ 1.23	$ 1.11
Diluted Earnings	1.63	1.43	1.34	1.22	1.10
Cash Dividends Declared	.64	.58	.55	.52	.48
Dividend Payout Ratio	39.26 %	40.56 %	41.04 %	42.62 %	43.64
Book Value	$ 15.27	$ 14.37	$ 12.90	$ 11.85	$ 11.20
Tangible Book Value	15.26	14.36	12.90	11.84	11.19
BALANCE SHEET DATA AT YEAR END:					
Total Assets	$ 4,241,060	$ 3,894,708	$ 3,510,320	$ 3,130,343	$ 2,721,4
Loans	3,263,399	2,950,352	2,545,421	2,248,183	1,804,8
Allowance for Loan Losses	30,838	33,784	30,057	27,256	23,221
Deposits	3,084,972	2,821,997	2,608,717	2,284,675	1,985,0
Borrowed Funds	750,950	704,938	586,224	577,214	481,48
Stockholders' Equity	388,187	354,450	305,830	250,936	233,30
AVERAGE BALANCE SHEET DATA:					
Total Assets	$ 4,177,341	$ 3,695,850	$ 3,329,308	$ 2,897,548	$ 2,515,1
Loans	3,177,519	2,758,116	2,364,187	1,990,823	1,584,1
Allowance for Loan Losses	34,960	32,022	28,238	24,531	21,554
Deposits	3,168,348	2,812,733	2,590,988	2,215,883	1,922,1
Borrowed Funds	623,587	540,307	432,554	419,372	347,94
Stockholders' Equity	374,876	334,088	290,806	243,330	224,58
FINANCIAL RATIOS:					
Return on Average Assets (ROA)	1.00 %	.95 %	.93 %	.89 %	.92
Return on Average Stockholders' Equity (ROE)	11.09 %	10.51 %	10.62 %	10.64 %	10.25
Average Equity to Average Assets	8.97 %	9.04 %	8.73 %	8.40 %	8.93

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

Overview – 2018 Versus 2017

Analysis of 2018 Earnings. Net income and diluted earnings per share ("EPS") for 2018 were $41.6 million and $1.63, respectively, representing increases of 18.4% and 14.0%, respectively, over the comparable 2017 amounts. Dividends per share increased 10.3% from $.58 for 2017 to $.64 for 2018. ROA and ROE for 2018 were 1.00% and 11.09%, respectively, as compared to .95% and 10.51%, respectively, for 2017.

Net income for 2018 increased $6.5 million over 2017. The increase is attributable to increases in net interest income of $6.0 million, or 6.2%, and noninterest income, before securities losses, of $2.7 million, or 26.5%, and decreases in the provision for loan losses and income tax expense of $6.6 million and $4.8 million, respectively. These items were partially offset by an increase in noninterest expense of $5.1 million, or 9.2%, and securities losses of $10.4 million in 2018 versus $1.9 million last year.

The increase in net interest income is primarily attributable to growth in the average balance of loans of $419.4 million, or 15.2%, and improved yield on the taxable securities portfolio largely resulting from portfolio restructuring activities. The positive impact of these items was partially offset by higher funding costs and a decline in prepayment penalties and late charges of $758,000. Substantially all the loan growth occurred in commercial and residential mortgage loans. Loan growth was funded with increases in the average balances of noninterest-bearing checking deposits, interest-bearing deposits, borrowings and stockholders' equity. Substantial contributors to the growth in deposits were new branch openings, the Bank's ongoing municipal deposit initiative, deposit promotions and the issuance of brokered certificates of deposit. The growth in stockholders' equity was substantially attributable to net income and the issuance of shares under the Corporation's DRIP, partially offset by cash dividends declared, a decline in the after-tax value of available-for-sale securities and share purchases under the Corporation's Stock Repurchase Program.

Net interest margin for 2018 was 2.64%, down 27 basis points from 2.91% for 2017. The Net Interest Income section of this discussion and analysis sets forth the reasons for the decline in net interest margin and measures implemented by management to stabilize net interest margin.

The mortgage loan pipeline at year-end 2018 was a modest $61 million, reflecting management's tempered approach to loan growth in the current interest rate environment.

The reduction in the provision for loan losses for 2018 versus 2017 is mainly due to lower levels of national and local unemployment, increases in collateral values, a decline in historical loss rates and less loan growth in the current year, partially offset by a larger decline in specific reserves in 2017. Net chargeoffs were essentially unchanged in 2018, amounting to $1.2 million versus $1.1 million last year.

The increase in noninterest income of $2.7 million, or 26.5%, before securities losses of $10.4 million, is primarily attributable to a gain on the sale of bank premises of $1.2 million, a $565,000 BOLI death benefit and increases of $566,000 in cash value accretion on BOLI and $356,000 in the net credit relating to the non-service cost components of the Bank's defined benefit pension plan. Cash value accretion increased because of purchases of BOLI during the first quarters of 2017 and 2018 of $25 million and $20 million, respectively. The sale of bank premises consisted of the land and building of one bank branch whose deposits have since been consolidated with a nearby branch.

In 2018, the Bank incurred pre-tax and after-tax losses on securities portfolio restructuring activities of $10.4 million and $7.5 million, respectively. The earn-back period for these losses, excluding $3.2 million incurred in a deleveraging transaction, is approximately 2.0 years. Interest income and net interest margin in 2019 are expected to benefit from these transactions by approximately $3.7 million and 11 basis points, respectively, which will help to mitigate the ongoing pressure on net interest margin.

The increase in noninterest expense of $5.1 million, or 9.2%, is primarily attributable to increases in salaries of $2.6 million, or 10.1%, employee benefits and other personnel expense of $1.3 million, or 17.5%, and occupancy and equipment expense of $1.4 million, or 14.1%. Partially offsetting these increases was a valuation allowance of $725,000 recorded in the fourth quarter of 2017 on other real estate owned. The increase in salaries is primarily due to new branch openings, additions to staff in the back office, normal annual salary adjustments and special salary-related accruals recorded in 2018. The increase in employee benefits and other personnel expense is largely due to increases in incentive compensation expense, retirement plan expense and payroll tax expense. The increase in occupancy and equipment expense is primarily due to the operating costs of new branches, increases in maintenance and repairs expense and a growth-related increase in depreciation on the Bank's facilities and equipment.

In addition to the measures undertaken by management to stabilize net interest margin, management continues to explore a variety of cost saving measures aimed at reducing noninterest expense and further improving an already very strong efficiency ratio.

The decrease in income tax expense of $4.8 million is due to: (1) a reduction in the statutory federal income tax rate from 35% in 2017 to 21% in 2018; (2) recognition in 2018 of tax benefits of New York State ("NYS") and NYC net operating loss carryforwards that originated in 2017 of $542,000; (3) recognition of $717,000 in tax benefits related to accelerated tax depreciation resulting from a cost segregation study; and (4) higher tax benefits in the 2018 period from BOLI. These items are the major contributors to the decline in the Corporation's effective tax rate from 22.0% in 2017 to 10.9% in 2018. Management expects the Corporation's effective tax rate to normalize in the range of 15% to 16% in 2019.

