

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 2019

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: 000-11486



ConnectOne Bancorp, Inc.

(Exact name of registrant as specified in its charter)

New Jersey
(State or Other Jurisdiction of
Incorporation or Organization)

52-1273725
(IRS Employer
Identification Number)

301 Sylvan Avenue
Englewood Cliffs, New Jersey 07632
(Address of Principal Executive Offices) (Zip Code)

201-816-8900
(Registrant's Telephone Number, Including Area Code)

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, no par value	CNOB	NASDAQ

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

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

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or 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 requirements 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 Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant has required to submit and post such files.) YES ☒ NO ☐

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a nonaccelerated filer, a smaller reporting company or emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Securities Exchange Act of 1934.

Large Accelerated Filer ☒

Accelerated Filer ☐

Non-Accelerated filer ☐

Small 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 voting and nonvoting common equity held by nonaffiliates computed by reference to the price at which the common equity was last sold or the average bid and ask price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter - \$736.8 million.

Shares Outstanding on March 2, 2020
Common Stock, no par value: 39,699,929 shares

DOCUMENTS INCORPORATED BY REFERENCE

Definitive proxy statement in connection with the 2020 Annual Stockholders Meeting to be filed with the Commission pursuant to Regulation 14A will be incorporated by reference in Part III

CONNECTONE BANCORP, INC.

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Information included in or incorporated by reference in this Annual Report on Form 10-K, other filings with the Securities and Exchange Commission, the Company’s press releases or other public statements, contain or may contain forward looking statements. Please refer to a discussion of the Company’s forward-looking statements and associated risks in “Item 1 - Business – Forward Looking Statements” and “Item 1A - Risk Factors” in this Annual Report on Form 10-K.

**CONNECTONE BANCORP, INC.
FORM 10-K**

PART I

Item 1. Business

Forward Looking Statements

This report, in Item 1, Item 7 and elsewhere, includes forward-looking statements within the meaning of Sections 27A of the Securities Act of 1933, as amended, and 21E of the Securities Exchange Act of 1934, as amended, that involve inherent risks and uncertainties. These forward-looking statements concern the financial condition, results of operations, plans, objectives, future performance and business of ConnectOne Bancorp, Inc. and its subsidiaries, including statements preceded by, followed by or that include words or phrases such as “believes,” “expects,” “anticipates,” “plans,” “trend,” “objective,” “continue,” “remain,” “pattern” or similar expressions or future or conditional verbs such as “will,” “would,” “should,” “could,” “might,” “can,” “may” or similar expressions. There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to: (1) competitive pressures among depository institutions may increase significantly; (2) changes in the interest rate environment may reduce interest margins; (3) prepayment speeds, loan origination and sale volumes, charge-offs and loan loss provisions may vary substantially from period to period; (4) general economic conditions may be less favorable than expected; (5) political developments, wars or other hostilities may disrupt or increase volatility in securities markets or other economic conditions; (6) legislative or regulatory changes or actions may adversely affect the businesses in which ConnectOne Bancorp, Inc. is engaged; (7) changes and trends in the securities markets may adversely impact ConnectOne Bancorp, Inc.; (8) a delayed or incomplete resolution of regulatory issues could adversely impact our planning; (9) difficulties in integrating any businesses that we may acquire, which may increase our expenses and delay the achievement of any benefits that we may expect from such acquisitions; (10) the impact of reputation risk created by the developments discussed above on such matters as business generation and retention, funding and liquidity could be significant; and (11) the outcome of any future regulatory and legal investigations and proceedings may not be anticipated. Further information on other factors that could affect the financial results of ConnectOne Bancorp, Inc. are included in Item 1A of this Annual Report on Form 10-K and in ConnectOne Bancorp’s other filings with the Securities and Exchange Commission. These documents are available free of charge at the Commission’s website at <http://www.sec.gov> and/or from ConnectOne Bancorp, Inc. ConnectOne Bancorp, Inc. assumes no obligation to update forward-looking statements at any time.

Historical Development of Business

ConnectOne Bancorp, Inc., (the “Company” and with ConnectOne Bank, “we” or “us”) a one-bank holding company, was incorporated in the State of New Jersey on November 12, 1982 as Center Bancorp, Inc. and commenced operations on May 1, 1983 upon the acquisition of all outstanding shares of capital stock of Union Center National Bank, its then principal subsidiary.

On January 20, 2014, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with ConnectOne Bancorp, Inc., a New Jersey corporation (“Legacy ConnectOne”). Effective July 1, 2014, the Company completed the merger contemplated by the Merger Agreement (the “Merger”) with Legacy ConnectOne merging with and into the Company, with the Company as the surviving corporation. Also at closing, the Company changed its name to “ConnectOne Bancorp, Inc.” and changed its NASDAQ trading symbol to “CNOB”. Immediately following the consummation of the Merger, Union Center National Bank merged with and into ConnectOne Bank, a New Jersey-chartered commercial bank (“ConnectOne Bank” or the “Bank”) and a wholly-owned subsidiary of Legacy ConnectOne, with ConnectOne Bank continuing as the surviving bank. Subject to the terms and conditions of the Merger Agreement, each share of common stock, no par value per share, of Legacy ConnectOne was converted into 2.6 shares of the Company’s common stock.

On July 11, 2018, the Company entered into an Agreement and Plan of Merger with Greater Hudson Bank (“GHB”), under which GHB would merge with and into ConnectOne Bank, with ConnectOne Bank as the surviving bank. This transaction was consummated effective January 2, 2019. As part of this merger, the Company acquired approximately \$0.4 billion in loans, assumed approximately \$0.4 billion in deposits and acquired seven branch offices located in Rockland, Orange and Westchester, Counties, New York.

On May 31, 2019, the Company, through the Bank, completed its purchase of New York/Boston-based BoeFly, LLC. BoeFly’s online business lending marketplace helps connect small- to medium-size businesses, primarily franchisors and franchisees, with professional loan brokers and lenders across the United States. BoeFly operates as an independent brand and subsidiary of the Bank.

On January 2, 2020, the Company completed its in-market merger with Bergen County, New Jersey based Bancorp of New Jersey Inc. (“BNJ”), pursuant to which BNJ merged with and into the Company, and BNJ’s bank subsidiary, Bank of New Jersey, merged with and into the Bank. All of BNJ’s offices are located in Bergen County, New Jersey.

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The Company's primary activity, at this time, is to act as a holding company for the Bank and its other subsidiaries. As used herein, the term "Parent Corporation" shall refer to the Company on an unconsolidated basis.

The Company owns 100% of the voting shares of Center Bancorp, Inc. Statutory Trust II, through which it issued trust preferred securities. The trust exists for the exclusive purpose of (i) issuing trust securities representing undivided beneficial interests in the assets of the trust; (ii) investing the gross proceeds of the trust securities in \$5.2 million of junior subordinated deferrable interest debentures (subordinated debentures) of the Company; and (iii) engaging in only those activities necessary or incidental thereto. These subordinated debentures and the related income effects are not eliminated in the consolidated financial statements as the statutory business trust is not consolidated in accordance with Financial Accounting Standards Board ("FASB") ASC 810-10 "Consolidation of Variable Interest Entities." Distributions on the subordinated debentures owned by the subsidiary trust have been classified as interest expense in the Consolidated Statements of Income. See Note 11 of the Notes to Consolidated Financial Statements.

Except as described above, the Company's wholly-owned subsidiaries are all included in the Company's consolidated financial statements. These subsidiaries include BoeFly, an advertising subsidiary, an insurance subsidiary, and various investment subsidiaries which hold, maintain and manage investment assets for the Company. The Company's subsidiaries also include a real estate investment trust (the "REIT") which holds a portion of the Company's real estate loan portfolio. All subsidiaries mentioned above are directly or indirectly wholly owned by the Company, except that the Company owns less than 100% of the preferred stock of the REIT. A real estate investment trust must have 100 or more shareholders. The REIT has issued less than 20% of its outstanding non-voting preferred stock to individuals, primarily Bank personnel and directors.

SEC Reports and Corporate Governance

The Company makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments thereto available on its website at <https://www.connectonebank.com> without charge as soon as reasonably practicable after filing or furnishing them to the SEC. Also available on the website are the Company's corporate code of conduct that applies to all of the Company's employees, including principal officers and directors, and charters for the Audit/Risk Committee, Nominating and Corporate Governance Committee and Compensation Committee.

Additionally, the Company will provide without charge, a copy of its Annual Report on Form 10-K to any shareholder by mail. Requests should be sent to ConnectOne Bancorp, Inc., Attention: Investor Relations, 301 Sylvan Avenue, Englewood Cliffs, New Jersey 07632.

Narrative Description of the Business

ConnectOne is New Jersey/New York metro area commercial bank offering a full suite of deposit and loan products and services to the general public and, in particular, to small and mid-sized businesses, local professionals and individuals residing, working and conducting business in our market area. Our mission is to prove that putting people first is a better way to do business.

Our talented, diverse team of financial experts and relationship specialists understand the demands of a successful business and are prepared to meet them. A big part of the trust we've earned from entrepreneurs and business owners stems from our firsthand knowledge of the businesses and communities we serve. That trust extends to the families we help thrive, from helping them refinance their homes to being able to easily access accounts wherever and whenever they're needed.

While we expect to take an opportunistic approach to acquisitions or mergers with whole institutions, banking offices or lines of business that complement our existing strategy, the bulk of our future growth may be organic. Our goal is to open new offices in the counties contained in our broader market area discussed below, however, we do not believe that we need to establish a physical location in each market that we serve. We believe that advances in technology have created new delivery channels which allow us to service clients and maintain business relationships with a reduced-branch model, establishing regional offices that serve as business hubs. Our experience has shown that the key to client acquisition and retention is attracting quality business relationship officers who will frequently go to the client, rather than having the client come to us.

Our Market Area

Our banking offices are located in within a 70-100 mile radius of New York City and span New Jersey, New York City, Queens, Long Island, and the Hudson Valley, including Rockland, Orange and Westchester counties. Our market area includes some of the most affluent markets in the United States.

Products and Services

We derive a majority of our revenue from net interest income (i.e., the difference between the interest we receive on our loans and securities and the interest we pay on deposits and borrowings). We offer a broad range of deposit and loan products. In addition, to attract the business of consumer and business clients, we provide a broad array of other banking services. Products and services provided include personal

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and business checking accounts, retirement accounts, money market accounts, time and savings accounts, credit cards, wire transfers, access to automated teller services, internet banking, Treasury Direct, ACH origination, and mobile banking by phone. In addition, we offer safe deposit boxes. The Bank also offers remote deposit capture banking for business clients, providing the ability to electronically scan and transmit checks for deposit, reducing time and cost.

Noninterest demand deposit products include “Totally Free Checking” and “Simply Better Checking” for retail clients and “Small Business Checking” and “Analysis Checking” for commercial clients. Interest-bearing checking accounts require minimum balances for both retail and commercial clients and include “Consumer Interest Checking” and “Business Interest Checking”. Money market accounts consist of products that provide a market rate of interest to depositors but offer a limited number of preauthorized withdrawals. Our savings accounts consist of statement type accounts. Time deposits consist of certificates of deposit, including those held in IRA accounts, generally with initial maturities ranging from 31 days to 60 months and brokered certificates of deposit, which we use for asset liability management purposes and to supplement other sources of funding. CDARS/ICS Reciprocal deposits are offered based on the Bank’s participation in the Promontory Interfinancial Network, LLC network. Clients who are FDIC insurance sensitive are able to place large dollar deposits with the Company and the Company uses CDARS to place those funds into certificates of deposit issued by other banks in the Network. This occurs in increments of less than the FDIC insurance limits so that both the principal and interest are eligible for FDIC insurance coverage in amounts larger than the standard dollar amount. Unless certain conditions are satisfied the FDIC currently considers these funds as brokered deposits.

Deposits serve as the primary source of funding for our interest-earning assets, but also generate noninterest revenue through insufficient funds fees, stop payment fees, wire transfer fees, safe deposit rental fees, debit card income, including foreign ATM fees and credit and debit card interchange, and other miscellaneous fees. In addition, the Bank generates additional noninterest revenue associated with residential loan originations and sales, loan servicing, late fees and merchant services.

We offer personal and commercial business loans on a secured and unsecured basis, revolving lines of credit, commercial mortgage loans, and residential mortgages on both primary and secondary residences, home equity loans, bridge loans and other personal purpose loans. However, we are not and have not historically been a participant in the sub-prime lending market.

Commercial loans are loans made for business purposes and are primarily secured by collateral such as cash balances with the Bank, marketable securities held by or under the control of the Bank, business assets including accounts receivable, inventory and equipment, and liens on commercial and residential real estate. Included in commercial loans are loans secured by New York City taxi medallions. As of December 31, 2019, the carrying value of our taxi medallion portfolio was \$25.0 million. All our taxi medallion loans are secured by New York City taxi medallions.

Commercial construction loans are loans to finance the construction of commercial or residential properties secured by first liens on such properties. Commercial real estate loans include loans secured by first liens on completed commercial properties, including multi-family properties, to purchase or refinance such properties. Residential mortgages include loans secured by first liens on 1-4 family residential real estate and are generally made to existing clients of the Bank to purchase or refinance primary and secondary residences. Home equity loans and lines of credit include loans secured by first or second liens on residential real estate for primary or secondary residences. Consumer loans are made to individuals who qualify for auto loans, cash reserve, credit cards and installment loans.

The Board of Directors has approved a loan policy granting designated lending authorities to specific officers of the Bank. Those officers are comprised of the Chief Executive Officer, Chief Lending Officer, Chief Credit Officer, Team Leaders and the Consumer Loan Officers. All loan approvals require the signatures of a minimum of two officers. The Senior Lending Group (Chief Executive Officer, Chief Lending Officer and Chief Credit Officer) can approve loans up to \$25 million in aggregate loan exposure and which do not exceed 65% of the Legal Lending Limit of the Bank (currently \$102.1 million as of December 31, 2019 for most loans), provided that (i) the credit does not involve an exception to policy and a principal balance greater than \$7.5 million or \$20 million in all credit outstanding to the borrower in the aggregate, (ii) the credit does not exceed certain dollar amount thresholds set forth in our policy, which varies by loan type, and (iii) the credit is not extended to an insider of the Bank. The Board Loan Committee (which includes the Chief Executive Officer and four other Board members) approves credits that are both exceptions to policy and are above prescribed amounts related to loan type and collateral. Loans to insiders must be approved by the entire Board.

The Bank’s lending policies generally provide for lending within our primary trade area. However, the Bank will make loans to persons outside of our primary trade area when we deem it prudent to do so. To promote a high degree of asset quality, the Bank focuses primarily upon offering secured loans. However, the Bank does make short-term unsecured loans to borrowers with high net worth and income profiles. The Bank generally requires loan clients to maintain deposit accounts with the Bank. In addition, the Bank generally provides for a minimum required rate of interest in its variable rate loans. The Bank’s legal lending limit to any one borrower is 15% of the Bank’s capital base (defined as tangible equity plus the allowance for loan losses) for most loans (\$102.1 million) and 25% of the capital base for loans secured by readily marketable collateral (\$170.0 million). At December 31, 2019, the Bank’s largest committed relationship (to several affiliated borrowers) totaled \$79.4 million. The Bank’s largest single loan outstanding at December 31, 2019 was \$31.5 million.

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Our business model includes using industry best practices for community banks, including personalized service, state-of-the-art technology and extended hours. We believe that this will generate deposit accounts with somewhat larger average balances than are found at many other financial institutions. We also use pricing techniques in our efforts to attract banking relationships having larger than average balances.

Competition

The banking business is highly competitive. We face substantial immediate competition and potential future competition both in attracting deposits and in originating loans. We compete with numerous commercial banks, savings banks and savings and loan associations, many of which have assets, capital and lending limits larger than those that we have. Other competitors include money market mutual funds, mortgage bankers, insurance companies, stock brokerage firms, regulated small loan companies, credit unions and issuers of commercial paper and other securities. In addition, the banking industry in general has begun to face competition for deposit, credit and money management products from non-bank technology firms, or fintech companies, which may offer products independently or through relationships with insured depository institutions.

Our larger competitors have greater financial resources to finance wide-ranging advertising campaigns. Additionally, we endeavor to compete for business by providing high quality, personal service to clients, client access to our decision-makers and competitive interest rates and fees. We seek to hire and retain quality employees who desire greater responsibility than may be available working for a larger employer.

SUPERVISION AND REGULATION

The banking industry is highly regulated. Statutory and regulatory controls increase a bank holding company's cost of doing business and limit the options of its management to deploy assets and maximize income. The following discussion is not intended to be a complete list of all the activities regulated by the banking laws or of the impact of such laws and regulations on the Company or the Bank. It is intended only to briefly summarize some material provisions.

Bank Holding Company Regulation

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956 (the "Holding Company Act"). As a bank holding company, the Company is supervised by the Board of Governors of the Federal Reserve System ("FRB") and is required to file reports with the FRB and provide such additional information as the FRB may require. The Company and its subsidiaries are subject to examination by the FRB.