Analysis of Fourth Quarter 2018 Earnings. Net income for the fourth quarter of 2018 was $10.1 million, representing an increase of $2.5 million, or 33.4%, over $7.6 million earned in the same quarter of last year. The increase is primarily attributable to increases in net interest income of $1.8 million and noninterest income, before securities losses, of $1.5 million, and a decrease in the provision for loan losses of $4.0 million. These items were partially offset by increases in noninterest expense and income tax expense of $446,000 and $765,000, respectively, and securities losses of $5.4 million in 2018 versus $1.9 million in 2017.

The increase in net interest income largely occurred for the same reasons discussed with respect to the full year period and because of an increase in prepayment penalties and late charges of $283,000. The increase in noninterest income, before securities losses, was mainly due to the aforementioned gain on the sale of bank premises and higher cash value accretion on BOLI. The decrease in the provision for loan losses was primarily attributable to improved economic conditions, lower loan growth and lower net chargeoffs in the fourth quarter of 2018, partially offset by a decrease in specific reserves in the 2017 period. The credit provision in the fourth quarter of 2018 arose for the same reasons discussed hereinafter with respect to the full year period. The increase in noninterest expense largely occurred for the same reasons discussed with respect to the full year period. The increase in income tax expense is mainly due to higher pre-tax income in the current quarter and a $909,000 credit to income tax expense in the 2017 quarter resulting from the passage of the Tax Act, partially offset by the aforementioned reduction in the statutory federal income tax rate.

Asset Quality. The Bank's allowance for loan losses to total loans was 1.15% at year-end 2017 and trended down to .94% by December 31, 2018. The decrease was driven mainly by an improvement in economic conditions and reductions in historical loss rates and growth rates on certain pools of loans.

The credit quality of the Bank's loan portfolio remains excellent. Nonaccrual loans amounted to $2.1 million, or .07% of total loans outstanding, at December 31, 2018, compared to $1.0 million, or .03%, at December 31, 2017. The increase in nonaccrual loans is due to loans of $5.0 million transferred to nonaccrual status partially offset by paydowns, loan sales and chargeoffs. Troubled debt restructurings amounted to $1.8 million, or .05% of total loans outstanding, at December 31, 2018. Of the troubled debt restructurings, $1.3 million are performing in accordance with their modified terms and $472,000 are nonaccrual and included in the aforementioned amount of nonaccrual loans. Loans past due 30 through 89 days amounted to $909,000, or .03% of total loans outstanding, at December 31, 2018, compared to $2.8 million, or .09%, at December 31, 2017.

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 76% 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 and investment grade corporate bonds of large U.S. financial institutions. In selecting 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 securities in its portfolio and makes decisions to hold or sell based on such assessments.

Key Strategic Initiatives and Challenges We Face. The Bank's strategy remains focused on increasing shareholder value through loan and deposit growth when conditions warrant and the maintenance of stellar credit quality, a strong efficiency ratio and an optimal amount of capital. We currently have 52 branches in Nassau and Suffolk Counties, Long Island and the NYC boroughs of Queens, Brooklyn and Manhattan and will continue to open new branches but at a slower pace. In addition, management is also focused on growing noninterest income from existing and potential new sources, which may include the development or acquisition of fee-based businesses.

As previously discussed, in response to the flattening yield curve management implemented a variety of measures to stabilize net interest margin and reduce operating expenses and thereby enable continued earnings growth. Additional steps are likely. As a result of actions already taken, quarterly net interest margin increased in the fourth quarter of 2018 as compared to the third quarter. However, net interest margin remains under pressure and is expected to be negatively impacted by further deposit repricings and increases in the federal funds rate. Management will continue to be measured and disciplined in its approach to the deposit repricings, deposit rate promotions and loan growth, and will not meaningfully loosen its underwriting standards to improve net interest margin. Assuming the persistence of the relatively flat yield curve, management believes that net interest margin for 2019 could be approximately 2.55%.

With respect to its lending activities, the Bank will continue to prudently manage concentration and credit risk and maintain its broker and correspondent relationships. Commercial mortgage loans will be emphasized over residential mortgage loans because of the better yield and shorter duration that such mortgages generally provide. 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 on net interest margin of the flattening yield curve.

In the current environment, banking regulators are concerned about, among other things, growth, commercial real estate concentrations, underwriting of commercial real estate and commercial and industrial loans, capital levels, liquidity, cybersecurity and predatory sales practices. Regulatory requirements, the cost of compliance and vigilant supervisory oversight are exerting downward pressure on revenues and upward pressure on required capital levels and operating expenses.

Overview – 2017 Versus 2016

Analysis of 2017 Earnings. Net income and diluted EPS for 2017 were $35.1 million and $1.43, respectively, representing increases of 13.7% and 6.7%, respectively, over the comparable 2016 amounts. Dividends per share increased 5.5% from $.55 for 2016 to $.58 for 2017. ROA and ROE for 2017 were .95% and 10.51%, respectively, as compared to .93% and 10.62%, respectively, for 2016.

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

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

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

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

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

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

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

Analysis of Fourth Quarter 2017 Earnings. Net income for the fourth quarter of 2017 was $7.6 million, up slightly from $7.5 million in the same quarter of 2016. The increase was primarily attributable to increases in net interest income and income from BOLI of $1.9 million and $188,000, respectively, and decreases in the provision for loan losses and income tax expense of $319,000 and $968,000, respectively. These items were substantially offset by increases in salaries and occupancy and equipment expense of $536,000 and $380,000, respectively, and the aforementioned securities loss and valuation allowance of $1.9 million and $725,000, respectively. The securities loss negatively impacted fourth quarter 2017 ROA and ROE by 13 and 141 basis points, respectively. The decrease in the provision for loan losses was primarily driven by a decrease in specific reserves in the fourth quarter of 2017 of $821,000 versus an increase of $482,000 in the same quarter of 2016, as partially offset by higher net chargeoffs in the 2017 quarter and adjustments to qualitative factors used in determining the allowance for loan losses. The decrease in income tax expense occurred because of lower pre-tax earnings in the fourth quarter of 2017 and for the same reasons discussed above with respect to the full year periods. Other fourth quarter variances occurred for substantially the same reasons discussed above with respect to the full year 2017 and 2016 periods.

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

The overall credit quality of the Bank's loan portfolio at year end 2017 was excellent. Nonaccrual loans amounted to $1.0 million, or .03% of total loans outstanding, at December 31, 2017, compared to $2.6 million, or .10%, at December 31, 2016. The decrease was attributable to paydowns and loans returned to an accrual status, partially offset by new nonaccrual loans. Troubled debt restructurings amounted to $1.0 million, or .04% of total loans outstanding, at December 31, 2017, representing a decrease of $498,000 from year-end 2016. The decrease was primarily attributable to payoffs of some loans and paydowns on other loans. Troubled debt restructurings at year-end 2017 included $785,000 that were performing in accordance with their modified terms and $100,000 that were nonaccrual and included in the aforementioned amount of nonaccrual loans. Loans past due 30 through 89 days amounted to $2.8 million, or .09% of total loans outstanding, at December 31, 2017, compared to $1.1 million, or .04%, at December 31, 2016.

The credit quality of the Bank's securities portfolio was also excellent. The Bank's mortgage securities were backed by mortgages underwritten on conventional terms, with 74% of these securities being full faith and credit obligations of the U.S. government and the balance being obligations of U.S. government sponsored entities. The remainder of the Bank's securities portfolio principally consisted of high quality, general obligation municipal securities rated AA or better by major rating agencies.

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

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

Application of Critical Accounting Policies

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

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

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

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

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

Net Interest Income

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

(dollars in thousands)	2018 Average Balance	Interest/ Dividends	Average Rate	2017 Average Balance	Interest/ Dividends	Average Rate	2016 Average Balance	Interest/ Dividends
Assets:								
Interest-earning bank balances	$ 29,588	$ 561	1.90 %	$ 25,356	$ 281	1.11 %	$ 32,711	$ 168
Investment securities:								
Taxable	357,650	11,479	3.21	327,491	7,473	2.28	374,199	7,813
Nontaxable (1)	451,174	16,978	3.76	461,149	20,744	4.50	465,457	21,056
Loans (1)	3,177,519	112,790	3.55	2,758,116	97,040	3.52	2,364,187	82,469
Total interest-earning assets	4,015,931	141,808	3.53	3,572,112	125,538	3.51	3,236,554	111,506
Allowance for loan losses	(34,960)			(32,022)			(28,238)	
Net interest-earning assets	3,980,971			3,540,090			3,208,316	
Cash and due from banks	36,377			31,555			30,450	
Premises and equipment, net	40,240			36,279			31,597	
Other assets	119,753			87,926			58,945	
	$ 4,177,341			$ 3,695,850			$ 3,329,308	
Liabilities and Stockholders' Equity:								

Savings, NOW & money market deposits	$ 1,720,936	12,105	.70	$ 1,635,044	7,113	.44	$ 1,501,096	5,344	.
Time deposits	493,584	10,452	2.12	305,029	5,479	1.80	298,194	5,107	1
Total interest-bearing deposits	2,214,520	22,557	1.02	1,940,073	12,592	.65	1,799,290	10,451	.
Short-term borrowings	210,023	4,858	2.31	132,137	1,345	1.02	57,395	296	.
Long-term debt	413,564	8,315	2.01	408,170	7,772	1.90	375,159	7,255	1
Total interest-bearing liabilities	2,838,107	35,730	1.26	2,480,380	21,709	.88	2,231,844	18,002	.
Checking deposits	953,828			872,660			791,698		
Other liabilities	10,530			8,722			14,960		
	3,802,465			3,361,762			3,038,502		
Stockholders' equity	374,876			334,088			290,806		
	$ 4,177,341			$ 3,695,850			$ 3,329,308		
Net interest income (1)		$ 106,078			$ 103,829			$ 93,504	
Net interest spread (1)			2.27 %			2.63 %			2
Net interest margin (1)			2.64 %			2.91 %			2

(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. In 2018, the tax-equivalent amount of $1.00 of nontaxable income was $1.27 using the statutory federal income tax rate of 21%. For 2017 and 2016, the tax-equivalent amount of $1.00 of nontaxable income was $1.54 using the statutory federal income tax rate of 35%.

Rate/Volume Analysis. The following table sets forth the effect of changes in volumes and rates on tax-equivalent interest income, interest expense and net interest income. The changes attributable to a combined impact of volume and rate have been allocated to the changes due to volume and the changes due to rate.

	2018 versus 2017			2017 versus 2016		
	Increase (decrease) due to changes in:			Increase (decrease) due to changes in:		
(in thousands)	Volume	Rate	Net Change	Volume	Rate	Net Change
Interest Income:						
Interest-earning bank balances	$ 53	$ 227	$ 280	$ (45)	$ 158	$ 113
Investment securities:						
Taxable	740	3,266	4,006	(1,027)	687	(340)
Nontaxable	(440)	(3,326)	(3,766)	(194)	(118)	(312)
Loans	14,880	870	15,750	13,854	717	14,571
Total interest income	15,233	1,037	16,270	12,588	1,444	14,032
Interest Expense:						
Savings, NOW & money market deposits	392	4,600	4,992	507	1,262	1,769
Time deposits	3,857	1,116	4,973	119	253	372
Short-term borrowings	1,112	2,401	3,513	600	449	1,049
Long-term debt	104	439	543	630	(113)	517
Total interest expense	5,465	8,556	14,021	1,856	1,851	3,707
Increase (decrease) in net interest income	$ 9,768	$ (7,519)	$ 2,249	$ 10,732	$ (407)	$ 10,325

Net Interest Income – 2018 Versus 2017

Net interest income on a tax-equivalent basis was $106.1 million in 2018, an increase of $2.2 million, or 2.2%, over $103.8 million in 2017. The increase is primarily attributable to growth in the average balance of loans of $419.4 million, or 15.2%, and higher interest income from improved yields on taxable investment securities, partially offset by higher funding costs, a decline in prepayment penalties and late charges of $758,000 and the impact of the aforementioned reduction in the federal income tax rate on tax-equivalent interest income. Loans grew primarily because of increases in commercial and residential mortgage loans. Growth in the average balance of loans was funded mainly by increases in the average balances of noninterest bearing checking deposits of $81.2 million, or 9.3%, interest-bearing deposits of $274.4 million, or 14.1%, borrowings of $83.3 million, or 15.4%, and stockholders' equity of $40.8 million, or 12.2%.

Net interest margin for 2018 was 2.64%, down 27 basis points from 2.91% for 2017. The decrease in net interest margin is largely attributable to:

- A reduction in prepayment penalties and late charges from $2.1 million for 2017 to $1.3 million for 2018, thus reducing net interest margin by 3 basis points;
- Yield curve flattening resulting from a significant increase in the federal funds target rate with lesser increases in intermediate and longer-term interest rates;
- Timing differences between the repricing of interest-earning assets and interest-bearing liabilities in a rising rate environment. While non-maturity deposits and short-term borrowings are subject to immediate repricing with changes in market interest rates, securities and most of the Bank's loans reprice over time upon paydown or maturity;
- Competitive market pressure to raise deposit rates to fund growth and protect against deposit outflows; and
- A reduction in the statutory federal income tax rate from 35% for 2017 to 21% for 2018, thus reducing the tax-equivalent amount of each dollar of tax-exempt income and causing a 9 basis point decline in net interest margin.

When comparing 2018 to 2017, these factors largely account for the significant increases experienced by the Bank in the cost of its non-maturity deposits and short-term borrowings of 26 basis points and 129 basis points, respectively, with a much more modest increase occurring in its loan portfolio yield of 3 basis points and a decrease in the non-taxable securities portfolio yield of 74 basis points.