The Holding Company Act prohibits the Company, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to subsidiary banks, except that it may, upon application, engage in, and may own shares of companies engaged in, certain businesses found by the FRB to be so closely related to banking "as to be a proper incident thereto." The Holding Company Act requires prior approval by the FRB of the acquisition by the Company of more than 5% of the voting stock of any other bank. Satisfactory capital ratios and Community Reinvestment Act ratings and anti-money laundering policies are generally prerequisites to obtaining federal regulatory approval to make acquisitions. The policy of the FRB, embodied in FRB regulations, provides that a bank holding company is expected to act as a source of financial strength to its subsidiary bank(s) and to commit resources to support the subsidiary bank(s) in circumstances in which it might not do so absent that policy.

As a New Jersey-chartered commercial bank and an FDIC-insured institution, acquisitions by the Bank require approval of the New Jersey Department of Banking and Insurance (the "Banking Department") and the FDIC, an agency of the federal government. The Holding Company Act does not place territorial restrictions on the activities of non-bank subsidiaries of bank holding companies. The Gramm-Leach-Bliley Act, discussed below, allows the Company to expand into insurance, securities, merchant banking activities, and other activities that are financial in nature, in certain circumstances.

Regulation of Bank Subsidiary

The operations of the Bank are subject to requirements and restrictions under federal law, including requirements to maintain reserves against deposits, restrictions on the types and amounts of loans that may be granted, and limitations on the types of investments that may be made and the types of services which may be offered. Various consumer laws and regulations also affect the operations of the Bank. There are various legal limitations, including Sections 23A and 23B of the Federal Reserve Act, which govern the extent to which a bank subsidiary may finance or otherwise supply funds to its holding company or its holding company's non-bank subsidiaries and affiliates. Under federal law, a bank subsidiary may only make loans or extensions of credit to, or invest in the securities of, its parent or the non-bank subsidiaries of its parent (other than direct subsidiaries of such bank which are not financial subsidiaries) or to any affiliate, or take their securities as collateral for loans to any borrower, upon satisfaction of various regulatory criteria, including specific collateral loan to value requirements.

The Dodd-Frank Act

The Dodd-Frank Act, adopted in 2010, will continue to have a broad impact on the financial services industry, as a result of the significant regulatory and compliance changes made by the Dodd-Frank Act, including, among other things, (i) enhanced resolution authority over troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; and (v) numerous other provisions designed to improve supervision and oversight of, and strengthening safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act establishes a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the FRB, the Office of the Comptroller of the Currency and the FDIC. A summary of certain provisions of the Dodd-Frank Act is set forth below:

- *Minimum Capital Requirements.* The Dodd-Frank Act required capital rules and the application of the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies. In addition to making bank holding companies subject to the same capital requirements as their bank subsidiaries, these provisions (often referred to as the Collins Amendment to the Dodd-Frank Act) were also intended to eliminate or significantly reduce the use of hybrid capital instruments, especially trust preferred securities, as regulatory capital. The Dodd-Frank Act also requires banking regulators to seek to make capital standards countercyclical, so that the required levels of capital increase in times of economic expansion and decrease in times of economic contraction. See “Capital Adequacy Guidelines” for a description of capital requirements adopted by U.S. federal banking regulators in 2013 and the treatment of trust preferred securities under such rules.
- *The Consumer Financial Protection Bureau (“Bureau”).* The Dodd-Frank Act created the Bureau. The Bureau is tasked with establishing and implementing rules and regulations under certain federal consumer protection laws with respect to the conduct of providers of certain consumer financial products and services. The Bureau has rulemaking authority over many of the statutes governing products and services offered to bank consumers. In addition, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are more stringent than those regulations promulgated by the Bureau and state attorneys general are permitted to enforce consumer protection rules adopted by the Bureau against state-chartered institutions. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Institutions with \$10 billion or less in assets, such as the Bank, will continue to be examined for compliance with the consumer laws by their primary bank regulators.
- *Deposit Insurance.* The Dodd-Frank Act made permanent the \$250,000 deposit insurance limit for insured deposits. Amendments to the Federal Deposit Insurance Act also revised the assessment base against which an insured depository institution’s deposit insurance premiums paid to the Deposit Insurance Fund (“DIF”) will be calculated. Under the amendments, the assessment base is no longer based on the institution’s deposit base, but rather its average consolidated total assets less its average tangible equity during the assessment period. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. The FDIC has set the designated reserve ratio at 2.0%.
- *Shareholder Votes.* The Dodd-Frank Act requires publicly traded companies like the Company to give shareholders a non-binding vote on executive compensation and so-called “golden parachute” payments in certain circumstances. The Dodd-Frank Act also authorizes the SEC to promulgate rules that would allow shareholders to nominate their own candidates using a company’s proxy materials. The SEC has not yet adopted such rules.

Although a significant number of the rules and regulations mandated by the Dodd-Frank Act have been finalized, many of the new requirements called for have yet to be implemented and will likely be subject to implementing regulations over the course of several years. In addition, some of the requirements of the Dodd-Frank Act that were implemented have already been revised. See “Economic Growth, Regulatory Relief and Consumer Protection Act” below. Given the uncertainty associated with the way the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies, the full extent of the impact such requirements will have on financial institutions’ operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements (which, in turn, could require the Company and the Bank to seek additional capital) or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

Economic Growth, Regulatory Relief and Consumer Protection Act.

The Economic Growth, Regulatory Relief and Consumer Protection Act (“EGRRCPA”), adopted in May of 2018, was intended to provide regulatory relief to midsized and regional banks. While many of its provisions are aimed at larger institutions, such as raising the threshold to be considered a systemically important financial institution to \$250 billion in assets from \$50 billion in assets, many of its provisions will provide regulatory relief to those institutions with \$10 billion or more in assets, as well as to those institutions with less than \$10 billion in assets. Among other things, the EGRRCPA increased the asset threshold for depository institutions and holding companies to perform stress tests required under Dodd Frank from \$10 billion to \$250 billion, exempted institutions with less than \$10 billion in consolidated assets from the Volcker Rule, raised the threshold for the requirement that publicly traded holding companies have a risk committee from \$10 billion in consolidated assets to \$50 billion in consolidated assets, directed the federal banking agencies to adopt a “community bank leverage ratio”, applicable to institutions and holding companies with less than \$10 billion in assets, and to provide that compliance with the new ratio would be deemed compliance with all capital requirements applicable to the institution or holding company (See “-Capital Adequacy Guidelines”), and provided that residential mortgage loans meeting certain criteria and originated by institutions with less than \$10 billion in total assets will be deemed to meet the “ability to repay rule” under the Truth in Lending Act. In addition, the EGRRCPA limited the definition of loans that would be subject to the higher risk weighting applicable to High Volatility Commercial Real Estate.

Many of the regulations needed to implement the EGRRCPA have yet to be promulgated by the federal banking agencies, and so it is still uncertain how full implementation of the EGRRCPA will affect the Company and the Bank.

Regulation W

Regulation W codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretative guidance with respect to affiliate transactions. Affiliates of a bank include, among other entities, the bank’s holding company and companies that are under common control with the bank. The Company is considered to be an affiliate of the Bank. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in their ability to engage in “covered transactions” with affiliates:

- to an amount equal to 10% of the bank’s capital and surplus, in the case of covered transactions with any one affiliate; and
- to an amount equal to 20% of the bank’s capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A “covered transaction” includes:

- a loan or extension of credit to an affiliate;
- a purchase of, or an investment in, securities issued by an affiliate;
- a purchase of assets from an affiliate, with some exceptions;
- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; and
- the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

Further, under Regulation W:

- a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;
- covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and
- with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by certain types of collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the FRB decides to treat these subsidiaries as affiliates.

FDICIA

Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), each federal banking agency has promulgated regulations, specifying the levels at which an insured depository institution such as the Bank would be considered “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” or “critically undercapitalized,” and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution. To qualify to engage in financial activities under the Gramm-Leach-Bliley Act, all depository institutions must be “well capitalized.”

The FDIC’s regulations implementing these provisions of FDICIA provide that an institution will be classified as “well capitalized” if it (i) has a total risk-based capital ratio of at least 10.0%, (ii) has a Tier 1 risk-based capital ratio of at least 8.0%, (iii) has a Tier 1 leverage ratio of at least 5.0%, (iv) has a common equity Tier 1 capital ratio of at least 6.5%, and (v) meets certain other requirements. An institution will be classified as “adequately capitalized” if it (i) has a total risk-based capital ratio of at least 8.0%, (ii) has a Tier 1 risk-based capital ratio of at least 6.0%, (iii) has a Tier 1 leverage ratio of at least 4.0%, has a common equity Tier 1 capital ratio of at least 4.5%, and (v) does not meet the definition of “well capitalized.” An institution will be classified as “undercapitalized” if it (i) has a total risk-based capital ratio of less than 8.0%, (ii) has a Tier 1 risk-based capital ratio of less than 6.0%, (iii) has a Tier 1 leverage ratio of less than 4.0%, or (iv) has a common equity Tier 1 capital ratio of less than 4.5%. An institution will be classified as “significantly undercapitalized” if it (i) has a total risk-based capital ratio of less than 6.0%, (ii) has a Tier 1 risk-based capital ratio of less than 4.0%, (iii) has a Tier 1 leverage ratio of less than 3.0%, or (iv) has a common equity Tier 1 capital ratio of less than 3.0%. An institution will be classified as “critically undercapitalized” if it has a tangible equity to total assets ratio that is equal to or less than 2.0%. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating.

In addition, significant provisions of FDICIA required federal banking regulators to impose standards in a number of other important areas to assure bank safety and soundness, including internal controls, information systems and internal audit systems, credit underwriting, asset growth, compensation, loan documentation and interest rate exposure.

Capital Adequacy Guidelines [CECL phase-in?]

In December 2010 and January 2011, the Basel Committee on Banking Supervision (the “Basel Committee”) published the final texts of reforms on capital and liquidity generally referred to as “Basel III.” In July 2013, the FRB, the FDIC and the Comptroller of the Currency adopted final rules (the “New Rules”), which implement certain provisions of Basel III and the Dodd-Frank Act. The New Rules replaced the existing general risk-based capital rules of the various banking agencies with a single, integrated regulatory capital framework. The New Rules require higher capital cushions and more stringent criteria for what qualifies as regulatory capital. The New Rules were effective for the Bank and the Company on January 1, 2015.

Under the New Rules, the Company and the Bank are required to maintain the following minimum capital ratios, expressed as a percentage of risk-weighted assets:

- Common Equity Tier 1 Capital Ratio of 4.5% (the “CET1”);
- Tier 1 Capital Ratio (CET1 capital plus “Additional Tier 1 capital”) of 6.0%; and
- Total Capital Ratio (Tier 1 capital plus Tier 2 capital) of 8.0%.

In addition, the Company and the Bank will be subject to a leverage ratio of 4% (calculated as Tier 1 capital to average consolidated assets as reported on the consolidated financial statements).

The New Rules also require a “capital conservation buffer.” Under this provision, the Company and the Bank are required to maintain a 2.5% capital conservation buffer, which is composed entirely of CET1, on top of the minimum risk-weighted asset ratios described above, resulting in the following minimum capital ratios:

- CET1 of 7%;
- Tier 1 Capital Ratio of 8.5%; and
- Total Capital Ratio of 10.5%.

The purpose of the capital conservation buffer is to absorb losses during periods of economic stress. Banking institutions with a CET1, Tier 1 Capital Ratio and Total Capital Ratio above the minimum set forth above but below the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers, based on the amount of the shortfall.

The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level, and it increased by 0.625% on each subsequent January 1 until it was fully phased in at 2.5% on January 1, 2019.

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The New Rules provide for several deductions from and adjustments to CET1. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in common equity issued by nonconsolidated financial entities must be deducted from CET1 to the extent that any one of those categories exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Under the New Rules, banking organizations such as the Company and the Bank may make a one-time permanent election regarding the treatment of accumulated other comprehensive income items in determining regulatory capital ratios. Effective as of January 1, 2015, the Company and the Bank elected to exclude accumulated other comprehensive income items for purposes of determining regulatory capital.

While the New Rules generally require the phase-out of non-qualifying capital instruments such as trust preferred securities and cumulative perpetual preferred stock, holding companies with less than \$15 billion in total consolidated assets as of December 31, 2009, such as the Company, may permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in Additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The New Rules prescribe a standardized approach for calculating risk-weighted assets. Depending on the nature of the assets, the risk categories generally range from 0% for U.S. Government and agency securities, to 600% for certain equity exposures, and result in higher risk weights for a variety of asset categories. In addition, the New Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

Consistent with the Dodd-Frank Act, the New Rules adopt alternatives to credit ratings for calculating the risk-weighting for certain assets.

In December 2018, the OCC, the Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("CECL"). The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard. The Company is planning to adopt the capital transition relief over the permissible three-year period.

On September 17, 2019, the federal banking agencies issued a final rule providing simplified capital requirements for certain community banking organizations (banks and holding companies) with less than \$10 billion in total consolidated assets, implementing provisions of EGRRCPA discussed above. Under the rule, a qualifying community banking organization would be eligible to elect the community bank leverage ratio framework, or continue to measure capital under the existing Basel III requirements set forth in the New Rules. The new rule takes effect January 1, 2020, and qualifying community banking organizations may elect to opt into the new community bank leverage ratio ("CBLR") in their call report for the first quarter of 2020.

A qualifying community banking organization ("QCBO") is defined as a bank, a savings association, a bank holding company or a savings and loan holding company with:

- a leverage capital ratio of greater than 9.0%;
- total consolidated assets of less than \$10.0 billion;
- total off-balance sheet exposures (excluding derivatives other than credit derivatives and unconditionally cancelable commitments) of 25% or less of total consolidated assets; and
- total trading assets and trading liabilities of 5% or less of total consolidated assets.

A QCBO opting into the CBLR must maintain a CBLR of 9.0%, subject to a two-quarter grace period to come back into compliance, provided that the QCBO maintains a leverage ratio of more than 8.0% during the grace period. A QCBO failing to satisfy these requirements must comply with the Basel III requirements as implemented by the New Rules. The numerator of the CBLR is Tier 1 capital, as calculated under present rules. The denominator of the CBLR is the QCBO's average assets, calculated in accordance with the QCBO's Call Report instructions and less assets deducted from Tier 1 capital.

The Company and the Bank have elected not to opt into the CBLR.

Federal Deposit Insurance and Premiums

Substantially all the deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC and are subject to deposit insurance assessments to maintain the DIF.

The assessment base for deposit insurance premiums is an institution's average consolidated total assets minus average tangible equity. In connection with adopting this assessment base calculation, the FDIC lowered total base assessment rates to between 2.5 and 9 basis points for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category. The Company paid \$2.0 million and \$3.1 million in total FDIC assessments in 2019 and 2018.

The FDIC has a designated reserve ratio (DRR), that is, the ratio of the DIF to insured deposits, of 1.35%. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than \$10 billion of the increase in the statutory minimum DRR to 1.35% from the former statutory minimum of 1.15%.

In addition to deposit insurance assessments, the FDIC is required to continue to collect from institutions payments for the servicing of obligations of the Financing Corporation ("FICO") that were issued in connection with the resolution of savings and loan associations, so long as such obligations remain outstanding. The Bank paid a FICO premium of \$16 thousand in 2019, as compared to \$139 thousand in 2018.

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (the “Modernization Act”):

- allows bank holding companies meeting management, capital, and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than previously was permissible, including insurance underwriting and making merchant banking investments in commercial and financial companies, if the bank holding company elects to become a financial holding company. Thereafter it may engage in certain financial activities without further approvals;
- allows insurers and other financial services companies to acquire banks;
- removes various restrictions that previously applied to bank holding company ownership of securities firms and mutual fund advisory companies; and
- establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

The Modernization Act also modified other financial laws, including laws related to financial privacy and community reinvestment. The Company has elected not to become a financial holding company.

Community Reinvestment Act

Under the Community Reinvestment Act (“CRA”), as implemented by FDIC regulations, an insured depository institution has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the FDIC, in connection with its examination of every bank, to assess the bank’s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such bank.

USA PATRIOT Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA PATRIOT Act”) gives the federal government powers to address terrorist threats through domestic security measures, surveillance powers, information sharing, and anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, the USA PATRIOT Act encourages information-sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of the USA PATRIOT Act impose affirmative obligations on a broad range of financial institutions, including banks, thrift institutions, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

Among other requirements, the USA PATRIOT Act imposes the following requirements with respect to financial institutions:

- All financial institutions must establish anti-money laundering programs that include, at a minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.
- The Secretary of the Department of Treasury, in conjunction with other bank regulators, is authorized to issue regulations that provide for minimum standards with respect to customer identification at the time new accounts are opened.
- Financial institutions that establish, maintain, administer, or manage private banking accounts or correspondent accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) are required to establish appropriate, specific and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.
- Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.
- Bank regulators are directed to consider a holding company’s effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

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The United States Treasury Department has issued a number of implementing regulations which address various requirements of the USA PATRIOT Act and are applicable 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.

Loans to Related Parties

The Company's authority to extend credit to its directors and executive officers, as well as to entities controlled by such persons, is currently governed by the requirements of the Sarbanes-Oxley Act of 2002 and Regulation O promulgated by the FRB. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, the Bank's Board of Directors must approve all extensions of credit to insiders.

Dividend Restrictions

The Parent Corporation is a legal entity separate and distinct from the Bank. Virtually all the revenue of the Parent Corporation available for payment of dividends on its capital stock will result from amounts paid to the Parent Corporation by the Bank. All such dividends are subject to the laws of the State of New Jersey, the Banking Act, the Federal Deposit Insurance Act ("FDIA") and the regulation of the Banking Department and of the FDIC.

Under the New Jersey Corporation Act, the Parent Corporation is permitted to pay cash dividends provided that the payment does not leave us insolvent. As a bank holding company under the BHCA, we would be prohibited from paying cash dividends if we are not in compliance with any capital requirements applicable to us. However, as a practical matter, for so long as our major operations consist of ownership of the Bank, the Bank will remain our source of dividend payments, and our ability to pay dividends will be subject to any restrictions applicable to the Bank.

Under the New Jersey Banking Act of 1948, as amended, dividends may be paid by the Bank only if, after the payment of the dividend, the capital stock of the Bank will be unimpaired and either the Bank will have a surplus of not less than 50% of its capital stock or the payment of the dividend will not reduce the Bank's surplus. The payment of dividends is also dependent upon the Bank's ability to maintain adequate capital ratios pursuant to applicable regulatory requirements.

The FRB has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the FRB's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. FRB regulations also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. Under the prompt corrective action laws, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized, and under regulations implementing the Basel III accord, a bank holding company's ability to pay cash dividends may be impaired if it fails to satisfy certain capital buffer requirements. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

Item 1A. Risk Factors

An investment in our common stock involves risks. Stockholders should carefully consider the risks described below, together with all other information contained in this Annual Report on Form 10-K, before making any purchase or sale decisions regarding our common stock. If any of the following risks actually occur, our business, financial condition or operating results may be harmed. In that case, the trading price of our common stock may decline, and stockholders may lose part or all of their investment in our common stock.

Risks Applicable to Our Business:

Our growth-oriented business strategy could be adversely affected if we are not able to attract and retain skilled employees or if we lose the services of our senior management team.

We may not be able to successfully manage our business as a result of the strain on our management and operations that may result from growth. Our ability to manage growth will depend upon our ability to continue to attract, hire and retain skilled employees. The loss of members of our senior management team, including those officers named in the summary compensation table of our proxy statement, could have a material adverse effect on our results or operations and ability to execute our strategic goals. Our success will also depend on the ability of our officers and key employees to continue to implement and improve our operational and other systems, to manage multiple, concurrent customer relationships and to hire, train and manage our employees.

We may need to raise additional capital to execute our growth-oriented business strategy.

In order to continue our growth, we will be required to maintain our regulatory capital ratios at levels higher than the minimum ratios set by our regulators. We can offer you no assurances that we will be able to raise capital in the future, or that the terms of any such capital will be beneficial to our existing security holders. In the event we are unable to raise capital in the future, we may not be able to continue our growth strategy.

We have a significant concentration in commercial real estate loans.

Our loan portfolio is made up largely of commercial real estate loans. These types of loans generally expose a lender to a higher degree of credit risk of non-payment and loss than do residential mortgage loans because of several factors, including dependence on the successful operation of a business or a project for repayment, and loan terms with a balloon payment rather than full amortization over the loan term. In addition, commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to four-family residential mortgage loans. Underwriting and portfolio management activities cannot completely eliminate all risks related to these loans. Any significant failure to pay on time by our customers or a significant default by our customers would materially and adversely affect us.

At December 31, 2019, we had \$3.7 billion of commercial real estate loans, including commercial construction loans, which represented 71.6% of loans receivable. Concentrations in commercial real estate are also monitored by regulatory agencies and subject to scrutiny. Guidance from these regulatory agencies includes all commercial real estate loans, including commercial construction loans, in calculating our commercial real estate concentration, but excludes owner-occupied commercial real estate loans. Based on this regulatory definition, our commercial real estate loans represented 452% of total risk-based capital.

Loans secured by owner-occupied real estate are reliant on the operating businesses to provide cash flow to meet debt service obligations, and as a result they are more susceptible to the general impact on the economic environment affecting those operating companies as well as the real estate.

Although the economy in our market area generally, and the real estate market in particular, is growing, we can give you no assurance that it will continue to grow or that the rate of growth will accelerate. Many factors, including the exchange rate for the U.S. dollar, potential international trade tariffs, possible virus pandemics and changes in federal tax laws affecting the deductibility of state and local taxes and mortgage interest could reduce or halt growth in our local economy and real estate market. Accordingly, it may be more difficult for commercial real estate borrowers to repay their loans in a timely manner, as commercial real estate borrowers' ability to repay their loans frequently depends on the successful development of their properties. The deterioration of one or a few of our commercial real estate loans could cause a material increase in our level of nonperforming loans, which would result in a loss of revenue from these loans and could result in an increase in the provision for credit losses and/or an increase in charge-offs, all of which could have a material adverse impact on our net income. We also may incur losses on commercial real estate loans due to declines in occupancy rates and rental rates, which may decrease property values and may decrease the likelihood that a borrower may find permanent financing alternatives. Any weakening of the commercial real estate market may increase the likelihood of default of these loans, which could negatively impact our loan portfolio's performance and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, we could incur material losses. Any of these events could increase our costs, require management time and attention, and materially and adversely affect us.

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Federal banking agencies have issued guidance regarding high concentrations of commercial real estate loans within bank loan portfolios. The guidance requires financial institutions that exceed certain levels of commercial real estate lending compared with their total capital to maintain heightened risk management practices that address the following key elements: board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. If there is any deterioration in our commercial real estate portfolio or if our regulators conclude that we have not implemented appropriate risk management practices, it could adversely affect our business, and could result in the requirement to maintain increased capital levels. Such capital may not be available at that time, and may result in our regulators requiring us to reduce our concentration in commercial real estate loans.

If we are limited in our ability to originate loans secured by commercial real estate we may face greater risk in our loan portfolio

If, because of our concentration of commercial real estate loans, or for any other reasons, we are limited in our ability to originate loans secured by commercial real estate, we may incur greater risk in our loan portfolio. For example, we are and may seek to further increase our growth rate in commercial and industrial loans, including both secured and unsecured commercial and industrial loans. Unsecured loans generally involve a higher degree of risk of loss than do secured loans because, without collateral, repayment is wholly dependent upon the success of the borrowers' businesses and personal guarantees. Secured commercial and industrial loans are generally collateralized by accounts receivable, inventory, equipment or other assets owned by the borrower and typically include a personal guaranty of the business owner. Compared to real estate, that type of collateral is more difficult to monitor, its value is harder to ascertain, it may depreciate more rapidly, and it may not be as readily saleable if repossessed. Therefore, we may be exposed to greater risk of loss on these credits.

The nature and growth rate of our commercial loan portfolio may expose us to increased lending risks.

Given the significant growth in our loan portfolio, many of our commercial real estate loans are unseasoned, meaning that they were originated relatively recently. As of December 31, 2019, we had \$3.0 billion in commercial real estate loans outstanding. Approximately 61% of the loans, or \$1.9 billion, had been originated in the past three years. In addition, as part of the GHB merger, we acquired \$0.4 billion in loans from GHB. Our limited experience with these loans does not provide us with a significant payment history pattern with which to judge future collectability. As a result, it may be difficult to predict the future performance of our loan portfolio. These loans may have delinquency or charge-off levels above our expectations, which could negatively affect our performance.

Our portfolio of loans secured by New York City taxi medallions could expose us to credit losses.

We maintain a credit exposure (\$25.0 million carrying value as of December 31, 2019) of loans secured by New York City taxi medallions. The taxi industry in New York City is facing significant competition and pressure from technology-based ride share companies such as Uber and Lyft. This has resulted in volatility in the pricing of medallions, and has impacted the earnings of many medallion holders, including our borrowers. Any further deterioration in the value of New York City taxi medallions, or in the medallion taxi industry in New York City, could expose us to additional losses through additional write downs on these loans.

We expect that the implementation of Current Expected Credit Loss ("CECL"), which will require us to record an allowance for credit losses materially in excess of our existing allowance for loan losses, could cause increased volatility in our financial condition and results of operation.

The Financial Accounting Standards Board ("FASB") has adopted a new accounting standard, CECL, effective for the Company as of January 1, 2020. CECL will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, other financial instruments and other commitments to extend credit and provide for the expected credit losses as allowances for credit losses. This will change the current method of providing allowances for loan losses that are probable, which will require us to record an allowance for credit losses as of January 1, 2020 materially in excess of our existing allowance for loan losses, and will greatly increase the data we will need to collect and review to determine the appropriate level of the allowance for credit losses. Although we expect the Bank and the Parent Corporation will continue to meet all capital adequacy requirements to which they are subject following recording of the impact of adoption to stockholders' equity, future provisioning for expected credit losses under CECL may have a material adverse effect on our financial condition and results of operations.

The small to medium-sized businesses that the Bank lends to may have fewer resources to weather a downturn in the economy, which may impair a borrower's ability to repay a loan to the Bank that could materially harm our operating results.

The Bank targets its business development and marketing strategy primarily to serve the banking and financial services needs of small to medium-sized businesses. These small to medium-sized businesses frequently have smaller market share than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience significant volatility in operating results. Any one or more of these factors may impair the borrower's ability to repay a loan. In addition, the success of a small to medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns and other events that negatively impact our market areas could cause the Bank to incur substantial credit losses that could negatively affect our results of operations and financial condition.

Our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

Our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results may be materially adversely affected.

Anti-takeover provisions in our corporate documents and in New Jersey corporate law may make it difficult and expensive to remove current management.

Anti-takeover provisions in our corporate documents and in New Jersey law may render the removal of our existing board of directors and management more difficult. Consequently, it may be difficult and expensive for our stockholders to remove current management, even if current management is not performing adequately.

Competition in originating loans and attracting deposits may adversely affect our profitability.

We face substantial competition in originating loans. This competition currently comes principally from other banks, savings institutions, mortgage banking companies, credit unions and other lenders. Many of our competitors enjoy advantages, including greater financial resources and higher lending limits, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. This competition could reduce our net income by decreasing the number and size of loans that we originate and the interest rates we may charge on these loans.

In attracting deposits, we face substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of our competitors enjoy advantages, including greater financial resources, more aggressive marketing campaigns, better brand recognition and more branch locations.

These competitors may offer higher interest rates than we do, which could decrease the deposits that we attract or require us to increase our rates to retain existing deposits or attract new deposits.

We have also been active in competing for New York and New Jersey governmental and municipal deposits. At December 31, 2019, governmental and municipal deposits accounted for approximately \$614.5 million in deposits. The governor of New Jersey has proposed that the state form and own a bank in which governmental and municipal entities would deposit their excess funds, with the state-owned bank then financing small businesses and municipal projects in New Jersey. Although this proposal is in the very early stages, should this proposal be adopted and a state-owned bank formed, it could impede our ability to attract and retain governmental and municipal deposits.

Increased deposit competition could adversely affect our ability to generate the funds necessary for lending operations, which may increase our cost of funds.

We also compete with non-bank providers of financial services, such as brokerage firms, consumer finance companies, insurance companies and governmental organizations, which may offer more favorable terms. Some of our non-bank competitors are not subject to the same extensive regulations that govern our operations. As a result, such non-bank competitors may have advantages over us in providing certain products and services. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our earnings and financial condition.

In addition, the banking industry in general has begun to face competition for deposit, credit and money management products from non-bank technology firms, or fintech companies, which may offer products independently or through relationships with insured depository institutions.

External factors, many of which we cannot control, may result in liquidity concerns for us.

Liquidity risk is the potential that the Bank may be unable to meet its obligations as they come due, capitalize on growth opportunities as they arise, or pay regular dividends because of an inability to liquidate assets or obtain adequate funding in a timely basis, at a reasonable cost and within acceptable risk tolerances.

Liquidity is required to fund various obligations, including credit commitments to borrowers, mortgage and other loan originations, withdrawals by depositors, repayment of borrowings, operating expenses, capital expenditures and dividend payments to shareholders.

Liquidity is derived primarily from deposit growth and retention; principal and interest payments on loans; prepayment and maturities of loans; principal and interest payments on investment securities; sale, maturity and prepayment of investment securities; net cash

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provided from operations, and access to other funding sources. In addition, in recent periods we have substantially increased our use of alternate deposit origination channels, such as brokered deposits, including reciprocal deposit services, and internet listing services.

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to market factors or an adverse regulatory action against us. In addition, our ability to use alternate deposit origination channels could be substantially impaired if we fail to remain “well capitalized”. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole. Furthermore, regional and community banks generally have less access to the capital markets than do the national and super-regional banks because of their smaller size and limited analyst coverage. Any decline in available funding could adversely impact our ability to originate loans, invest in securities, meet our expenses, or fulfill obligations such as meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, results of operations and financial condition.

Declines in the value of our investment securities portfolio may adversely impact our results.

As of December 31, 2019, we had approximately \$404.7 million in investment securities, available-for-sale. We may be required to record impairment charges on our investment securities if they suffer a decline in value below their amortized cost basis that is considered credit related. Numerous factors, including lack of liquidity for re-sales of certain investment securities, absence of reliable pricing information on investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment could have a negative effect on our investment portfolio in future periods. If an impairment charge is significant enough, it could affect the ability of the Bank to upstream dividends to the Company, which could have a material adverse effect on our liquidity and our ability to pay dividends to shareholders and could also negatively impact our regulatory capital ratios.

The Bank’s ability to pay dividends is subject to regulatory limitations, which, to the extent that the Company requires such dividends in the future, may affect the Company’s ability to honor its obligations and pay dividends.

As a bank holding company, the Company is a separate legal entity from the Bank and its subsidiaries and does not have significant operations. We currently depend on the Bank’s cash and liquidity to pay our operating expenses and to fund dividends to shareholders. We cannot assure you that in the future the Bank will have the capacity to pay the necessary dividends and that we will not require dividends from the Bank to satisfy our obligations. Various statutes and regulations limit the availability of dividends from the Bank. It is possible, depending upon our and the Bank’s financial condition and other factors, that bank regulators could assert that payment of dividends or other payments by the Bank are an unsafe or unsound practice. In the event that the Bank is unable to pay dividends, we may not be able to service our obligations, as they become due, or pay dividends on our capital stock. Consequently, the inability to receive dividends from the Bank could adversely affect our financial condition, results of operations, cash flows and prospects.

In addition, as described under “Capital Adequacy Guidelines,” banks and bank holding companies are required to maintain a capital conservation buffer on top of minimum risk-weighted asset ratios. The capital conservation buffer is 2.5%. Banking institutions which do not maintain capital in excess of the capital conservation buffer will face constraints on the payment of dividends, equity repurchases and compensation based on the amount of the shortfall. Accordingly, if the Bank fails to maintain the applicable minimum capital ratios and the capital conservation buffer, distributions to the Company may be prohibited or limited.

We may incur impairment to goodwill.

We review our goodwill at least annually. Significant negative industry or economic trends, reduced estimates of future cash flows or disruptions to our business, could indicate that goodwill might be impaired. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely on projections of future operating performance. We operate in a competitive environment and projections of future operating results and cash flows may vary significantly from actual results. Additionally, if our analysis results in an impairment to our goodwill, we would be required to record a non-cash charge to earnings in our financial statements during the period in which such impairment is determined to exist. Any such charge could have a material adverse effect on our results of operations.

We have grown and may continue to grow through acquisitions.

Since January 1, 2019, we have acquired GHB, BoeFly, LLC and BNJ. To be successful as a larger institution, we must successfully integrate the operations and retain the customers of acquired institutions, attract and retain the management required to successfully manage larger operations, and control costs.

Future results of operations will depend in large part on our ability to successfully integrate the operations of the acquired institutions and retain the customers of those institutions. If we are unable to successfully manage the integration of the separate cultures, customer bases and operating systems of the acquired institutions, and any other institutions that may be acquired in the future, our results of operations may be adversely affected.

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In addition, to successfully manage substantial growth, we may need to increase non-interest expenses through additional personnel, leasehold and data processing costs, among others. In order to successfully manage growth, we may need to adopt and effectively implement policies, procedures and controls to maintain credit quality, control costs and oversee our operations. No assurance can be given that we will be successful in this strategy.

We may be challenged to successfully manage our business as a result of the strain on management and operations that may result from growth. The ability to manage growth will depend on our ability to continue to attract, hire and retain skilled employees. Success will also depend on the ability of officers and key employees to continue to implement and improve operational and other systems, to manage multiple, concurrent customer relationships and to hire, train and manage employees.

Finally, substantial growth may stress regulatory capital levels, and may require us to raise additional capital. No assurance can be given that we will be able to raise any required capital, or that it will be able to raise capital on terms that are beneficial to stockholders.

Attractive acquisition opportunities may not be available to us in the future.

We expect that other banking and financial service companies, many of which have significantly greater resources than us, will compete with us in acquiring other financial institutions if we pursue such acquisitions. This competition could increase prices for potential acquisitions that we believe are attractive. Also, acquisitions are subject to various regulatory approvals. If we fail to receive the appropriate regulatory approvals, we will not be able to consummate an acquisition that we believe is in our best interests. Among other things, our regulators will consider our capital, liquidity, profitability, regulatory compliance and levels of goodwill when considering acquisition and expansion proposals. Any acquisition could be dilutive to our earnings and shareholders' equity per share of our common stock.