Management has implemented and will continue to implement a variety of measures designed to stabilize net interest margin. These measures slowed the rate of decline in quarterly net interest margin in the second and third quarters of 2018 and made a significant contribution to an increase in the fourth quarter. They include, among others, the following:

- Reducing overall balance sheet growth by slowing loan growth and the related need for funding. As a result, management has been able to slow the pace of branch openings and related growth in noninterest expense, limit deposit rate promotions and be more selective in offering higher rates to new and existing customers;
- Changing the mix of loans being originated toward higher yielding commercial mortgages rather than lower yielding residential mortgages;

· Restructuring the securities portfolio by selling lower yielding securities and replacing them with higher yielding securities or using the proceeds to eliminate inefficient leverage by paying down borrowings. The overall yield on the taxable securities portfolio increased by 87 basis points, or from 3.06% in the third quarter to 3.93% in the fourth quarter, mainly due to the restructuring transactions; and
· Hedging a portion of short-term borrowings with interest rate swaps and thereby providing a degree of net interest margin protection in the event of an increase in overnight borrowing rates. In 2018, the Bank entered into a pay-fixed/receive-variable interest rate swap with a notional amount of $150 million and in January 2019 entered into another pay-fixed/receive-variable interest rate swap with a notional amount of $50 million.

The mortgage loan pipeline at year-end 2018 was a modest $61 million, reflecting management's tempered approach to loan growth.

During the third and fourth quarters of 2018, the Bank sold $274.4 million of available-for-sale securities in restructuring transactions designed to improve securities portfolio yield and net interest margin and eliminate inefficient leverage. In the third quarter, the Bank sold $135 million of mortgage-backed securities and $39.6 million of short-term municipal bonds with yields of 2.51% and 2.90%, respectively, and reinvested the proceeds in mortgage-backed securities and corporate bonds with an overall yield of 4.02%. In October 2018, the Bank eliminated inefficient leverage by selling $60.6 million of mortgage-backed securities with a yield of 2.51% and used the proceeds to pay down overnight borrowings with a cost of 2.47%. In November 2018, the Bank sold an additional $39.2 million of mortgage-backed securities with a yield of 2.55% and reinvested the proceeds in corporate bonds with an overall current yield of 5.08%. The pre-tax and after-tax loss on all 2018 securities sales totaled $10.4 million and $7.5 million, respectively, and the payback period, excluding the deleveraging transaction, is approximately 2.0 years. Because these transactions were completed toward the end of 2018, they had only a partial impact on interest income and net interest margin for the year. On a full year basis for 2019, interest income and net interest margin are expected to benefit from these transactions by approximately $3.7 million and 11 basis points, respectively.

Net Interest Income – 2017 Versus 2016

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

Net interest income also benefitted from an improvement in the Bank’s net interest margin. Net interest margin was 2.91% for 2017 as compared to 2.89% for 2016. The increase in net interest margin was attributable to higher portfolio yields on loans and taxable securities partially offset by higher rates on deposits and borrowings. The cost of deposits and borrowings were driven up, by among other things, increases in the federal funds target rate. The level of net interest margin reflected the low interest rate environment that had persisted for an extended period of time.

Noninterest Income

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

Noninterest income before securities losses increased $2.7 million, or 26.5%, when comparing 2018 to 2017. The increase is primarily attributable to a gain on the sale of bank premises of $1.2 million, a $565,000 BOLI death benefit and increases of $566,000 in cash value accretion on BOLI, $356,000 in the net credit relating to the non-service cost components of the Bank’s defined benefit pension plan and $99,000 on the sale of loans held-for-sale. Cash value accretion increased because of purchases of BOLI during the first quarters of 2017 and 2018 of $25 million and $20 million, respectively. The sale of bank premises consisted of the land and building of one bank branch whose deposits will be consolidated with a nearby branch.

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

Noninterest Expense

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

Noninterest expense increased $5.1 million, or 9.2%, when comparing 2018 to 2017. The increase is primarily attributable to increases in salaries of $2.6 million, or 10.1%, employee benefits and other personnel expense of $1.3 million, or 17.5%, and occupancy and equipment expense of $1.4 million, or 14.1%. Partially offsetting these increases was a valuation allowance of $725,000 recorded in the fourth quarter of 2017 on other real estate owned. The increase in salaries is primarily due to new branch openings, additions to staff in the back office, normal annual salary adjustments and special salary-related accruals recorded in 2018. The increase in employee benefits and other personnel expense is largely due to increases in incentive compensation expense of $520,000, retirement plan expense of $299,000 and payroll tax expense of $201,000. The increase in occupancy and equipment expense is primarily due to the operating costs of new branches, increases in maintenance and repairs expense and a growth-related increase in depreciation on the Bank's facilities and equipment.

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

Income Taxes

Income tax expense as a percentage of pre-tax book income (“effective tax rate”) was 10.9%, 22.0% and 22.7% in 2018, 2017 and 2016, respectively. Among other things, the Corporation’s effective tax rate reflects the tax benefits derived from the Bank’s municipal securities portfolio, ownership of BOLI, maintenance of a captive REIT and for 2018, a reduction in the statutory federal income tax rate due to the Tax Act and the benefits of a cost segregation study, state and local net operating loss carryforwards and the BOLI death proceeds.

2018 Versus 2017. The Corporation’s effective tax rate decreased from 22.0% in 2017 to 10.9% in 2018. Income tax expense decreased $4.8 million from $9.9 million in 2017 to $5.1 million in 2018. The decrease in income tax expense is due to: (1) a reduction in the statutory federal income tax rate from 35% in 2017 to 21% in 2018; (2) recognition in 2018 of tax benefits of NYS and NYC net operating loss carryforwards of $542,000; (3) recognition of $717,000 in tax benefits related to accelerated tax depreciation resulting from a cost segregation study; and (4) higher tax benefits in the 2018 period from BOLI. Management expects the Corporation’s effective tax rate to normalize in the range of 15% to 16% in 2019.

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

Financial Condition

Total assets were $4.2 billion at December 31, 2018, an increase of $346.4 million, or 8.9%, from the previous year-end. The increase was primarily attributable to growth in loans of $313.0 million, or 10.6%, and available-for-sale securities of $37.9 million, or 5.3%.

Asset growth during 2018 was largely funded by growth in deposits, borrowings and stockholders' equity. Total deposits grew $263.0 million, or 9.3%, to $3.1 billion at December 31, 2018. The growth in deposits is comprised of increases in noninterest-bearing checking deposits of $39.4 million, or 4.4%, and time deposits of $235.6 million, or 72.9%, partially offset by a decrease in savings, NOW and money market deposits of $12.1 million. Substantial contributors to the growth in time deposits were deposit promotions and the issuance of brokered certificates of deposit amounting to $100 million. The growth in borrowings is comprised of an increase in short-term borrowings of $107.8 million, partially offset by a decrease in long-term debt of $61.8 million. Substantial contributors to the growth in stockholders' equity were net income and the issuance of shares under the Corporation's stock-based compensation plan and DRIP, partially offset by dividends declared and shares repurchased.

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, 2018, 2017 and 2016.

(in thousands)	2018	2017	2016
Held-to-Maturity Securities:			
State and municipals	$ 5,142	$ 6,970	$ 10,419
Pass-through mortgage securities	267	311	361
Collateralized mortgage obligations	95	355	607
	$ 5,504	$ 7,636	$ 11,387
Available-for-Sale Securities:			
State and municipals	$ 420,038	$ 461,323	$ 450,660
Pass-through mortgage securities	65,486	71,391	185,809
Collateralized mortgage obligations	154,901	187,414	178,830
Corporate bonds	117,590	—	—
	$ 758,015	$ 720,128	$ 815,299

The following table presents the maturities and weighted average tax equivalent yields of the Bank's investment securities at December 31, 2018.