Hurricanes or other adverse weather or health related events could negatively affect our local economies or disrupt our operations, which would have an adverse effect on our business or results of operations.

Hurricanes and other weather events can disrupt our operations, result in damage to our properties and negatively affect the local economies in which we operate. In addition, these weather events may result in a decline in value or destruction of properties securing our loans and an increase in delinquencies, foreclosures and loan losses. Finally, health related events, such as a viral pandemic, could adversely affect the business of our customers and our local economies, thereby adversely affecting our results of operations.

We may be adversely affected by changes in U.S. tax laws related to the Tax Cuts and Jobs Act.

Changes in tax laws contained in The Tax Cuts and Jobs Act, enacted in December 2017, include a number of provisions that have an impact on the banking industry, borrowers and the market for single-family residential real estate. Changes include (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for home equity loans, (iii) a limitation on the deductibility of business interest expense and (iv) a limitation on the deductibility of property taxes and state and local income taxes.

The changes in the tax laws may have an adverse effect on the market for, and 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 changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, such as New Jersey. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in the loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in the provision for loan losses, which would reduce profitability and could have a material adverse effect on the Company's business, financial condition and results of operations.

Recent New Jersey legislative changes may increase our tax expense.

In connection with adopting the 2019 fiscal year budget, the New Jersey legislature adopted, and the Governor signed, legislation that will increase our state income tax liability and could increase our overall tax expense. The legislation imposes a temporary surtax on corporations earning New Jersey allocated income in excess of \$1 million of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and of 1.5% for tax years beginning on or after January 1, 2020 through December 31, 2021. The legislation also requires combined filing for members of an affiliated group for tax years beginning on or after January 1, 2019, changing New Jersey's current status as a separate return state, and limits the deductibility of dividends received. These changes are not temporary. Although regulations implementing the legislative changes have not yet been issued, it is possible that the Company will lose the benefit of at least certain of its tax management strategies, and, if so, our total tax expense will likely increase.

The Company will be subject to heightened regulatory requirements if total assets exceed \$10 billion.

The Company's total assets were \$6.2 billion at December 31, 2019 and approximately \$7.1 billion at January 2, 2020 after closing on the BNJ acquisition. Banks with assets in excess of \$10 billion are subject to requirements imposed by the Dodd-Frank Act and its implementing regulations, including: the examination authority of the Consumer Financial Protection Bureau to assess compliance with Federal consumer financial laws, imposition of higher FDIC premiums, and reduced debit card interchange fees, all of which increase operating costs and reduce earnings.

As the Company approaches \$10 billion in total consolidated assets, additional costs have been incurred to prepare for the implementation of these imposed requirements. The Company may be required to invest more significant management attention and resources to evaluate and continue to make any changes necessary to comply with the new statutory and regulatory requirements under the Dodd-Frank Act. Further, Federal financial regulators may require accelerated actions and investments to prepare for compliance before \$10 billion in total consolidated assets is exceeded, and may suspend or delay certain regulatory actions, such as approving a merger agreement, if preparations are deemed inadequate. Upon reaching this threshold, the Company faces the risk of failing to meet these requirements, which may negatively impact results of operations and financial condition. While the effect of any presently contemplated or future changes in the laws or regulations or their interpretations would have is unpredictable, these changes could be materially adverse to the Company's investors.

Reforms to and uncertainty regarding LIBOR may adversely affect the business.

In 2017, a committee of private-market derivative participants and their regulators convened by the Federal Reserve, the Alternative Reference Rates Committee, or "ARRC", was created to identify an alternative reference interest rate to replace LIBOR. The ARRC announced Secured Overnight Financing Rate, or "SOFR", a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities, as its preferred alternative to LIBOR. The Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced its intention to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. Subsequently, the Federal Reserve Bank announced final plans for the production of SOFR, which resulted in the commencement of its published rates by the Federal Reserve Bank of New York on April 2, 2018. Whether or not SOFR attains market traction as a LIBOR replacement tool remains in question and the future of LIBOR at this time is uncertain. The uncertainty as to the nature and effect of such reforms and actions and the political discontinuance of LIBOR may adversely affect the value of and return on the Company's financial assets and liabilities that are based on or are linked to LIBOR, the Company's results of operations or financial condition. In addition, these reforms may also require extensive changes to the contracts that govern these LIBOR based products, as well as the Company's systems and processes.

Risks Applicable to the Banking Industry Generally:

Our allowance for loan losses and allowance for credit losses beginning January 1, 2020 may not be adequate to cover actual losses.

Like all financial institutions, we maintain an allowance for loan losses and allowance for credit losses beginning January 1, 2020 to provide for loan defaults and nonperformance. The process for determining the amount of the allowance is critical to our financial results and condition. It requires difficult, subjective and complex judgments about the future, including the impact of national and regional economic conditions on the ability of our borrowers to repay their loans. If our judgment proves to be incorrect, our allowance for loan losses may not be sufficient to cover losses in our loan portfolio. Further, state and federal regulatory agencies, as an integral part of their examination process, review our loans and allowance and may require an increase in our allowance for loan losses and allowance for credit losses beginning January 1, 2020.

Changes in interest rates may adversely affect our earnings and financial condition.

Our net income depends primarily upon our net interest income. Net interest income is the difference between interest income earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and borrowed funds. The level of net interest income is primarily a function of the average balance of our interest-earning assets, the average balance of our interest-bearing liabilities, and the spread between the yield on such assets and the cost of such liabilities. These factors are influenced by both the pricing and mix of our interest-earning assets and our interest-bearing liabilities which, in turn, are impacted by such external factors as the local economy, competition for loans and deposits, the monetary policy of the Federal Open Market Committee of the Federal Reserve Board of Governors (the "FOMC"), and market interest rates.

A sustained increase in market interest rates could adversely affect our earnings if our cost of funds increases more rapidly than our yield on our earning assets, and compresses our net interest margin. In addition, the economic value of portfolio equity would decline if interest rates increase. For example, we estimate that as of December 31, 2019, a 200 basis point increase in interest rates would have resulted in our economic value of portfolio equity declining by approximately \$50.8 million or 7.22%. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate Sensitivity Analysis."

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Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. We expect that we will periodically experience gaps in the interest rate sensitivities of our assets and liabilities. That means either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets, an increase in market rates of interest could reduce our net interest income. Likewise, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could reduce our net interest income. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control, including inflation, deflation, recession, unemployment, money supply, domestic and international events and changes in the United States and other financial markets.

We also attempt to manage risk from changes in market interest rates, in part, by controlling the mix of interest rate sensitive assets and interest rate sensitive liabilities. However, interest rate risk management techniques are not exact. A rapid increase or decrease in interest rates could adversely affect our results of operations and financial performance.

The banking business is subject to significant government regulations.

We are subject to extensive governmental supervision, regulation and control. These laws and regulations are subject to change, and may require substantial modifications to our operations or may cause us to incur substantial additional compliance costs. In addition, future legislation and government policy could adversely affect the commercial banking industry and our operations. Such governing laws can be anticipated to continue to be the subject of future modification. Our management cannot predict what effect any such future modifications will have on our operations. In addition, the primary focus of Federal and state banking regulation is the protection of depositors and not the shareholders of the regulated institutions.

For example, the Dodd-Frank Act may result in substantial new compliance costs. The Dodd-Frank Act was signed into law on July 21, 2010. Generally, the Dodd-Frank Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law, many of which will not become effective until various Federal regulatory agencies have promulgated rules implementing the statutory provisions. Uncertainty remains as to the ultimate impact of the Dodd-Frank Act, which could have a material adverse impact either on the financial services industry as a whole, or on our business, results of operations and financial condition.

The following aspects of the financial reform and consumer protection act are related to the operations of the Bank:

- A new independent consumer financial protection bureau was established within the Federal Reserve, empowered to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. However, financial institutions with less than \$10.0 billion in total assets, like the Bank, are subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws.
- The act also imposes new obligations on originators of residential mortgage loans, such as the Bank. Among other things, originators must make a reasonable and good faith determination based on documented information that a borrower has a reasonable ability to repay a particular mortgage loan over the long term. If the originator cannot meet this standard, the loan may be unenforceable in foreclosure proceedings. The act contains an exception from this ability to repay rule for “qualified mortgages”, which are deemed to satisfy the rule, but does not define the term, and left authority to the Consumer Financial Protection Bureau (“CFPB”) to adopt a definition. A rule issued by the CFPB in January 2013, and effective January 10, 2014, sets forth specific underwriting criteria for a loan to qualify as a Qualified Mortgage Loan. The criteria generally exclude loans that are interest-only, have excessive upfront points or fees, have negative amortization features or balloon payments, or have terms in excess of 30 years. The underwriting criteria also impose a maximum debt to income ratio of 43%. If a loan meets these criteria and is not a “higher priced loan” as defined in FRB regulations, the CFPB rule establishes a safe harbor preventing a consumer from asserting as a defense to foreclosure the failure of the originator to establish the consumer’s ability to repay. However, this defense will be available to a consumer for all other residential mortgage loans. Although the majority of residential mortgages historically originated by the Bank would qualify as Qualified Mortgage Loans, the Bank has also made, and may continue to make in the future, residential mortgage loans that will not qualify as Qualified Mortgage Loans. These loans may expose the Bank to greater losses, loan repurchase obligations, or litigation related expenses and delays in taking title to collateral real estate, if these loans do not perform and borrowers challenge whether the Bank satisfied the ability to repay rule on originating the loan.
- Tier 1 capital treatment for “hybrid” capital items like trust preferred securities is eliminated subject to various grandfathering and transition rules.
- The prohibition on payment of interest on demand deposits was repealed, effective July 21, 2011.
- Deposit insurance is permanently increased to \$250,000.
- The deposit insurance assessment base calculation now equals the depository institution’s total assets minus the sum of its average tangible equity during the assessment period.

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- The minimum reserve ratio of the Deposit Insurance Fund increased to 1.35% of estimated annual insured deposits or assessment base; however, the FDIC is directed to “offset the effect” of the increased reserve ratio for insured depository institutions with total consolidated assets of less than \$10 billion.

In addition, in order to implement Basel III and certain additional capital changes required by the Dodd-Frank Act, on July 9, 2013, the Federal banking agencies, including the FDIC, the Federal Reserve and the Office of the Comptroller of the Currency, approved, as an interim final rule, the regulatory capital requirements for U.S. insured depository institutions and their holding companies. This regulation requires financial institutions to maintain higher capital levels and more equity capital.

These provisions, as well as any other aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, may impact the profitability of our business activities and may change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations in order to comply and could therefore also materially and adversely affect our business, financial condition and results of operations.

Our management is actively reviewing the provisions of the Dodd-Frank Act, many of which are to be phased-in over the next several months and years and assessing the probable impact on our operations. However, the ultimate effect of these changes on the financial services industry in general, and us in particular, is uncertain at this time.

The laws that regulate our operations are designed for the protection of depositors and the public, not our shareholders.

The federal and state laws and regulations applicable to our operations give regulatory authorities extensive discretion in connection with their supervisory and enforcement responsibilities, and generally have been promulgated to protect depositors and the Deposit Insurance Fund and not for the purpose of protecting shareholders. These laws and regulations can materially affect our future business. Laws and regulations now affecting us may be changed at any time, and the interpretation of such laws and regulations by bank regulatory authorities is also subject to change.

We can give no assurance that future changes in laws and regulations or changes in their interpretation will not adversely affect our business. Legislative and regulatory changes may increase our cost of doing business or otherwise adversely affect us and create competitive advantages for non-bank competitors.

The potential impact of changes in monetary policy and interest rates may negatively affect our operations.

Our operating results may be significantly affected (favorably or unfavorably) by market rates of interest that, in turn, are affected by prevailing economic conditions, by the fiscal and monetary policies of the United States government and by the policies of various regulatory agencies. Our earnings will depend significantly upon our interest rate spread (i.e., the difference between the interest rate earned on our loans and investments and the interest paid on our deposits and borrowings). Like many financial institutions, we may be subject to the risk of fluctuations in interest rates, which, if significant, may have a material adverse effect on our operations.

We cannot predict how changes in technology will impact our business; increased use of technology may expose us to service interruptions or breaches in security.

The financial services market, including banking services, is increasingly affected by advances in technology, including developments in:

- Telecommunications;
- Data processing;
- Automation;
- Internet-based banking, including personal computers, mobile phones and tablets;
- Debit cards and so-called “smart cards”; and
- Remote deposit capture.

Our ability to compete successfully in the future will depend, to a certain extent, on whether we can anticipate and respond to technological changes. We offer electronic banking services for our consumer and business customers via our website, www.cnob.com, including Internet banking and electronic bill payment, as well as mobile banking by phone. We also offer check cards, ATM cards, credit cards, and automatic and ACH transfers. The successful operation and further development of these and other new technologies will likely require additional capital investments in the future. In addition, increased use of electronic banking creates opportunities for interruptions in service or security breaches, which could expose us to claims by customers or other third parties and damage our reputation. We cannot assure you that we will have sufficient resources or access to the necessary proprietary technology to remain competitive in the future, or that we will be able to maintain a secure electronic environment.

Item 1B. Unresolved Staff Comments

None.

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The Bank operates sixteen banking offices in Bergen County, NJ, consisting of four offices in Fort Lee, two offices in each Englewood Cliffs, Englewood and Hackensack, one office each in Cliffside Park, Cresskill, Haworth, Ridgewood, Saddle River and Woodcliff Lake; five banking offices in Union County, NJ, consisting of two offices in Union Township, and one office each in Springfield Township, Berkeley Heights, and Summit; two banking offices in Morris County, NJ, consisting of one office each in Boonton and Morristown; one office in Newark in Essex County, NJ; one office in West New York in Hudson County, NJ; one office in Princeton in Mercer County, NJ; one office in Holmdel in Monmouth County, one banking office in the borough of Manhattan in New York City, one office in Melville, Nassau County on Long Island, one in Astoria, Queens and seven branches in the Hudson Valley, including in White Plains and Tarrytown, in Westchester County, New York, Bardonia and Blauvelt, in Rockland County, New York and in Middletown, Monroe and Warwick, in Orange County, New York. The increase in Bergen County branches resulted from branches acquired from the Bank of New Jersey merger. The Bank's principal office is located at 301 Sylvan Avenue, Englewood Cliffs, NJ. The principal office is a three-story leased building constructed in 2008.

The following table sets forth certain information regarding the Bank's leased locations.

Banking Office Location	Term
301 Sylvan Avenue, Englewood Cliffs, NJ	Term expires November 2028
12 East Palisade Avenue, Englewood, NJ	Term expires July 2022
1 Union Avenue, Cresskill, NJ	Term expires June 2026
899 Palisade Avenue, Fort Lee, NJ	Term expires August 2022
142 John Street, Hackensack, NJ	Term expires December 2021
171 East Ridgewood Avenue, Ridgewood, NJ	Term expires April 2024
71 East Allendale Road, Saddle River, NJ	Term expires May 2032
356 Chestnut Street, Union, NJ	Term expires May 2027
104 Ely Place, Boonton, NJ	Term expires August 2021
545 Morris Avenue, Summit, NJ	Term expires February 2024
217 Chestnut Street, Newark, NJ	Term expires December 2024
5914 Park Avenue, West New York, NJ	Term expires September 2023
344 Nassau Street, Princeton, NJ	Term expires July 2022
963 Holmdel Road, Holmdel, NJ	Term expires July 2021
551 Madison Avenue, Suite 202, NY, NY	Term expires October 2028
48 South Service Rd, 2 nd Fl, Melville, NY	Term Expires July 2025
36-19 Broadway, Astoria, NY	Term Expires August 2028
485 Schutt Rd, Middletown, NY	Term Expires October 2025
62 Main St., Warwick, NY	Term Expires January 2024
715 Route 304, Bardonia NY (2)	Term Expires August 2028
567 North Broadway, White Plains NY	Term Expires December 2028
360 Route 17M, Monroe NY (3)	Term Expires January 2022; one expires 2025
155 White Plains Rd., Tarrytown NY	Term Expires December 2026
170 East Erie St, Blauvelt NY	Term Expires February 2028
744 E Palisades Ave, Englewood Cliffs, NJ	Term Expires June 2024
204 Main Street, Fort Lee, NJ	Term Expires June 2020
401 Hackensack Avenue, Hackensack, NJ	Term Expires August 2020
458 West Street, Fort Lee, NJ	Term Expires February 2026
104 Grand Avenue, Englewood, NJ	Term Expires October 2021
354 Palisades Avenue, Cliffside Park, NJ	Term Expires July 2021
585 Chestnut Ridge Rd, Woodcliff Lakes, NJ	Term Expires June 2022

Item 3. Legal Proceedings

There are no significant pending legal proceedings involving the Company other than those arising out of routine operations. None of these matters would have a material adverse effect on the Company or its results of operations if decided adversely to the Company.

Item 4. Mine Safety Disclosures

Not applicable.

PART II**Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Security Market Information**

The common stock of the Company is traded on the NASDAQ Global Select Market under the symbol "CNOB". As of December 31, 2019, the Company had 549 stockholders of record, excluding beneficial owners for whom Cede & Company or others act as nominees.