	Principal Maturing (1)							
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
(dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Held-to-Maturity Securities:								
State and municipals	$ 3,059	3.09 %	$ 2,083	5.26 %	$ —	— %	$ —	— %
Pass-through mortgage securities	—	—	51	6.29	2	5.68	214	4.99
Collateralized mortgage obligations	—	—	—	—	—	—	95	8.53
	$ 3,059	3.09 %	$ 2,134	5.28 %	$ 2	5.68 %	$ 309	6.08 %
Available-for-Sale Securities: (2)								
State and municipals	$ 48,271	5.15 %	$ 37,683	3.30 %	$ 166,086	3.46 %	$ 167,998	3.75 %
Pass-through mortgage securities	—	—	—	—	2,347	2.56	63,139	3.08
Collateralized mortgage obligations	—	—	—	—	—	—	154,901	3.34
Corporate bonds	—	—	—	—	117,590	5.14	—	—
	$ 48,271	5.15 %	$ 37,683	3.30 %	$ 286,023	4.14 %	$ 386,038	3.48 %

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

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

During 2018, the Bank received cash dividends of $2.2 million on its FRB and FHLB stock, representing an average yield of 6.33%.

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

	December 31,				
(in thousands)	2018	2017	2016	2015	2014
Commercial and industrial	$ 98,785	$ 109,623	$ 126,038	$ 93,056	$ 77,140
Commercial mortgages:					
Multifamily	756,714	682,593	610,385	572,322	529,093
Other	433,330	414,783	371,142	348,909	222,537
Owner-occupied	91,251	95,631	103,671	115,100	107,345
Residential mortgages:					
Closed end	1,809,651	1,558,564	1,238,431	1,025,215	779,994
Revolving home equity	67,710	83,625	86,461	87,848	83,109
Consumer and other	5,958	5,533	9,293	5,733	5,601
	3,263,399	2,950,352	2,545,421	2,248,183	1,804,819
Allowance for loan losses	(30,838)	(33,784)	(30,057)	(27,256)	(23,221)
	$ 3,232,561	$ 2,916,568	$ 2,515,364	$ 2,220,927	$ 1,781,598

Maturity and rate information for commercial and industrial loans outstanding at December 31, 2018 is set forth below.

	Maturity			
(in thousands)	Within One Year	After One But Within Five Years	After Five Years	Total
Commercial and industrial loans:				
Fixed rate	$ 302	$ 23,885	$ 6,573	$ 30,760
Variable rate	27,127	34,197	6,701	68,025
	$ 27,429	$ 58,082	$ 13,274	$ 98,785

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,				
(dollars in thousands)	2018	2017	2016	2015	2014
Nonaccrual loans (includes loans held-for-sale):					
Troubled debt restructurings	$ 472	$ 100	$ 788	$ 900	$ 1,280
Other	1,663	900	1,770	535	424
Total nonaccrual loans	2,135	1,000	2,558	1,435	1,704
Loans past due 90 days or more and still accruing	—	—	621	—	—
Other real estate owned	—	5,125	—	—	—
Total nonperforming assets	2,135	6,125	3,179	1,435	1,704
Troubled debt restructurings - performing	1,289	947	757	3,581	704
Total risk elements	$ 3,424	$ 7,072	$ 3,936	$ 5,016	$ 2,408
Nonaccrual loans as a percentage of total loans	.07 %	.03 %	.10 %	.06 %	.09 %
Nonperforming assets as a percentage of total loans and other real estate owned	.07 %	.21 %	.12 %	.06 %	.09 %
Risk elements as a percentage of total loans and other real estate owned	.10 %	.24 %	.15 %	.22 %	.13 %

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

	Year Ended December 31,				
(in thousands)	2018	2017	2016	2015	2014
Gross interest income on nonaccrual loans and troubled debt restructurings:					
Amount that would have been recorded during the year under original terms	$ 185	$ 101	$ 153	$ 276	$ 127
Actual amount recorded during the year	135	66	82	171	33

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

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

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

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

	December 31, 2018	
	Internally Assigned Risk Rating	
	Pass	Special

(in thousands)	1 - 2	3 - 4	5 - 6	Watch	Mention	Substandard	Doubtful	Total
Commercial and industrial	$ 4,278	$ 6,113	$ 87,293	$ —	$ 667	$ 434	$ —	$ 98,785
Commercial mortgages:								
Multifamily	—	58,645	698,069	—	—	—	—	756,714
Other	—	13,769	404,069	14,194	1,298	—	—	433,330
Owner-occupied	—	642	85,068	1,090	3,911	540	—	91,251
	$ 4,278	$ 79,169	$ 1,274,499	$ 15,284	$ 5,876	$ 974	$ —	$ 1,380,080

	December 31, 2017							
Commercial and industrial	$ 5,633	$ 5,594	$ 97,619	$ 450	$ 279	$ 48	$ —	$ 109,623
Commercial mortgages:								
Multifamily	—	35,429	637,699	2,354	7,111	—	—	682,593
Other	—	20,372	384,007	7,567	2,837	—	—	414,783
Owner-occupied	—	887	92,731	—	1,482	531	—	95,631
	$ 5,633	$ 62,282	$ 1,212,056	$ 10,371	$ 11,709	$ 579	$ —	$ 1,302,630

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, 2018							
	Internally Assigned Risk Rating							
	Pass							
(in thousands)	1	2	3	Watch	Special Mention	Substandard	Doubtful	Total
Residential mortgages:								
Closed end	$ 1,756,792	$ 36,834	$ 13,899	$ 312	$ —	$ 1,814	$ —	$ 1,809,651
Revolving home equity	63,291	1,979	1,448	—	249	743	—	67,710
Consumer and other	1,344	3,576	38	—	—	324	—	5,282
	$ 1,821,427	$ 42,389	$ 15,385	$ 312	$ 249	$ 2,881	$ —	$ 1,882,643

	December 31, 2017							
Residential mortgages:								
Closed end	$ 1,512,041	$ 29,270	$ 12,857	$ 2,200	$ 828	$ 1,368	$ —	$ 1,558,564
Revolving home equity	79,084	2,112	1,469	256	704	—	—	83,625
Consumer and other	4,829	299	108	—	—	—	—	5,236
	$ 1,595,954	$ 31,681	$ 14,434	$ 2,456	$ 1,532	$ 1,368	$ —	$ 1,647,425

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 decreased by $2.9 million during 2018, amounting to $30.8 million, or .94% of total loans, at December 31, 2018, as compared to $33.8 million, or 1.15% of total loans, at December 31, 2017. The decrease of 21 basis points in the reserve coverage ratio is primarily due to an improvement in economic conditions and reductions in historical loss rates and growth rates on certain pools of loans.

During 2018, the Bank had loan chargeoffs and recoveries of $1.5 million and $306,000, respectively, and recorded a credit provision for loan losses $1.8 million. The credit provision for loan losses for 2018 resulted from a consistently applied pre-determined methodology and was primarily attributable to:

- Lower levels of national and local unemployment measured on a 12-month rolling average basis;
- Increases in the value of underlying collateral measured by such things as median home prices and commercial vacancy rates;
- Continued improvement in overall economic conditions; and
- A decline in historical loss rates. In calculating the provision for loan losses, the historical loss rate applied to each pool of loans is equal to the highest average annualized loss rate over a lookback period of 24, 36, 48 and 60 months.
- The impact of the preceding factors on the provision for loan losses was partially offset by loan growth and net chargeoffs.