Share Repurchase Program

Historically, repurchases have been made from time to time as, in the opinion of management, market conditions warranted, in the open market or in privately negotiated transactions. No repurchases were made of the Company's common stock during 2018.

In March 2019, the Board of Directors of the Company approved a share repurchase program for up to 1,200,000 shares. The Company may repurchase shares from time to time in the open market, in privately negotiated share purchases or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission and applicable federal securities laws. The share repurchase plan does not obligate the Company to acquire any particular amount of common stock, and it may be modified or suspended at any time at the Company's discretion. During the year ended December 31, 2019, the Company repurchased a total of 540,018 shares, leaving 659,982 shares remaining for repurchase under the program.

The following table details share repurchases for the year 2019:

	Total Number of Shares Purchased	Average Price Paid per Share	Cumulative Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
				1,200,000
First quarter 2019	13,000	\$ 19.16	13,000	1,187,000
Second quarter 2019	227,018	21.64	240,018	959,982
Third quarter 2019	-	-	240,018	959,982
Fourth quarter 2019:				
October 2019	-	-	240,018	959,982
November 2019	-	-	240,018	959,982
December 2019	300,000	24.89	540,018	659,982
Total Fourth quarter 2019	300,000	24.89	540,018	659,982

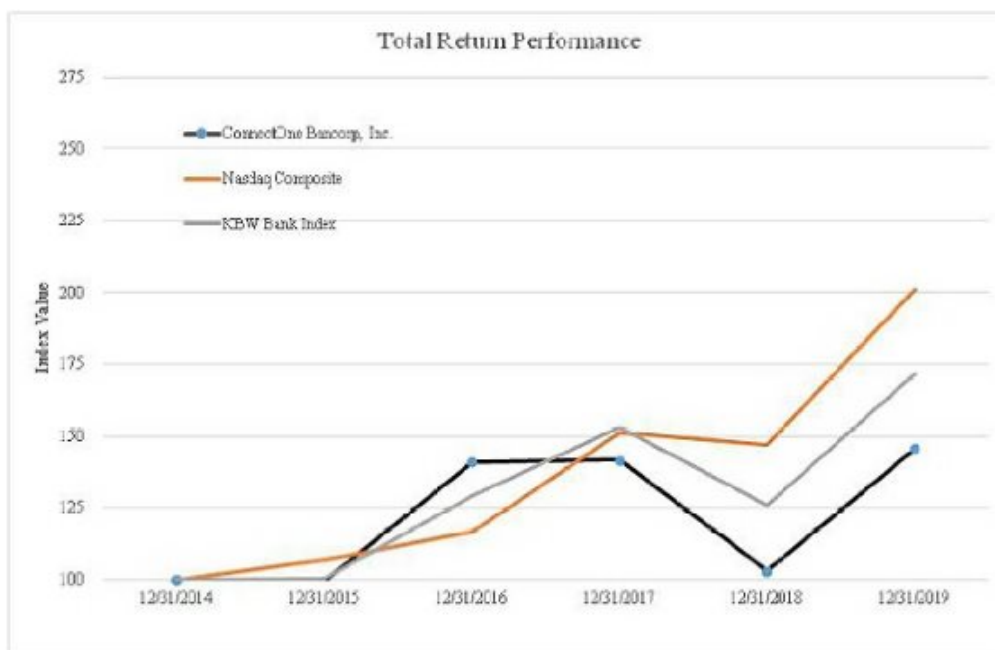
Dividends

Federal laws and regulations contain restrictions on the ability of the Parent Corporation and the Bank to pay dividends. For information regarding restrictions on dividends, see Part I, Item 1, "Business" and Part II, Item 8, "Financial Statements and Supplementary Data", Note 20 of the Notes to Consolidated Financial Statements."

Stockholders Return Comparison

Set forth on the following page is a line graph presentation comparing the cumulative stockholder return on the Parent Corporation's common stock, on a dividend reinvested basis, against the cumulative total returns of the NASDAQ Composite and the KBW Bank Index for the period from December 31, 2014 through December 31, 2019.

**COMPARE 5-YEAR CUMULATIVE TOTAL RETURN
AMONG CONNECTONE BANCORP INC.
NASDAQ AND KBW BANK INDEX**



**Assumes \$100 Invested on December 31, 2014, with Dividends Reinvested
Year Ended December 31, 2019**

**COMPARISON OF CUMULATIVE TOTAL RETURN OF ONE OR MORE
COMPANIES, PEER GROUPS, INDUSTRY INDEXES AND/OR BROAD MARKETS**

Company/Index/Market	Fiscal Year Ending					
	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19
ConnectOne Bancorp, Inc.	100.00	99.41	141.16	141.82	102.92	145.65
NASDAQ	100.00	107.11	116.72	151.41	147.16	201.22
KBW Bank Index	100.00	100.49	129.14	153.14	126.02	171.55

Item 6. Selected Financial Data

The following tables set forth selected consolidated financial data as of the dates and for the periods presented. The selected consolidated statement of financial condition data as of December 31, 2019 and 2018 and the selected consolidated summary of income data for the years ended December 31, 2019, 2018 and 2017 have been derived from our audited consolidated financial statements and related notes that we have included elsewhere in this Annual Report. The selected consolidated statement of financial condition data as of December 31, 2017, 2016, 2015 and the selected consolidated summary of income data for the years ended December 31, 2016 and 2015 have been derived from audited consolidated financial statements that are not presented in this Annual Report.

The selected historical consolidated financial data as of any date and for any period are not necessarily indicative of the results that may be achieved as of any future date or for any future period. You should read the following selected statistical and financial data in conjunction with the more detailed information contained in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes that we have presented elsewhere in this Annual Report.

SUMMARY OF SELECTED STATISTICAL INFORMATION AND FINANCIAL DATA

	2019	As of or For the Years Ended December 31,				2015				
		2018	2017	2016						
		(dollars in thousands, except share data)								
Selected Statement of Financial Condition Data										
Total assets	\$	6,174,032	\$	5,462,092	\$	5,108,442	\$	4,426,348	\$	4,015,909
Loans receivable		5,113,527		4,541,092		4,171,456		3,475,832		3,099,007
Allowance for loan losses		38,293		34,954		31,748		25,744		26,572
Securities – available-for-sale		404,701		412,034		435,284		353,290		195,770
Securities – held-to-maturity		-		-		-		-		224,056
Goodwill and other intangible assets		168,034		147,646		148,273		148,997		149,817
Borrowings		500,293		600,001		670,077		476,280		671,587
Subordinated debt (net of issuance costs)		128,885		128,556		54,699		54,534		54,343
Deposits		4,767,542		4,092,092		3,795,128		3,344,271		2,790,966
Tangible common stockholders' equity ⁽¹⁾		563,156		466,281		417,164		325,127		316,277
Total stockholders' equity		731,190		613,927		565,437		531,032		477,344
Average total assets		6,014,535		5,159,567		4,629,380		4,236,758		3,661,306
Average common stockholders' equity		705,496		586,727		553,390		491,110		456,036
Dividends										
Cash dividends paid on common stock	\$	12,160	\$	9,664	\$	9,612	\$	9,067	\$	8,996
Dividend payout ratio		16.57%		16.01%		22.24%		29.19%		21.84%
Cash dividends per common share	\$	0.36	\$	0.30	\$	0.30	\$	0.30	\$	0.30
Selected Statement of Income Data										
Interest income	\$	271,484	\$	216,133	\$	181,324	\$	161,241	\$	140,967
Interest expense		(85,165)		(58,918)		(36,255)		(31,096)		(23,814)
Net interest income		186,319		157,215		145,069		130,145		117,153
Provision for loan losses		(8,100)		(21,100)		(6,000)		(38,700)		(12,605)
Net interest income after provision for loan losses		178,219		136,115		139,069		91,445		104,548
Noninterest income		8,035		5,739		8,204		9,920		11,173
Noninterest expense		(92,228)		(70,720)		(78,759)		(58,507)		(54,484)
Income before income tax expense		94,026		71,134		68,514		42,858		61,237
Income tax expense		(20,631)		(10,782)		(25,294)		(11,776)		(19,926)
Net income		73,395		60,352		43,220		31,082		41,311
Preferred stock dividends		-		-		-		(22)		(112)
Net income available to common stockholders	\$	73,395	\$	60,352	\$	43,220	\$	31,060	\$	41,199

(1) This measure is not recognized under generally accepted accounting principles in the United States (“GAAP”) and is therefore considered to be a non-GAAP financial measure. See –“Non-GAAP Reconciliation Table” for a reconciliation of this measure to its most comparable GAAP measure.

	2019	As of or For the Years Ended December 31,								
		2018	2017	2016	2015					
		(dollars in thousands, except share data)								
Per Common Share Data										
Basic earnings per share	\$	2.08	\$	1.87	\$	1.35	\$	1.02	\$	1.37
Diluted earnings per share		2.07		1.86		1.34		1.01		1.36
Book value per common share		20.85		18.99		17.63		16.62		15.49
Tangible book value per common share ⁽¹⁾		16.06		14.42		13.01		11.96		10.51
Selected Performance Ratios										
Return on average assets		1.22%		1.17%		0.93%		0.73%		1.13%
Return on average common stockholders' equity		10.40		10.29		7.81		6.30		9.03
Return on average tangible common equity ⁽¹⁾		13.61		13.76		10.68		9.09		13.48
Net interest margin		3.35		3.28		3.45		3.38		3.55
Selected Asset Quality Ratios as a % of Loans Receivable:										
Nonaccrual loans (excluding loans held-for-sale)		0.97%		1.14%		1.57%		0.16%		0.67%
Loans 90 days or greater past due and still accruing (PCI)		0.06		0.04		0.04		0.15		-
Performing TDRs		0.42		0.21		0.36		0.38		2.77
Allowance for loan losses		0.75		0.77		0.76		0.74		0.86
Nonperforming assets ⁽²⁾ to total assets		0.80%		0.95%		1.29%		1.57%		0.58%
Allowance for loan losses to nonaccrual loans (excluding loans held- for-sale		147.0		146.8		168.4		449.0		128.1
Net loan charge-offs to average loans ⁽³⁾		0.10		0.41		0.00		1.18		0.01
Capital Ratios										
Leverage ratio		9.54%		9.34%		8.92%		9.29%		9.07%
Common equity Tier 1 risk-based ratio		9.95		9.75		9.15		9.74		9.14
Risk-based Tier 1 capital ratio		10.04		9.86		9.26		9.87		9.61
Risk-based capital ratio		12.96		13.15		11.04		11.78		11.77
Tangible common equity to tangible assets ⁽¹⁾		9.38		8.77		8.41		8.93		8.18

(1) These measures are not measures recognized under generally accepted accounting principles in the United States ("GAAP"), and are therefore considered to be non-GAAP financial measures. See –"Non-GAAP Reconciliation Table" for a reconciliation of these measures to their most comparable GAAP measures.

(2) Nonperforming assets are defined as nonaccrual loans, nonaccrual loans held-for-sale, and other real estate owned.

(3) Charge-offs in 2019, 2018 and 2016 included \$1.0 million, \$17.0 million and \$36.5 million, respectively, related to the taxi medallion portfolio.

Non-GAAP Reconciliation Table

	2019	2018	As of December 31, 2017	2016	2015
			(dollars in thousands, except per share data)		
Tangible common equity and tangible common equity/tangible assets					
Common stockholders' equity	\$ 731,190	\$ 613,927	\$ 565,437	\$ 531,032	\$ 466,094
Less: goodwill and other intangible assets	168,034	147,646	148,273	148,997	149,817
Tangible common stockholders' equity	<u>\$ 563,156</u>	<u>\$ 466,281</u>	<u>\$ 417,164</u>	<u>\$ 382,035</u>	<u>\$ 316,277</u>
Total assets	\$ 6,174,032	\$ 5,462,092	\$ 5,108,442	\$ 4,426,348	\$ 4,015,909
Less: goodwill and other intangible assets	168,034	147,646	148,273	148,997	149,817
Tangible assets	<u>\$ 6,005,998</u>	<u>\$ 5,314,446</u>	<u>\$ 4,960,169</u>	<u>\$ 4,277,351</u>	<u>\$ 3,866,092</u>
Tangible common equity ratio	9.38%	8.77%	8.41%	8.93%	8.18%
Tangible book value per common share					
Book value per common share	\$ 20.85	\$ 18.99	\$ 17.63	\$ 16.62	\$ 15.49
Less: goodwill and other intangible assets	4.79	4.57	4.62	4.66	4.98
Tangible book value per common share	<u>\$ 16.06</u>	<u>\$ 14.42</u>	<u>\$ 13.01</u>	<u>\$ 11.96</u>	<u>\$ 10.51</u>
Return on average tangible common equity					
Net income available to common stockholders	\$ 73,395	\$ 60,352	\$ 43,220	\$ 31,060	\$ 41,199
Average common stockholders' equity	\$ 705,496	\$ 586,727	\$ 553,390	\$ 491,110	\$ 456,036
Less: goodwill and other intangible assets	166,116	147,970	148,649	149,425	150,296
Average tangible common stockholders' equity	<u>\$ 539,380</u>	<u>\$ 438,757</u>	<u>\$ 404,741</u>	<u>\$ 341,685</u>	<u>\$ 305,740</u>
Return on average common stockholders' equity	10.40%	10.29%	7.81%	6.32%	9.03%
Return on average tangible common stockholders' equity	13.61%	13.76%	10.68%	9.09%	13.48%

Item 7. Management’s Discussion and Analysis (“MD&A”) of Financial Condition and Results of Operations

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing the Company’s results of operations for each of the past three years and financial condition for each of the past two years. In order to fully appreciate this analysis, the reader is encouraged to review the consolidated financial statements and accompanying notes thereto appearing under Item 8 of this report, and statistical data presented in this document.

Cautionary Statement Concerning Forward-Looking Statements

See Item 1 of this Annual Report on Form 10-K for information regarding forward-looking statements.

Critical Accounting Policies and Estimates

Management’s Discussion and Analysis of Financial Condition and Results of Operations is based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to our audited consolidated financial statements contains a summary of our significant accounting policies. Management believes our policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical policy and its application are periodically reviewed with the Audit Committee and our Board of Directors.

Allowance for Loan Losses and Related Provision

The allowance for loan losses represents management’s estimate of probable incurred loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated probable incurred losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the Company’s Consolidated Statements of Condition.

The evaluation of the adequacy of the allowance for loan losses includes, among other factors, an analysis of historical loss rates by loan category applied to current loan totals. However, actual loan losses may be higher or lower than historical trends, which vary. Actual losses on specified problem loans, which also are provided for in the evaluation, may vary from estimated loss percentages, which are established based upon a limited number of potential loss classifications.

The allowance for loan losses is established through a provision for loan losses charged to expense. Management believes that the current allowance for loan losses will be adequate to absorb probable incurred loan losses on existing loans that may become uncollectible based on the evaluation of known and inherent risks in the originated loan portfolio. The evaluation takes into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, and specific problem loans and current economic conditions which may affect our borrowers’ ability to pay. The evaluation also details historical losses by loan category and the resulting loan loss rates which are projected for current loan total amounts. Loss estimates for specified problem loans are also detailed. Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to make additional provisions for loan losses based upon information available to them at the time of their examination. All of the factors considered in the analysis of the adequacy of the allowance for loan losses may be subject to change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that could materially adversely impact earnings in future periods. Additional information can be found in Note 1 of the Notes to Consolidated Financial Statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity’s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company’s consolidated financial statements or tax returns.

Fluctuations in the actual outcome of these future tax consequences could impact the Company’s consolidated financial condition or results of operations. Note 1 (under the caption “Use of Estimates”) and Note 12 of the Notes to Consolidated Financial Statements include additional discussion on the accounting for income taxes.

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Goodwill

The Company has adopted the provisions of FASB ASC 350-10-05, which requires that goodwill be reported separate from other intangible assets in the Consolidated Statements of Condition and not be amortized but tested for impairment annually or more frequently if indicators arise for impairment. No impairment charge was deemed necessary for the years ended December 31, 2019, 2018 and 2017.

Business Combinations

The Company accounts for business combinations under the purchase method of accounting. The application of this method of accounting requires the use of significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration between assets that are amortized, accreted or depreciated from those that are recorded as goodwill. Our estimates of the fair values of assets acquired and liabilities assumed are based upon assumptions that we believe to be reasonable, and whenever necessary, include assistance from independent third-party appraisal and valuation firms.

Overview and Strategy

We serve as a holding company for the Bank, which is our primary asset and only operating subsidiary. We follow a business plan that emphasizes the delivery of customized banking services in our market area to customers who desire a high level of personalized service and responsiveness. The Bank conducts a traditional banking business, making commercial loans, consumer loans and residential and commercial real estate loans. In addition, the Bank offers various non-deposit products through non-proprietary relationships with third party vendors. The Bank relies upon deposits as the primary funding source for its assets. The Bank offers traditional deposit products.

Many of our customer relationships start with referrals from existing customers. We then seek to cross sell our products to customers to grow the customer relationship. For example, we will frequently offer an interest rate concession on credit products for customers that maintain a noninterest-bearing deposit account at the Bank. This strategy has helped maintain our funding costs and the growth of our interest expense even as we have substantially increased our total deposits. It has also helped fuel our significant loan growth. We believe that the Bank's significant growth and increasing profitability demonstrate the need for and success of our brand of banking.