During 2017, the Bank had loan chargeoffs and recoveries of $1.1 million and $19,000, respectively, and recorded a $4.9 million provision for loan losses. The $4.9 million provision for loan losses was primarily attributable to loan growth and net chargeoffs, partially offset by an improvement in the local housing market and in overall economic conditions.

The 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,				
(dollars in thousands)	2018	2017	2016	2015	2014
Balance, beginning of year	$ 33,784	$ 30,057	$ 27,256	$ 23,221	$ 20,848
Loans charged off:					
Commercial and industrial	683	102	445	166	96
Commercial mortgages:					
Multifamily	—	—	—	91	—
Other	—	—	—	1	37
Owner-occupied	—	820	—	—	400
Residential mortgages:					
Closed end	552	97	259	7	121
Revolving home equity	253	100	—	67	173
Consumer and other	9	27	5	37	7
	1,497	1,146	709	369	834
Recoveries of loans charged off:					
Commercial and industrial	34	13	4	7	2
Commercial mortgages:					
Multifamily	—	—	—	27	—
Other	—	—	—	39	—
Residential mortgages:					
Closed end	118	3	9	9	3
Revolving home equity	150	—	12	5	4
Consumer and other	4	3	5	—	9
	306	19	30	87	18
Net chargeoffs	1,191	1,127	679	282	816
Provision for loan losses	(1,755)	4,854	3,480	4,317	3,189
Balance, end of year	$ 30,838	$ 33,784	$ 30,057	$ 27,256	$ 23,221
Ratio of net chargeoffs to average loans outstanding	.04 %	.04 %	.03 %	.01 %	.05 %

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

(dollars in thousands)	December 31, 2018 Amount	% of Loans to Total Loans	2017 Amount	% of Loans to Total Loans	2016 Amount	% of Loans to Total Loans	2015 Amount	% of Loans to Total Loans	2014 Amount	% of Loans to Total Loans
Commercial and industrial	$ 1,158	3.0 %	$ 1,441	3.7 %	$ 1,408	4.9 %	$ 928	4.1 %	$ 838	4.3
Commercial mortgages:										
Multifamily	5,851	23.2	6,423	23.2	6,119	24.0	6,858	25.5	7,207	29.3
Other	3,783	13.3	4,734	14.1	4,296	14.6	3,674	15.5	2,340	12.3
Owner-occupied	743	2.8	1,076	3.2	959	4.1	1,047	5.1	1,023	6.0
Residential mortgages:										
Closed end	18,844	55.4	19,347	52.8	15,740	48.6	13,639	45.6	10,599	43.2
Revolving home equity	410	2.1	689	2.8	1,401	3.4	1,016	3.9	1,121	4.6
Consumer and other	49	.2	74	.2	134	.4	94	.3	93	.3
	$ 30,838	100.0 %	$ 33,784	100.0 %	$ 30,057	100.0 %	$ 27,256	100.0 %	$ 23,221	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 NYC. 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 97% of the Bank's total loans outstanding at December 31, 2018. Most of these loans were made to businesses and consumers on Long Island and in the boroughs of NYC, and a large percentage of these loans are secured by properties located in those areas. The primary sources of repayment for residential and commercial mortgage loans include employment and other income of the borrowers, the businesses of the borrowers and cash flows from the underlying properties. In the case of multifamily mortgage loans, a substantial portion of the underlying properties are rent stabilized or rent controlled. These sources of repayment are dependent on, among other things, the strength of the local economy.

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 $263.0 million, or 9.3%, to $3.1 billion at December 31, 2018. The increase is attributable to growth in noninterest-bearing checking deposits of $39.4 million, or 4.4%, and time deposits of $235.6 million, or 72.9%, partially offset by a decrease in savings, NOW and money market deposits of $12.1 million. The increase in time deposits includes $100 million of brokered certificates of deposit issued during the first quarter of 2018.

The remaining maturities of the Bank's time deposits at December 31, 2018 can be found in "Note E – Deposits" to the Corporation's December 31, 2018 consolidated financial statements.

Borrowings include short-term and long-term FHLB borrowings and borrowings under repurchase agreements. Total borrowings increased $46.0 million during 2018 to $751.0 million at year-end. The increase is comprised of an increase in short-term borrowings of $107.8 million, partially offset by a decrease in long-term debt of $61.8 million. Short-term borrowings are used to, among other things, offset the seasonal outflow of deposits. The decrease in long-term debt includes maturities of $101.5 million, partially offset by new fixed rate long-term FHLB borrowings of $39.7 million.

Deleveraging Transactions. During the third and fourth quarters of 2018, the Bank sold $274.4 million of available-for-sale securities in restructuring transactions designed to improve securities portfolio yield and net interest margin and eliminate inefficient leverage. In the third quarter, the Bank sold $135 million of mortgage-backed securities and $39.6 million of short-term municipal bonds with yields of 2.51% and 2.90%, respectively, and reinvested the proceeds in mortgage-backed securities and corporate bonds with an overall yield of 4.02%. In October 2018, the Bank eliminated inefficient leverage by selling $60.6 million of mortgage-backed securities with a yield of 2.51% and used the proceeds to pay down overnight borrowings with a cost of 2.47%. In November 2018, the Bank sold an additional $39.2 million of mortgage-backed securities with a yield of 2.55% and reinvested the proceeds in corporate bonds with an overall current yield of 5.08%. The pre-tax and after-tax loss on all 2018 securities sales totaled $10.4 million and $7.5 million, respectively, and the payback period, excluding the deleveraging transaction, is approximately 2.0 years. Because these transactions were completed toward the end of 2018, they had only a partial impact on interest income and net interest margin for the year. On a full year basis for 2019, interest income and net interest margin are expected to benefit from these transactions by approximately $3.7 million and 11 basis points, respectively.

During the fourth quarter of 2017, the Bank sold approximately $88.6 million of mortgage-backed securities with a yield of 1.55% and an expected average life of 3.4 years and reinvested substantially all of the proceeds in mortgage-backed securities with a yield of 2.61% and an expected average life of 4.9 years. The sale resulted in a pre-tax loss of $1.9 million and an after-tax loss of $1.3 million. During the first quarter of 2017, the Bank executed a deleveraging transaction in which the Bank sold approximately $40 million of mortgage-backed securities at a gain of $57,000 and used the resulting proceeds to pay down short-term borrowings. During the second quarter of 2016, the Bank executed a deleveraging transaction involving the sale of $40.3 million of mortgage-backed securities at a gain of $1.8 million and the prepayment of $30 million of long-term debt at a cost of $1.8 million.

Capital. Stockholders' equity totaled $388.2 million at December 31, 2018, an increase of $33.7 million from $354.5 million at December 31, 2017. The increase is primarily attributable to net income of $41.6 million and the issuance of shares under the Corporation's stock-based compensation and DRIP of $19.0 million, partially offset by cash dividends declared of $16.2 million, a decrease in the after-tax value of available-for-sale securities of $5.9 million and the repurchase of common stock amounting to $1.5 million.