Our results of operations depend primarily on our net interest income, which is the difference between the interest earned on our interest-earning assets and the interest paid on funds borrowed to support those assets, primarily deposits. Net interest margin is the difference between the weighted average rate received on interest-earning assets and the weighted average rate paid to fund those interest-earning assets, which is also affected by the average level of interest-earning assets as compared with that of interest-bearing liabilities. Net income is also affected by the amount of noninterest income and noninterest expenses.

General

The following discussion and analysis presents the more significant factors affecting the Company's financial condition as of December 31, 2019 and 2018 and results of operations for each of the years in the three-year period ended December 31, 2019. The MD&A should be read in conjunction with the consolidated financial statements, notes to consolidated financial statements and other information contained in this report.

Operating Results Overview

Net income for the year ended December 31, 2019 was \$73.4 million, an increase of \$13.0 million, or 21.6%, compared to net income of \$60.4 million for 2018. Diluted earnings per share were \$2.07 for 2019, an 11.3% increase from \$1.86 for 2018.

The change in net income from 2018 to 2019 was attributable to the following:

- Increased net interest income of \$29.1 million primarily due to the acquisition of GHB.
- Decreased provision for loan losses of \$13.0 million primarily due to \$17.0 million increase in specific reserves (then concurrently charged-off) within the taxi medallion loan portfolio in 2018.
- Increase in noninterest income of \$2.6 million primarily resulting from an increase in deposit, loan, and other income, which included higher overdrafts fees, and income related to the operations of BoeFly.
- Increase in noninterest expenses of \$21.8 million, primarily due to an increase in salaries and employee benefits of \$9.6 million, merger expenses of \$7.6 million and professional and consulting expenses of \$1.9 million. The increases are mainly attributable to the acquisition of GHB.
- Increase in income tax expense of \$9.8 million resulting primarily from an increase in income from taxable sources.

Net income for the year ended December 31, 2018 was \$60.4 million, an increase of \$17.1 million, or 39.6%, compared to net income of \$43.2 million for 2017. Diluted earnings per share were \$1.86 for 2018, a 38.8% increase from \$1.34 for 2017.

The change in net income from 2017 to 2018 was attributable to the following:

- Increased net interest income of \$12.1 million primarily due to organic growth.
- Increased provision for loan losses of \$15.1 million primarily due to \$17.0 million increase in specific reserves (then concurrently charged-off) within the taxi medallion loan portfolio, offset by a decrease in provision on the remaining loan portfolio due to slower loan growth.
- Decrease in noninterest income of \$2.5 million primarily resulting from lower net gains on the sale of investment securities (\$1.6 million) and lower net gains on the sale of loans held-for-sale in 2018 (\$0.6 million).
- Decrease in noninterest expense of approximately \$8.0 million primarily due to a \$15.6 million increase in valuation allowance for loans held-for-sale related to the Company's taxi medallion loans in 2017, offset by increase in salaries and employee benefits (\$4.7 million), merger expenses (\$1.3 million) and other expenses (\$1.5 million).
- Decreased income tax expense of \$14.5 million resulting primarily from a decrease in the federal statutory rate used in 2018 and a charge against the Company's deferred tax assets of \$5.6 million in 2017, both due to the impact of the Tax Cuts and Jobs Act of 2017.

Net Interest Income

Fully taxable equivalent net interest income for 2019 totaled \$188.0 million, an increase of \$28.8 million, or 18.1%, from 2018. The increase in net interest income was due to an increase in average interest-earning assets, which grew by 15.7% to \$5.6 billion and a widening of 7 basis-points in the net interest margin. The widening of the net interest margin was mainly attributable to higher interest-earning assets, specifically rate and volume of loans, offset by higher cost of funds. Average total loans, which includes loans held-for-sale, increased by 16.6% to \$5.0 billion in 2019 from \$4.3 billion in 2018. The increase in average total loans is primarily attributable to the acquisition of GHB.

Fully taxable equivalent net interest income for 2018 totaled \$159.1 million, an increase of \$10.7 million, or 7.2%, from 2017. The increase in net interest income was due to an increase in average interest-earning assets, which grew by 12.8% to \$4.9 billion, offset by a 17 basis-points contraction in the net interest margin. The decrease in the net interest margin was primarily attributable to the issuance of long-term subordinated debt during the first quarter of 2018, the change in the taxable equivalent adjustment due to the Tax Act, an increase in deposit funding costs, and lower yields earned on securities. Average total loans increased by 13.6% to \$4.3 billion in 2018 from \$3.8 billion in 2017.

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Average Balance Sheets

The following table sets forth certain information relating to our average assets and liabilities for the years ended December 31, 2019, 2018 and 2017 and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown.

(Tax-Equivalent Basis)	Years Ended December 31,								
	Average	2019	Yield/ Rate	Average	2018	Yield/ Rate	Average	2017	Yield/ Rate
	Balance	Income/ Expense		Balance	Income/ Expense		Balance	Income/ Expense	
(dollars in thousands)									
ASSETS									
Interest-earning assets:									
Investment securities ⁽¹⁾⁽²⁾	\$ 478,478	\$ 13,885	2.90%	\$ 432,780	\$ 12,629	2.92%	\$ 393,144	\$ 12,290	3.13%
Loans ^{(2) (3) (4)}	5,049,458	256,299	5.08%	4,330,874	202,578	4.68%	3,811,922	170,314	4.47%
Federal funds sold and interest-earning deposits with banks	55,819	1,167	2.09%	58,631	839	1.43%	70,527	711	1.01%
Restricted investment in bank stocks	27,389	1,778	6.49%	29,200	2,012	6.89%	27,093	1,421	5.24%
Total interest-earning assets	5,611,144	273,129	4.87%	4,851,485	218,058	4.49%	4,302,686	184,736	4.29%
Noninterest-earning assets:									
Allowance for loan losses	(37,433)			(33,449)			(28,276)		
Noninterest-earning assets	440,824			341,531			354,970		
Total assets	\$ 6,014,535			\$ 5,159,567			\$ 4,629,380		
LIABILITIES & STOCKHOLDERS' EQUITY									
Savings, NOW, money market, interest checking	\$ 2,267,812	28,393	1.25%	\$ 1,838,025	15,778	0.86%	\$ 1,773,454	9,502	0.54%
Time deposits	1,549,700	37,177	2.40%	1,278,821	24,158	1.89%	1,015,552	14,168	1.40%
Total interest-bearing deposits	3,817,512	65,570	1.72%	3,116,846	39,936	1.28%	2,789,006	23,670	0.85%
Borrowings	502,314	12,079	2.40%	562,728	11,639	2.07%	529,445	9,178	1.73%
Subordinated debentures ⁽⁵⁾	128,708	7,371	5.73%	125,156	7,189	5.74%	54,610	3,245	5.94%
Capital lease obligation	2,414	145	6.01%	2,571	154	5.99%	2,704	162	5.99%
Total interest-bearing liabilities	4,450,948	85,165	1.91%	3,807,301	58,918	1.55%	3,375,765	36,255	1.07%
Noninterest-bearing deposits	819,917			745,548			681,215		
Other liabilities	38,174			19,991			19,010		
Stockholders' equity	705,496			586,727			553,390		
Total liabilities and stockholders' equity	\$ 6,014,535			\$ 5,159,567			\$ 4,629,380		
Net interest income/interest rate spread ⁽⁶⁾		187,964	2.96%		159,140	2.94%		148,481	3.22%
Tax-equivalent adjustment		(1,645)			(1,925)			(3,412)	
Net interest income as reported		\$ 186,319			\$ 157,215			\$ 145,069	
Net interest margin ⁽⁷⁾			3.35%			3.28%			3.45%

(1) Average balances are based on amortized cost.

(2) Interest income is presented on a tax equivalent basis using 21% federal tax rate for 2019 and 2018 and 35% for 2017.

(3) Includes loan fee income.

(4) Loans include nonaccrual loans and loans held-for-sale.

(5) Average balances are net of debt issuance costs of \$1,447, \$1,710 and \$545 as of December 31, 2019, December 31, 2018 and December 31, 2017, respectively. Amortization expense related to debt issuance costs included in interest expense were \$329, \$332 and \$165 as of December 31, 2019, December 31, 2018 and December 31, 2017, respectively.

(6) Represents difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities and is presented on a tax equivalent basis.

(7) Represents net interest income on a tax equivalent basis divided by average total interest-earning assets.

Rate/Volume Analysis

The following table presents, by category, the major factors that contributed to the changes in net interest income. Changes due to both volume and rate have been allocated in proportion to the relationship of the dollar amount change in each.

	2019/2018 Increase (Decrease) Due to Change in:			2018/2017 Increase (Decrease) Due to Change in:		
	Average Volume	Average Rate	Net Change (dollars in thousands)	Average Volume	Average Rate	Net Change
Interest income:						
Investment securities:	\$ 1,326	\$ (70)	\$ 1,256	\$ 1,157	\$ (818)	\$ 339
Loans receivable and loans held- for-sale	36,474	17,247	53,721	24,274	7,990	32,264
Federal funds sold and interest- earnings deposits with banks	(59)	387	328	(170)	298	128
Restricted investment in bank stocks	(118)	(116)	(234)	145	446	591
Total interest income:	\$ 37,623	\$ 17,448	\$ 55,071	\$ 25,406	\$ 7,916	\$ 33,322
Interest expense:						
Savings, NOW, money market, interest checking	\$ 5,416	\$ 7,199	\$ 12,615	\$ 554	\$ 5,722	\$ 6,276
Time deposits	6,498	6,521	13,019	4,973	5,017	9,990
Borrowings and subordinated debentures	(1,250)	1,872	622	4,740	1,665	6,405
Capital lease obligation	(9)	-	(9)	(8)	-	(8)
Total interest expense:	\$ 10,655	\$ 15,592	\$ 26,247	\$ 10,259	\$ 12,404	\$ 22,663
Net interest income:	<u>\$ 26,968</u>	<u>\$ 1,856</u>	<u>\$ 28,824</u>	<u>\$ 15,147</u>	<u>\$ (4,488)</u>	<u>\$ 10,659</u>

Provision for Loan Losses

In determining the provision for loan losses, management considers national and local economic trends and conditions; trends in the portfolio including orientation to specific loan types or industries; experience, ability and depth of lending management in relation to the complexity of the portfolio; effects of changes in lending policies, trends in volume and terms of loans; levels and trends in delinquencies, impaired loans and net charge-offs and the results of independent third party loan review.

For the year ended December 31, 2019, the provision for loan losses was \$8.1 million, a decrease of \$13.0 million, compared to the provision for loan losses of \$21.1 million for 2018, due primarily to specific reserves (and concurrent charge-offs) of \$17.0 million related to the taxi medallion loans in 2018.

For the year ended December 31, 2018, the provision for loan losses was \$21.1 million, an increase of \$15.1 million, compared to the provision for loan losses of \$6.0 million for 2017, due primarily to specific reserves (and concurrent charge-offs) of \$17.0 million related to the taxi medallion loans in 2018, offset by a decrease in the provision for the remaining loan portfolio resulting from slower loan growth.

With the adoption of CECL beginning on January 1, 2020, provision expense may become more volatile due to changes in CECL model assumptions of credit quality, macroeconomic factors and conditions, and loan composition, which drive the allowance for credit losses balance. See Note 1b to our audited financial statements included herein.

Noninterest Income

Noninterest income for the full-year 2019 increased by \$2.6 million, or 46.8%, to \$8.0 million from \$5.5 million in 2018. The increase was primarily the result of a \$1.4 million increase in deposit, loan and other income. This increase was mainly attributable to higher overdrafts fees and income related to the operations of BoeFly. Increase in net gains on sale of loans held-for-sale of \$0.5 million was mainly attributable to increases in mortgage loan sales of \$0.3 million and net gains on the sale of a pool of commercial real estate loans during the third quarter 2019 of \$0.2 million. Other increases in noninterest income include an increase of \$0.4 million in BOLI and increase of \$0.6 million in net gains on equity securities, offset by net losses in sales of securities available-for-sale of \$0.3 million.

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Noninterest income for the full-year 2018 decreased by \$2.5 million, or 30.0%, to \$5.7 million from \$8.2 million in 2017. The decrease was primarily the result of a \$1.6 million decrease in net gains on sale of investment securities and a \$0.6 million decrease in net gains on sale of loans held-for-sale.

Noninterest Expense

Noninterest expenses for the full-year 2019 increased by \$21.8 million, or 30.9%, to \$92.2 million from \$70.5 million in 2018. The increase was primarily attributable to increases in salaries and employee benefits of \$9.6 million, merger expenses of \$7.6 million, professional and consulting of \$1.9 million, occupancy and equipment of \$1.4 million and amortization of core deposit intangibles of \$0.8 million. These increases were mainly the result of the acquisition of GHB and BNJ. In addition, the Bank had a loss on extinguishment of debt of \$1.0 million during the second quarter of 2019. Lastly, there was a decrease in FDIC expense of \$1.1 million that was attributable to the Bank receiving a small bank credit of approximately \$1.3 million during the second quarter of 2019.

Noninterest expenses for the full-year 2018 decreased by \$8.0 million, or 10.2%, to \$70.7 million from \$78.8 million in 2017. Included in noninterest expense in 2017 was a \$15.6 million valuation allowance for loans held-for-sale related to the Company's taxi medallion loans. Excluding the valuation allowance, noninterest expenses increased \$7.6 million, or 12.0%, from 2017. The balance of the increase was attributable to an increased level of business and staff resulting from organic growth. Salaries and employee benefits increased by \$4.7 million, professional and consulting increased by \$0.7 million and other expenses increased by \$1.5 million. Additionally, \$1.3 million in merger expenses were incurred in 2018 as a result of the acquisition of GHB.

Income Taxes

Income tax expense was \$20.6 million for 2019 compared to \$10.8 million for 2018 and \$25.3 million for 2017. The higher level of income tax expense in 2019 when compared to 2018 was primarily attributable to higher income before taxes and the negative impact of recent tax legislation in New Jersey. Income tax expense for 2017 included a \$5.6 million charge to adjust the value of deferred tax assets to reflect the lower corporate tax rate, resulting from The Tax Cuts and Jobs Act of 2017 ("the Act"). The lower level of income tax expense in 2018 when compared to 2017 was primarily attributable to the reduction of the federal statutory rate resulting from the Act. The effective tax rates were 21.9% in 2019, 15.2% in 2018 and 36.9% for 2017. Excluding the effect of the \$5.6 million charge, the effective tax rate in 2017 was 28.8%.

For a more detailed description of income taxes see Note 12 of the Notes to Consolidated Financial Statements.

Financial Condition Overview

At December 31, 2019, the Company's total assets were \$6.2 billion, an increase of \$712 million from December 31, 2018. Total loans (including loans held-for-sale) were \$5.1 billion, an increase of \$606 million from December 31, 2018. Deposits were \$4.8 billion, an increase of \$675 million from December 31, 2018.

At December 31, 2018, the Company's total assets were \$5.5 billion, an increase of \$354 million from December 31, 2017. Total loans (including loans held-for-sale) were \$4.5 billion, an increase of \$345 million from December 31, 2017. Deposits were \$4.1 billion, an increase of \$297 million from December 31, 2017.

Loan Portfolio

The Bank's lending activities are generally oriented to small-to-medium sized businesses, high net worth individuals, professional practices and consumer and retail clients living and working in the Bank's metropolitan, New York market area consisting of Bergen, Union, Morris, Essex, Hudson, Mercer and Monmouth counties, New Jersey, as well as NYC's five boroughs, and Nassau Rockland, Orange and Westchester counties, in New York. The Bank has not made loans to borrowers outside of the United States. The Bank believes that its strategy of high-quality client service, competitive rate structures and selective marketing have enabled it to gain market share.

Commercial loans are loans made for business purposes and are primarily secured by collateral such as cash balances with the Bank, marketable securities held by or under the control of the Bank, business assets including accounts receivable, inventory and equipment and liens on commercial and residential real estate. Commercial construction loans are loans to finance the construction of commercial or residential properties secured by first liens on such properties. Commercial real estate loans include loans secured by first liens on completed commercial properties, including multi-family properties, to purchase or refinance such properties. Residential mortgages include loans secured by first liens on residential real estate and are generally made to existing clients of the Bank to purchase or refinance primary and secondary residences. Home equity loans and lines of credit include loans secured by first or second liens on residential real estate for primary or secondary residences. Consumer loans are made to individuals who qualify for auto loans, cash reserve, credit cards and installment loans.

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During 2019 and 2018, loan portfolio growth was positively impacted in several ways including (i) an increase in demand for small business lines of credit and business term loans as economic conditions remained strong (ii) industry consolidation and lending restrictions involving larger competitors allowing the Bank to gain market share, (iii) an increase in refinancing strategies employed by borrowers during the current low rate environment, and (iv) the Bank's success in attracting highly experienced commercial loan officers with substantial local market knowledge.

Gross loans at December 31, 2019 totaled \$5.1 billion, an increase of \$574 million, or 12.6%, over gross loans at December 31, 2018 of \$4.5 billion. The increase in gross loans was primarily attributable to the acquisition of GHB.

The largest component of the gross loan portfolio at December 31, 2019 and December 31, 2018 was commercial real estate loans. Commercial real estate loans at December 31, 2019 totaled \$3.0 billion, an increase of \$264 million, or 9.5%, compared to commercial real estate loans at December 31, 2018 of \$2.8 billion. Commercial construction loans at December 31, 2019 totaled \$623 million, an increase of \$158 million, or 33.9%, compared to construction loans at December 31, 2018 of \$465 million. Commercial loans totaled \$1.1 billion at December 31, 2019, an increase of \$141 million, or 14.3%, compared to commercial loans at December 31, 2018 of \$989 million.

Residential real estate loans totaled \$320 million at December 31, 2019, an increase of \$10 million, or 3.2%, compared to residential real estate loans at December 31, 2018 of \$310 million. Consumer loans at December 31, 2019 totaled \$3.3 million, an increase of \$0.1 million, or 28.3%, compared to consumer loans of \$2.6 million at December 31, 2018. The growth in our gross loans for 2019 was primarily attributable to the acquisition of GHB.

The following table sets forth the classification of our loans by loan portfolio segment for the periods presented.

	2019	2018	December 31, 2017	2016	2015
	(dollars in thousands)				
Commercial	\$ 1,129,661	\$ 988,758	\$ 824,082	\$ 553,576	\$ 570,116
Commercial real estate	3,041,959	2,778,167	2,592,909	2,204,710	1,966,696
Commercial construction	623,326	465,389	483,216	486,228	328,838
Residential real estate	320,020	309,991	271,795	232,547	233,690
Consumer	3,328	2,594	2,808	2,380	2,454
Gross loans	5,118,294	4,544,899	4,174,810	3,479,441	3,101,794
Net deferred (fees) costs	(4,767)	(3,807)	(3,354)	(3,609)	(2,787)
Loans receivable	5,113,527	4,541,092	4,171,456	3,475,832	3,099,007
Allowance for loan losses	(38,293)	(34,954)	(31,748)	(25,744)	(26,572)
Net loans receivable	<u>\$ 5,075,234</u>	<u>\$ 4,506,138</u>	<u>\$ 4,139,708</u>	<u>\$ 3,450,088</u>	<u>\$ 3,072,435</u>

The following table sets forth the classification of our gross loans by loan portfolio segment and by fixed and adjustable rate loans as of December 31, 2019 by remaining contractual maturity.

	In One Year or Less	At December 31, 2019, Maturing After One Year through Five Years	After Five Years	Total
	(dollars in thousands)			
Commercial	\$ 481,147	\$ 339,738	\$ 308,776	\$ 1,129,661
Commercial real estate	257,097	792,511	1,992,351	3,041,959
Commercial construction	503,575	119,751	-	623,326
Residential real estate	7,080	19,964	292,976	320,020
Consumer	3,047	244	37	3,328
Total	<u>\$ 1,251,946</u>	<u>\$ 1,272,208</u>	<u>\$ 2,594,140</u>	<u>\$ 5,118,294</u>
Loans with:				
Fixed rates	\$ 334,891	\$ 796,647	\$ 864,116	\$ 1,995,654
Variable rates	917,055	475,561	1,730,024	3,122,640
Total	<u>\$ 1,251,946</u>	<u>\$ 1,272,208</u>	<u>\$ 2,594,140</u>	<u>\$ 5,118,294</u>

For additional information regarding loans, see Note 5 of the Notes to the Consolidated Financial Statements.

Asset Quality

General. One of our key objectives is to maintain a high level of asset quality. When a borrower fails to make a scheduled payment, we attempt to cure the deficiency by sending late notices, as well as making personal contact with the borrower. Typically, late notices are sent approximately 10 days after the date the payment is due, followed up by direct contact with the borrower approximately 15 days after payment is due. In most cases, deficiencies are promptly resolved. If the delinquency continues, late charges are assessed and additional efforts are made to collect the deficiency. Total loans delinquent 30 days or more are reported to the board of directors of the Bank on a monthly basis.

On loans where the collection of principal or interest payments is doubtful, the accrual of interest income ceases (“nonaccrual” loans). Except for loans that are well secured and in the process of collection, it is our policy to discontinue accruing additional interest and reverse any interest accrued on any loan that is 90 days or greater past due. On occasion, this action may be taken earlier if the financial condition of the borrower raises significant concern with regard to his/her ability to service the debt in accordance with the terms of the loan agreement. Interest income is not accrued on these loans until the borrower’s financial condition and payment record demonstrate an ability to service the debt.

Real estate acquired as a result of foreclosure is classified as other real estate owned (“OREO”) until sold. OREO is recorded at the lower of cost or fair value less estimated selling costs. Costs associated with acquiring and improving a foreclosed property are usually capitalized to the extent that the carrying value does not exceed fair value less estimated selling costs. Holding costs are charged to expense. Gains and losses on the sale of OREO are charged to operations, as incurred.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and the probability of collecting scheduled principal and interest payments when due. Loans for which the terms have been modified as a concession to the borrower due to the borrower experiencing financial difficulties are considered troubled debt restructurings (“TDR”) and are classified as impaired. Loans considered to be TDRs can be categorized as nonaccrual or performing. The impairment of a loan can be measured at (1) the fair value of the collateral less costs to sell, if the loan is collateral dependent, (2) at the value of expected future cash flows using the loan’s effective interest rate, or (3) at the loan’s observable market price. Generally, the Bank measures impairment of such loans by reference to the fair value of the collateral less costs to sell. Loans that experience minor payment delays and payment shortfalls generally are not classified as impaired.

Generally, impaired loans consist of nonaccrual loans and performing troubled debt restructurings. Of this group of impaired loans, loans of \$250,000 and over are individually evaluated for impairment, while loans with balances less than \$250,000 are collectively evaluated for impairment, and, accordingly, are not separately identified for impairment disclosures.

Asset Classification. Federal regulations and our policies require that we utilize an internal asset classification system as a means of reporting problem and potential problem assets. We have incorporated an internal asset classification system, substantially consistent with Federal banking regulations, as a part of our credit monitoring system. Federal banking regulations set forth a classification scheme for problem and potential problem assets as “substandard,” “doubtful” or “loss” assets. An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” that the insured institution will sustain “some loss” if the deficiencies are not corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated “special mention.”

When an insured institution classifies one or more assets, or portions thereof, as “substandard” or “doubtful,” it is required that a general valuation allowance for loan losses must be established for loan losses in an amount deemed prudent by management. General valuation allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies one or more assets, or portions thereof, as “loss,” it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

A bank’s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by Federal bank regulators which can order the establishment of additional general or specific loss allowances. The Federal banking agencies have adopted an interagency policy statement on the allowance for loan losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that institutions have effective systems and controls to identify, monitor and address asset quality problems; that management analyze all significant factors that affect the collectability of the portfolio in a reasonable manner; and that management establish acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Our management believes that, based on information currently available, our allowance for loan

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losses is maintained at a level which covers all known and probable incurred losses in the portfolio at each reporting date. However, actual losses are dependent upon future events and, as such, further additions to the level of allowances for loan losses may become necessary.

The table below sets forth information on our classified loans and loans designated as special mention (excluding loans held-for-sale) as of the dates presented:

	December 31,	
	2019	2018
(dollars in thousands)		
Classified Loans:		
Substandard	\$ 82,315	\$ 67,252
Doubtful	-	-
Loss	-	-
Total classified loans	82,315	67,252
Special Mention Loans	37,009	21,460
Total classified and special mention loans	<u>\$ 119,324</u>	<u>\$ 88,712</u>

During the year ended December 31, 2019, “substandard” loans, which include lower credit quality loans which possess higher risk characteristics than “special mention” loans, increased from \$67.3 million, or 1.5% of loans receivable, at December 31, 2018 to \$82.3 million, or 1.6% of loans receivable, at December 31, 2019. During the year ended December 31, 2019, “special mention” loans increased to \$37.0 million, or 0.7% of loans receivable from \$21.5 million, or 0.5% of loans receivable, at December 31, 2018. The increase in both substandard and special mention loans is primarily attributable to the acquisition of GHB.

Nonperforming Loans, Performing Troubled Debt Restructurings, Past Due Loans and OREO

Nonperforming loans include nonaccrual loans and accruing loans which are contractually past due 90 days or greater. Nonaccrual loans represent loans on which interest accruals have been suspended. The Company considers charging off loans, or a portion thereof, when they become contractually past due ninety days or more as to interest or principal payments or when other internal or external factors indicate that collection of principal or interest is doubtful. Performing troubled debt restructurings represent loans on which a concession was granted to a borrower, such as a reduction in interest rate to a rate lower than the current market rate for new debt with similar risks, and which are currently performing in accordance with the modified terms. For additional information regarding loans, see Note 5 of the Notes to the Consolidated Financial Statements.

The following table sets forth, as of the dates indicated, the amount of the Company’s nonaccrual loans, other real estate owned (“OREO”), performing troubled debt restructurings (“TDRs”) and loans past due 90 days or greater and still accruing:

	2019	2018	At December 31,		
			2017	2016	2015
(dollars in thousands)					
Nonaccrual loans	\$ 49,481	\$ 51,855	\$ 65,613	\$ 5,734	\$ 20,737
Nonaccrual loans (held-for-sale)	-	-	-	63,044	-
OREO	-	-	538	626	2,549
Total nonperforming assets ⁽¹⁾	<u>\$ 49,481</u>	<u>\$ 51,855</u>	<u>\$ 66,151</u>	<u>\$ 69,404</u>	<u>\$ 23,286</u>
Performing TDRs	\$ 21,410	\$ 11,165	\$ 14,920	\$ 13,338	\$ 85,925
Loans 90 days or greater past due and still accruing (non-PCI)	\$ -	\$ -	\$ -	\$ -	\$ -
Loans 90 days or greater past due and still accruing (PCI)	<u>\$ 3,107</u>	<u>\$ 1,647</u>	<u>\$ 1,664</u>	<u>\$ 5,293</u>	<u>\$ -</u>

(1) Nonperforming assets are defined as nonaccrual loans, nonaccrual loans held-for-sale, and other real estate owned.

Nonaccrual loans (excluding loans held-for-sale) to loans receivable	0.97%	1.14%	1.57%	0.16%	0.67%
Nonperforming assets to total assets	0.80%	0.95%	1.29%	1.57%	0.58%
Nonperforming assets, performing TDRs, and loans 90 days or greater past due and still accruing to total loans ⁽²⁾	1.44%	1.42%	1.97%	2.48%	3.52%

(2) Includes loans held-for-sale.

Allowance for Loan Losses and Related Provision

The allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. We maintain an allowance for loan losses at a level considered adequate to provide for all known and probable incurred losses in the portfolio. The level of the allowance is based on management's evaluation of estimated losses in the portfolio, after consideration of risk characteristics of the loans and prevailing and anticipated economic conditions. Loan charge-offs (i.e., loans judged to be uncollectible) are charged against the reserve and any subsequent recovery is credited. Our officers analyze risks within the loan portfolio on a continuous basis and through an external independent loan review function, and the results of the loan review function are also reviewed by our Audit Committee. A risk system, consisting of multiple grading categories for each portfolio class, is utilized as an analytical tool to assess risk and appropriate reserves. In addition to the risk system, management further evaluates risk characteristics of the loan portfolio under current and anticipated economic conditions and considers such factors as the financial condition of the borrower, past and expected loss experience, and other factors which management feels deserve recognition in establishing an appropriate reserve. These estimates are reviewed at least quarterly and, as adjustments become necessary, they are recognized in the periods in which they become known. Although management strives to maintain an allowance it deems adequate, future economic changes, deterioration of borrowers' creditworthiness, and the impact of examinations by regulatory agencies all could cause changes to our allowance for loan losses.

At December 31, 2019, the allowance for loan losses was \$38.3 million, an increase of \$3.3 million, or 9.6%, from \$35.0 million as of December 31, 2018. The increase in the allowance for loan losses was primarily attributable to increases in our general reserves due to loan growth, as well as increase in specific reserves. With the adoption of CECL beginning on January 1, 2020, provision expense may become more volatile due to changes in CECL model assumptions of credit quality, macroeconomic factors and conditions, and loan composition, which drive the allowance for credit losses balance.

During the year ended December 31, 2019, the Bank recorded net charge-offs of \$4.8 million, compared with net charge-offs of \$17.9 million during the year ended December 31, 2018. The allowance for loan losses as a percentage of loans receivable was 0.75% at December 31, 2019 and 0.77% at December 31, 2018. During 2018, the Bank charged-off \$17.0 million related to the taxi medallion loan portfolio, which contributed to the large increase in net charge-off activity when compared to the current year. In addition, the Bank also recorded a partial charge-off of \$0.9 million in 2018 for one commercial real estate loan that was reported as nonaccrual as of December 31, 2018.

The Company adopted ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("CECL") effective January 1, 2020. The main objective of this amendment is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendment requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to enhance their credit loss estimates. The Company's CECL implementation efforts are continuing to focus on completion of model validation, developing new disclosures, establishing formal policies and procedures and other governance and control documentation. Based on the Company's portfolio balances, and forecasted economic conditions as of December 31, 2019, management believes the adoption of the CECL standard could result in an increase to its total current reserves to a range of \$50 million to \$60 million, as compared to the Company's current reserve levels of \$38.3 million. The estimated increase to the Company's reserve level includes nonaccretable credit marks on PCI loans of approximately \$8.4 million, which will be transferred into current reserves at adoption. This preliminary estimate is contingent upon continued validation of our model, testing and refinement of the model methodologies and judgments utilized to determine the estimate. Additionally, the preliminary estimate does not incorporate the impact of the merger with BNJ which closed during the first quarter of 2020.

Five-Year Statistical Allowance for Loan Losses

The following table reflects the relationship of loan volume, the provision and allowance for loan losses and net charge-offs for the past five years.

	Years Ended December 31,				
	2019	2018	2017	2016	2015
	(dollars in thousands)				
Balance at the January 1,	\$ 34,954	\$ 31,748	\$ 25,744	\$ 26,572	\$ 14,160
Charge-offs:					
Commercial ⁽¹⁾	1,029	17,066	70	39,343	507
Commercial real estate	3,470	915	155	107	-
Residential real estate	557	23	14	94	-
Consumer	20	7	-	29	31
Total charge-offs	5,076	18,011	239	39,573	538
Recoveries:					
Commercial	265	109	178	4	340
Commercial real estate	30	-	51	35	-
Residential real estate	3	2	12	3	2
Consumer	17	6	2	3	3
Total recoveries	315	117	243	45	345
Net charge-offs (recoveries)	4,761	17,894	(4)	39,528	193
Provision for loan losses	8,100	21,100	6,000	38,700	12,605
Balance at end of year	<u>\$ 38,293</u>	<u>\$ 34,954</u>	<u>\$ 31,748</u>	<u>\$ 25,744</u>	<u>\$ 26,572</u>
Ratio of net charge-offs (recoveries) during the year to average loans outstanding during the year	0.09%	0.41%	0.00%	1.18%	0.01%
Allowance for loan losses as a percentage of loans receivable at December 31,	0.75%	0.77%	0.76%	0.74%	0.86%

⁽¹⁾ For the years ended December 31, 2019, December 31, 2018 and December 31, 2016, the loan charge-offs within the commercial loan segment were primarily made up of \$1.0 million, \$17.0 million and \$36.7 million in charge-offs related to the taxi medallion portfolio, respectively.

For additional information regarding loans, see Note 5 of the Notes to the Consolidated Financial Statements.

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Implicit in the lending function is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan being made, the creditworthiness of the borrower and prevailing economic conditions. The allowance for loan losses has been allocated in the table below according to the estimated amount deemed to be reasonably necessary to provide for the possibility of losses being incurred within the following categories of loans at December 31, for each of the past five years.

The table below shows, for three types of loans, the amounts of the allowance allocable to such loans and the percentage of such loans to gross loans, along with the amount of the unallocated allowance.

	Commercial		Residential Real Estate		Consumer		Unallocated		
	Amount of	Loans to	Amount of	Loans to	Amount of	Loans to	Amount of	Total	
	Allowance	Gross	Allowance	Gross	Allowance	Gross	Allowance	Allowance	
		Loans		Loans					
									(dollars in thousands)
2019	\$ 36,506	93.7%	\$ 1,685	6.3%	\$ 3	0.1%	\$ 99	\$ 38,293	
2018	33,241	93.1%	1,266	6.8%	2	0.1%	445	34,954	
2017	30,090	93.4%	1,051	6.5%	2	0.1%	605	31,748	
2016	24,005	93.2%	957	6.7%	3	0.1%	779	25,744	
2015	25,127	92.4%	977	7.5%	4	0.1%	464	26,572	

Investments

For the year ended December 31, 2019, the average volume of investment securities, including equity securities, increased by \$45.7 million to approximately \$478.5 million or 8.5% of average earning assets, from \$432.8 million, or 8.9% of average earning assets, for the year ended December 31, 2019. At December 31, 2019, the principal components of the investment portfolio are U.S. Treasury and Government Agency Obligations, Federal Agency Obligations including mortgage-backed securities, Obligations of U.S. States and Political Subdivision, Corporate Bonds and other debt and equity securities.