The deliberate slowing of balance sheet growth in 2018 eliminated the need to raise capital through the DRIP and has provided the Corporation with an opportunity to control capital growth through stock repurchases at what management believes to be very attractive pricing. In this regard, effective with the second quarter 2018 cash dividend, the Corporation reduced the optional quarterly cash purchase limit per shareholder under the DRIP from $75,000 to $5,000. Effective with the first quarter 2019 cash dividend, optional quarterly cash purchases are currently unavailable. The change in 2018 substantially reduced the number of shares issued under the DRIP resulting in less dilution to earnings per share. Sale of shares under the DRIP contributed $18.2 million and $22.6 million to capital in 2018 and 2017, respectively, with a substantial portion of the 2018 amount generated during the first half of the year. In addition, in October 2018, the Corporation's Board of Directors approved a common stock repurchase program in an amount up to $20 million. Under this program, the Corporation may repurchase shares through open market purchases, privately negotiated transactions or in any manner that is compliant with applicable securities laws. The Corporation purchased and retired 77,300 shares of its common stock in the fourth quarter of 2018 at an average price of $19.94 per share, totaling $1.5 million.

The Corporation's ROE was 11.09%, 10.51% and 10.62% for the years ended December 31, 2018, 2017 and 2016, respectively and its ROA was 1.00%, .95% and .93%, respectively. Book value per share increased 6.3% during 2018 to $15.27 at December 31, 2018. Book value per share was $14.37 and $12.90 at December 31, 2017 and 2016, 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, 2018 are set forth in the table below. The Corporation and the Bank exceeded the Basel III minimum capital adequacy requirements, including the capital conservation buffer of 1.875% applicable to the Bank for 2018, and the Bank was well capitalized under the PCA provisions at December 31, 2018.

	Corporation		Bank	
Tier 1 leverage	9.40	%	9.45	%
Common equity tier 1 risk-based	15.29	%	15.38	%
Tier 1 risk-based	15.29	%	15.38	%
Total risk-based	16.48	%	16.57	%

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

Cash Flows and Liquidity

Cash Flows. During 2018, the Corporation's cash and cash equivalent position decreased by $22.3 million, from $69.7 million at December 31, 2017 to $47.4 million at December 31, 2018. The decrease occurred primarily because cash used to originate loans, purchase securities and BOLI, repay borrowings, repurchase common stock and pay cash dividends exceeded cash provided by the growth in deposits and borrowings, paydowns and sales of securities, paydowns of loans, common stock issued under the DRIP and operations.

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, 2018, the Bank had approximately $298 million of unencumbered available-for-sale securities. In addition, based on securities and loan collateral in place at the FRB of New York and FHLB of New York, the Bank had borrowing capacity of approximately $1.2 billion at December 31, 2018.

Off-Balance-Sheet Arrangements and Contractual Obligations

The Corporation's off-balance-sheet arrangements and contractual obligations at December 31, 2018 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. The Corporation believes that its current sources of liquidity are more than sufficient to fulfill the obligations it has at December 31, 2018 pursuant to off-balance-sheet arrangements and contractual obligations.

		Amount of Commitment Expiration Per Period			
(in thousands)	Total Amounts Committed	One Year or Less	Over One Year Through Three Years	Over Three Years Through Five Years	Over Five Years
Commitments to extend credit	$ 235,568	$ 108,003	$ 39,894	$ 13,277	$ 74,394
Standby letters of credit	3,670	3,265	405	—	—
Long-term debt	362,027	73,500	136,975	131,552	20,000
Operating lease obligations	22,044	2,986	5,741	5,200	8,117
Purchase obligations	9,550	1,593	4,017	3,940	—
Time deposits	559,057	283,259	163,173	49,978	62,647
	$ 1,191,916	$ 472,606	$ 350,205	$ 203,947	$ 165,158

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 – Summary of Significant Accounting Policies” to the Corporation’s consolidated financial statements 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 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. Among other things, gap analysis does not fully take into account the fact that the repricing of some assets and liabilities is discretionary and subject to competitive and other pressures.

The table that follows summarizes the Corporation's cumulative interest rate sensitivity gap at December 31, 2018, 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.

(in thousands)	Repricing Period Three Months or Less	Over Three Months Through One Year	Over One Year Through Five Years	Over Five Years	Non-Interest-Sensitive	Total
Assets:						
Investment securities	$ 31,689	$ 105,615	$ 322,434	$ 308,010	$ (4,229)	$ 763,519
Loans	184,616	205,081	1,251,133	1,620,434	(28,703)	3,232,561
Other assets	41,256	81,132	—	—	122,592	244,980
	257,561	391,828	1,573,567	1,928,444	89,660	4,241,060
Liabilities & Stockholders' Equity:						
Checking deposits	—	—	—	—	935,574	935,574
Savings, NOW and money market deposits	272,338	286,369	862,556	169,078	—	1,590,341
Time deposits, $100,000 and over	46,094	80,627	145,187	37,257	—	309,165
Time deposits, other	24,646	131,892	67,964	25,390	—	249,892
Borrowed funds	248,923	63,500	418,527	20,000	—	750,950
Other liabilities	—	—	—	—	16,951	16,951
Stockholders' equity	—	—	—	—	388,187	388,187
	592,001	562,388	1,494,234	251,725	1,340,712	4,241,060
Interest-rate sensitivity gap	$ (334,440)	$ (170,560)	$ 79,333	$ 1,676,719	$ (1,251,052)	$ —
Cumulative interest-rate sensitivity gap	$ (334,440)	$ (505,000)	$ (425,667)	$ 1,251,052	$ —	$ —

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

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

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

In utilizing interest rate sensitivity modeling to project net interest income and calculate EVE, management makes a variety of estimates and assumptions which include, among others, the following: (1) how much and when yields and costs on individual categories of interest-earning assets and interest-bearing liabilities will change in response to projected changes in market interest rates; (2) future cash flows, including prepayments of mortgage assets and calls of municipal securities; (3) cash flow reinvestment assumptions; (4) appropriate discount rates to be applied to loan, deposit and borrowing cash flows; and (5) decay or runoff rates for non-maturity 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 non-maturity deposits is not. For non-maturity deposits, management makes estimates of how much and when it will need to change the rates paid on the Bank’s various non-maturity 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 non-maturity deposit study conducted by an independent consultant and updated on a periodic basis 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, 2018 arrived at by discounting estimated future cash flows at rates that management believes are reflective of current market conditions and (2) an estimate of net interest income for the year ending December 31, 2019 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 non-maturity deposits are assumed to have an overall average life of 6.3 years based on the current mix of such deposits and the most recently updated non-maturity deposit study.

The rate change information in the following table shows estimates of net interest income for the year ending December 31, 2019 and calculations of EVE at December 31, 2018 assuming rate changes of plus 100, 200 and 300 basis points and minus 100 and 200 basis points. The rate change scenarios were selected based on, among other things, the relative level of current interest rates and: (1) are assumed to be shock or immediate changes for both EVE and net interest income; (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 non-maturity 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 affected.

	Economic Value of Equity at December 31, 2018		Net Interest Income for 2019	
Rate Change Scenario (dollars in thousands)	Amount	Percent Change From Base Case	Amount	Percent Change From Base Case
+ 300 basis point rate shock	$ 514,661	-21.8%	$ 87,476	-18.1%
+ 200 basis point rate shock	563,732	-14.3%	93,918	-12.0%
+ 100 basis point rate shock	615,146	-6.5%	100,576	-5.8%
Base case (no rate change)	657,746	—	106,748	—
- 100 basis point rate shock	679,906	3.4%	111,075	4.1%
- 200 basis point rate shock	650,242	-1.1%	112,516	5.4%

As shown in the preceding table, assuming a static balance sheet, an immediate increase in interest rates of 100, 200 or 300 basis points could negatively impact the Bank's net interest income for the year ended December 31, 2019 because, among other things, the Bank would need to pay more for overnight borrowings and it is assumed the Bank would need to increase the rates paid on its non-maturity deposits in order to remain competitive. Unlike non-maturity deposits and short-term borrowings, the Bank's securities and almost all of its loans are not subject to immediate repricing with changes in market rates. Conversely, an immediate decrease in interest rates of 100 or 200 basis points could positively impact the Bank's net interest income for the same time period because, among other things, the Bank would immediately pay less for overnight borrowings and be able to reduce deposit rates while the downward repricing of its interest-earning assets would lag. The decline in EVE in the minus 200 basis points scenario is predominantly due to the inability to reduce interest rates on deposit accounts below zero. Changes in management's estimates as to the rates that will need to be paid on non-maturity deposits could have a significant impact on the net interest income amounts shown for each scenario in the table.

Forward-Looking Statements

This Annual Report on Form 10-K and the documents incorporated into it by reference contain or may contain various forward-looking statements. These forward-looking statements include statements of goals; intentions and expectations; estimates of risks and of future costs and benefits; assessments of probable loan losses; assessments of market risk; and statements of the ability to achieve financial and other goals. Forward-looking statements are typically identified by words such as “would,” “should,” “could,” “believe,” “expect,” “anticipate,” “intend,” “outlook,” “estim “forecast,” “project” and other similar words and expressions. Forward-looking statements are subject to numerous assumptions, risks and uncertainties which may change over time. Forward-looking statements speak only as of the date they are made. We do not assume any duty and do not undertake to update our forward-looking statements. Because forward-looking statements are subject to assumptions and uncertainties, actual results or future events could differ, possibly materially, from those that we anticipated in our forward-looking statements and future results could differ materially from historical performance.

Our forward-looking statements are subject to the following principal risks and uncertainties: general economic conditions and trends, either nationally or locally; conditions in the securities markets; fluctuations in the trading price of our common stock; changes in interest rates; changes in the shape of the yield curve; 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 (dollars in thousands)	2018	2017
Assets:		
Cash and cash equivalents	$ 47,358	$ 69,672
Investment securities:		
Held-to-maturity, at amortized cost (fair value of $5,552 and $7,749)	5,504	7,636
Available-for-sale, at fair value	758,015	720,128
	763,519	727,764
Loans:		
Commercial and industrial	98,785	109,623
Secured by real estate:		
Commercial mortgages	1,281,295	1,193,007
Residential mortgages	1,809,651	1,558,564
Home equity lines	67,710	83,625
Consumer and other	5,958	5,533
	3,263,399	2,950,352
Allowance for loan losses	(30,838)	(33,784)
	3,232,561	2,916,568
Restricted stock, at cost	40,686	37,314
Bank premises and equipment, net	41,267	39,648
Bank-owned life insurance	80,925	59,665
Pension plan assets, net	15,154	19,152
Deferred income tax benefit	3,447	—
Other assets	16,143	24,925
	$ 4,241,060	$ 3,894,708
Liabilities:		
Deposits:		
Checking	$ 935,574	$ 896,129
Savings, NOW and money market	1,590,341	1,602,460
Time, $100,000 and over	309,165	203,890
Time, other	249,892	119,518
	3,084,972	2,821,997
Short-term borrowings	388,923	281,141
Long-term debt	362,027	423,797
Accrued expenses and other liabilities	16,951	10,942

Deferred income taxes payable	—	2,381
	3,852,873	3,540,258
Commitments and Contingent Liabilities (Note L)		
Stockholders' Equity:		
Common stock, par value $.10 per share:		
Authorized, 80,000,000 shares;		
Issued and outstanding, 25,422,740 and 24,668,390 shares	2,542	2,467
Surplus	145,163	127,122
Retained earnings	249,922	224,315
	397,627	353,904
Accumulated other comprehensive income (loss), net of tax	(9,440)	546
	388,187	354,450
	$ 4,241,060	$ 3,894,708

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 (dollars in thousands, except per share data)	2018	2017	2016
Interest and dividend income:			
Loans	$ 112,784	$ 97,027	$ 82,456
Investment securities:			
Taxable	12,040	7,754	7,981
Nontaxable	13,413	13,484	13,686
	138,237	118,265	104,123
Interest expense:			
Savings, NOW and money market deposits	12,105	7,113	5,344
Time deposits	10,452	5,479	5,107
Short-term borrowings	4,858	1,345	296
Long-term debt	8,315	7,772	7,255
	35,730	21,709	18,002
Net interest income	102,507	96,556	86,121
Provision (credit) for loan losses	(1,755)	4,854	3,480
Net interest income after provision (credit) for loan losses	104,262	91,702	82,641
Noninterest income:			
Investment Management Division income	2,175	2,090	2,000
Service charges on deposit accounts	2,634	2,792	2,666
Net gains (losses) on sales of securities	(10,406)	(1,866)	1,868
Other	7,876	5,145	3,970
	2,279	8,161	10,504
Noninterest expense:			
Salaries	27,926	25,373	23,258
Employee benefits and other personnel expense	8,539	7,268	6,872
Occupancy and equipment	11,686	10,245	9,264
Debt extinguishment	—	—	1,756
Other	11,755	11,966	12,066
	59,906	54,852	53,216
Income before income taxes	46,635	45,011	39,929
Income tax expense	5,062	9,889	9,049
Net income	$ 41,573	$ 35,122	$ 30,880
Earnings per share:			
Basic	$1.64	$1.44	$1.35
Diluted	$1.63	$1.43	$1.34
Cash dividends declared per share	$.64	$.58	$.55

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Year Ended December 31 (in thousands)	2018	2017	2016
Net income	$ 41,573	$ 35,122	$ 30,880
Other comprehensive income (loss):			
Change in net unrealized holding gains (losses) on available-for-sale securities	(8,485)	1,631	(17,004)
Change in funded status of pension plan	(4,316)	1,718	1,443
Change in net unrealized loss on derivative instrument	(1,130)	—	—
Other comprehensive income (loss) before income taxes	(13,931)	3,349	(15,561)
Income tax expense (benefit)	(4,222)	1,199	(6,433)
Other comprehensive income (loss)	(9,709)	2,150	(9,128)
Comprehensive income	$ 31,864	$ 37,272	$ 21,752

See notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)	Common Stock Shares	Amount	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2016						