During the year ended December 31, 2019, rate related factors decreased investment revenue by \$0.1 million, while volume related factors increased investment revenue by \$1.3 million. The tax-equivalent yield on investments decreased by 2 basis points to 2.90% from a yield of 2.92% during the year ended December 31, 2018. This was primarily due to over declines in prevailing market rates and investment rates over the course of 2019.

Securities available-for-sale are a part of the Company's interest rate risk management strategy and may be sold in response to changes in interest rates, changes in prepayment risk, liquidity management and other factors. The Company continues to reposition the investment portfolio as part of an overall corporate-wide strategy to produce reasonable and consistent margins where feasible, while attempting to limit risks inherent in the Company's Consolidated Statement of Condition.

At December 31, 2019, net unrealized gains on securities available-for-sale, which are carried as a component of accumulated other comprehensive income and included in stockholders' equity, net of tax, amounted to \$2.7 million as compared with net unrealized losses of \$5.8 million at December 31, 2018. The increase in unrealized losses is predominately attributable to changes in market conditions and interest rates. For additional information regarding the Company's investment portfolio, see Note 4, Note 17 and Note 22 of the Notes to the Consolidated Financial Statements.

During 2019, there were sales totaling \$183.7 million from the Company's available-for-sale portfolio, as compared with no sales in 2018 and \$29.5 million in sales in 2017. The gross realized gains or (losses) on securities sold, called or matured amounted to approximately \$(0.3) million in 2019 and \$1.6 million in 2017, while there were no impairment charges in 2019, 2018 and 2017.

The table below illustrates the maturity distribution and weighted average yield on a tax-equivalent basis for amortized cost of our investment securities, excluding equity securities, as of December 31, 2019, on a contractual maturity basis.

	Due in 1 year or less		Due after 1 year through 5 years		Due after 5 years through 10 years		Due after 10 years				
	Amortized	Weighted	Amortized	Weighted	Amortized	Weighted	Amortized	Weighted	Amortized	Total	Market
	Cost	Average	Cost	Average	Cost	Average	Cost	Average	Cost	Weighted	Value
		Yield		Yield		Yield		Yield		Average	
(dollars in thousands)											
Investment Securities Available-for-Sale											
Federal Agency Obligations	\$ 1	3.98%	\$ -	-%	\$ -	-%	\$ 27,666	3.08%	\$ 27,667	3.08%	\$ 28,237
Residential Mortgage Pass-through Securities	8	2.61	242	2.80	1,853	2.79	197,508	2.28	199,611	2.28	200,496
Commercial Mortgage Pass-through Securities	-	-	2,955	2.71	-	-	2,040	2.65	4,995	2.69	4,997
Obligations of U.S. States and Political Subdivisions	871	2.84	8,298	3.85	19,685	4.33	105,646	4.31	134,500	4.28	136,519
Corporate Bonds and Notes	3,247	4.10	19,909	3.38	4,986	5.17	-	-	28,142	3.78	28,382
Asset-backed Securities	-	-	-	-	1,576	2.20	4,269	2.46	5,845	2.39	5,780
Certificates of Deposit	-	-	148	2.97	-	-	-	-	148	2.97	150
Other Securities	140	0.25	-	-	-	-	-	-	140	0.25	140
Total Investment Securities	\$ 4,267	3.71%	\$ 31,552	3.43%	\$ 28,100	4.26%	\$ 337,129	2.99%	\$ 401,048	3.12%	\$ 404,701

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For information regarding the carrying value of the investment portfolio, see Note 4, Note 17 and Note 22 of the Notes to the Consolidated Financial Statements.

The securities listed in the table above are either rated investment grade by Moody's and/or Standard and Poor's or have shadow credit ratings from a credit agency supporting an investment grade and conform to the Company's investment policy guidelines. There were no municipal securities, or corporate securities, of any single issuer exceeding 10% of stockholders' equity at December 31, 2019. Other securities do not have a contractual maturity and are included in the "Due in 1 year or less" maturity in the table above.

The following table sets forth the carrying value of the Company's investment securities, as of December 31 for each of the last three years.

	2019	2018	2017
	(dollars in thousands)		
Investment Securities Available-for-Sale:			
Federal agency obligations	\$ 28,237	\$ 44,955	\$ 56,022
Residential mortgage pass-through securities	200,496	185,204	181,891
Commercial mortgage pass-through securities	4,997	3,874	4,054
Obligations of U.S. States and political subdivisions	136,519	139,185	131,128
Trust preferred securities	-	-	4,671
Corporate bonds and notes	28,382	25,813	29,693
Asset-backed securities	5,780	9,691	12,050
Certificates of deposit	150	322	625
Equity securities ⁽¹⁾	-	-	11,728
Other securities	140	2,990	3,422
Total	\$ 404,701	\$ 412,034	\$ 435,284

(1) Beginning January 1, 2018, equity securities were reclassified out of investment securities available-for-sale in conjunction with ASU 2016-01.

For other information regarding the Company's investment securities portfolio, see Note 4, Note 17 and Note 22 of the Notes to the Consolidated Financial Statements.

Interest Rate Sensitivity Analysis

The principal objective of our asset and liability management function is to evaluate the interest-rate risk included in certain balance sheet accounts; determine the level of risk appropriate given our business focus, operating environment, and capital and liquidity requirements; establish prudent asset concentration guidelines; and manage the risk consistent with Board approved guidelines. We seek to reduce the vulnerability of our operations to changes in interest rates, and actions in this regard are taken under the guidance of the Bank's Asset Liability Committee (the "ALCO"). The ALCO generally reviews our liquidity, cash flow needs, maturities of investments, deposits and borrowings, and current market conditions and interest rates.

We currently utilize net interest income simulation and economic value of equity ("EVE") models to measure the potential impact to the Bank of future changes in interest rates. As of December 31, 2019, and December 31, 2018, the results of the models were within guidelines prescribed by our Board of Directors. If model results were to fall outside prescribed ranges, action, including additional monitoring and reporting to the Board, would be required by the ALCO and Bank's management.

The net interest income simulation model attempts to measure the change in net interest income over the next one-year period, and over the next three-year period on a cumulative basis, assuming certain changes in the general level of interest rates.

Based on our model, which was run as of December 31, 2019, we estimated that over the next one-year period a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 1.55%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 1.71%. As of December 31, 2018, we estimated that over the next one-year period a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 0.40%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 1.21%.

Based on our model, which was run as of December 31, 2019, we estimated that over the next three years, on a cumulative basis, a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 2.86%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 4.86%. As of December 31, 2018, we estimated that over the next three years, on a cumulative basis, a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 1.59%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 2.17%.

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An EVE analysis is also used to dynamically model the present value of asset and liability cash flows with instantaneous rate shocks of up 200 basis points and down 100 basis points. The economic value of equity is likely to be different as interest rates change. Our EVE as of December 31, 2019, would decline by 7.2% with an instantaneous rate shock of up 200 basis points, and increase by 3.69% with an instantaneous rate shock of down 100 basis points. Our EVE as of December 31, 2018, would decline by 12.01% with an instantaneous rate shock of up 200 basis points, and increase by 3.15% with an instantaneous rate shock of down 100 basis points.

The following table illustrates the most recent results for EVE and NII as of December 31, 2019.

Interest Rates (basis points)	Estimated EVE	Estimated Change in EVE		Interest Rates (basis points)	Estimated NII	Estimated Change in NII	
		Amount	%			Amount	%
+300	\$623,042	\$(80,336)	(11.42)	+300	\$191,975	\$5,322	2.85
+200	652,583	(50,795)	(7.22)	+200	189,552	2,899	1.55
+100	679,630	(23,748)	(3.38)	+100	188,399	1,746	0.94
0	703,378	-	0.0	0	186,653	-	0.0
-100	729,344	25,966	3.69	-100	183,453	(3,200)	(1.71)

Estimates of Fair Value

The estimation of fair value is significant to certain assets of the Company, including available-for-sale investment securities. These are all recorded at either fair value or the lower of cost or fair value. Fair values are volatile and may be influenced by a number of factors. Circumstances that could cause estimates of the fair value of certain assets and liabilities to change include a change in prepayment speeds, expected cash flows, credit quality, discount rates, or market interest rates. Fair values for most available-for-sale investment securities are based on quoted market prices. If quoted market prices are not available, fair values are based on judgments regarding future expected loss experience, current economic condition risk characteristics of various financial instruments, and other factors. See Note 22 of the Notes to Consolidated Financial Statements for additional discussion.

These estimates are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Impact of Inflation and Changing Prices

The financial statements and notes thereto presented elsewhere herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the operations; unlike most industrial companies, nearly all of the Company's assets and liabilities are monetary. As a result, interest rates have a greater impact on performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Liquidity

Liquidity is a measure of a bank's ability to fund loans, withdrawals or maturities of deposits, and other cash outflows in a cost-effective manner. Our principal sources of funds are deposits, scheduled amortization and prepayments of loan principal, maturities of investment securities, and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit flow and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

At December 31, 2019, the amount of liquid assets remained at a level management deemed adequate to ensure that, on a short and long-term basis, contractual liabilities, depositors' withdrawal requirements, and other operational and client credit needs could be satisfied. As of December 31, 2019, liquid assets (cash and due from banks, interest-bearing deposits with banks and unencumbered investment securities) were \$506 million, which represented 8.2% of total assets and 9.6% of total deposits and borrowings, compared to \$441.4 million at December 31, 2018, which represented 8.1% of total assets and 9.4% of total deposits and borrowings on such date.

The Bank is a member of the Federal Home Loan Bank of New York and, based on available qualified collateral as of December 31, 2019, had the ability to borrow \$1.9 billion. In addition, at December 31, 2019, the Bank had in place borrowing capacity of \$25 million through correspondent banks. The Bank also has a credit facility established with the Federal Reserve Bank of New York for direct discount

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window borrowings with capacity based on pledged collateral of \$5.4 million. At December 31, 2019, the Bank had aggregate available and unused credit of approximately \$1.1 billion, which represents the aforementioned facilities totaling \$2.0 billion net of \$900 million in outstanding borrowings and letters of credit. At December 31, 2019, outstanding commitments for the Bank to extend credit were \$1.0 billion.

Cash and cash equivalents totaled \$201.5 million on December 31, 2019, increasing by \$29.1 million from \$172.4 million at December 31, 2018. Operating activities provided \$60.7 million in net cash. Investing activities used \$102.5 million in net cash, primarily reflecting an increase in loans and net cash flow from the securities portfolio. Financing activities provided \$70.9 million in net cash, primarily reflecting a net increase of \$260.5 million in deposits, offset by net FHLB repayments of \$165.2 million.

Deposits

Deposits are our primary source of funds. Average total deposits increased \$775 million, or 20.1% to \$4.6 billion in 2019 from \$3.9 billion in 2018 and increased \$392 million, or 11.3% to \$3.9 billion in 2018 from 2017. The increase in total average deposits in 2019 was primarily attributable to both the acquisition of GHB and organic growth, while the increase in 2018 was attributable to organic growth.

The following table sets forth the year-to-date average balances and weighted average rates for various types of deposits for 2019, 2018 and 2017.

	2019		2018		2017	
	Balance	Rate	Balance	Rate	Balance	Rate
(dollars in thousands)						
Demand, noninterest-bearing	\$ 819,917	—	\$ 745,548	—	\$ 681,215	—
Demand, interest-bearing & NOW	980,669	1.04%	726,665	0.69%	603,796	0.36%
Money market accounts	1,121,605	1.59%	947,157	1.11%	983,956	0.71%
Savings	165,538	0.24%	164,203	0.17%	185,703	0.16%
Time	1,549,700	2.40%	1,278,821	1.89%	1,015,552	1.40%
Total Deposits	<u>\$ 4,637,429</u>	1.41%	<u>\$ 3,862,394</u>	1.03%	<u>\$ 3,470,221</u>	0.68%

The following table sets forth the distribution of total deposit accounts, by account types for each of the dates indicated.

	December 31, 2019		December 31, 2018	
	Amount	% of total	Amount	% of total
(dollars in thousands)				
Demand, noninterest-bearing	\$ 861,728	18.1%	\$ 768,584	18.8%
Demand, interest-bearing & NOW	1,079,621	22.6%	845,424	20.7%
Money market accounts	1,108,983	23.3%	951,276	23.2%
Savings	163,489	3.4%	160,755	3.9%
Time	1,553,721	32.6%	1,366,053	33.4%
Total Deposits	<u>\$ 4,767,542</u>	100.00%	<u>\$ 4,092,092</u>	100.00%

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The following table summarizes the maturity distribution of time deposits in denomination of \$100,000 or more:

	December 31, 2019	December 31, 2018
	(dollars in thousands)	
3 months or less	\$ 244,747	\$ 242,889
Over 3 to 6 months	136,167	126,432
Over 6 to 12 months	242,445	185,871
Over 12 months	301,166	221,266
Total	\$ 924,525	\$ 776,458

Federal Home Loan Bank Advances

Federal Home Loan Bank advances are secured, under the terms of a blanket collateral agreement, primarily by commercial mortgage loans. As of December 31, 2019, the Company had a net carrying value of \$500.3 million in notes outstanding at a weighted average interest rate of 1.96%. As of December 31, 2018, the Company had \$600.0 million in notes outstanding at a weighted average interest rate of 2.59%.

Contractual Obligations and Other Commitments

The following table summarizes contractual obligations at December 31, 2019 and the effect such obligations are expected to have on liquidity and cash flows in future periods.

	Total	Less than 1 year	1 – 3 years	4 – 5 years	Over 5 years
December 31, 2019					
Contractual obligations:					
Operating lease obligations	\$ 20,363	\$ 3,681	\$ 5,696	\$ 4,340	\$ 6,646
Other long-term liabilities/long-term debt:					
Time Deposits	1,553,721	1,086,493	432,806	34,422	-
Federal Home Loan Bank advances and repurchase agreements	500,293	400,000	72,737	25,000	2,556
Capital lease	2,319	321	641	676	681
Subordinated debentures	128,885	-	-	-	128,885
Total other long-term liabilities/long-term debt	2,185,218	1,486,814	506,184	60,098	132,122
Other commercial commitments – off balance sheet:					
Commitments under commercial loans and lines of credit	564,444	367,486	185,802	11,156	-
Home equity and other revolving lines of credit	47,278	13,562	11,177	15,718	6,821
Outstanding commercial mortgage loan commitments	392,225	212,683	179,196	-	346
Standby letters of credit	32,155	29,421	670	2,064	-
Overdraft protection lines	752	448	50	-	254
Total off-balance sheet arrangements and contractual obligations	1,036,854	623,600	376,895	28,938	7,421
Total contractual obligations and other commitments	\$ 3,242,435	\$ 2,114,095	\$ 888,775	\$ 93,376	\$ 146,189

Capital

The maintenance of a solid capital foundation continues to be a primary goal for the Company. Accordingly, capital plans and dividend policies are monitored on an ongoing basis. The most important objective of the capital planning process is to balance effectively the retention of capital to support future growth and the goal of providing stockholders with an attractive long-term return on their investment.

The Company's Tier 1 leverage capital (defined as tangible stockholders' equity for common stock and Trust Preferred Capital Securities) at December 31, 2019 amounted to \$563.5 million or 9.5% of average total assets. At December 31, 2018, the Company's Tier 1 leverage capital amounted to \$478.9 million or 9.3% of average total assets. The increase in Tier 1 capital reflects the Company's retained earnings during 2019 and the acquisition of GHB.

United States bank regulators have issued guidelines establishing minimum capital standards related to the level of assets and off balance-sheet exposures adjusted for credit risk. Specifically, these guidelines categorize assets and off balance-sheet items into four risk-weightings and require banking institutions to maintain a minimum ratio of capital to risk-weighted assets. At December 31, 2019, the Company's CET 1, Tier 1 and total risk-based capital ratios were 10.0%, 10.0% and 13.0%, respectively. For information on risk-based capital and regulatory guidelines for the Parent Corporation and its bank subsidiary, see Note 16 to the Consolidated Financial Statements.

The foregoing capital ratios are based in part on specific quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the bank regulators regarding capital components, risk weightings, and other factors.

Subordinated Debentures

During December 2003, Center Bancorp Statutory Trust II, a statutory business trust and wholly owned subsidiary of the Parent Corporation issued \$5.0 million of MMCapS capital securities to investors due on January 23, 2034. The trust loaned the proceeds of this offering to the Company and received in exchange \$5.2 million of the Parent Corporation's subordinated debentures. The subordinated debentures are redeemable in whole or part. The floating interest rate on the subordinated debentures is three-month LIBOR plus 2.85% and re-prices quarterly. The rate at December 31, 2019 was 4.79%.

During June 2015, the Parent Corporation issued \$50 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "fixed-to-floating rate Notes") to certain institutional accredited investors. The net proceeds from the sale of the fixed-to-floating rate Notes were used in the first quarter of 2016 to redeem \$11.3 million in the Company's outstanding. Senior Noncumulative Perpetual Preferred Stock issued to the U.S. Treasury under the Small Business Lending Fund Program, and for general corporate purposes, which included the Parent Corporation contributing \$35 million of the net proceeds to the Bank in the form of common equity. The fixed-to-floating rate Notes are non-callable for five years, have a stated maturity of July 1, 2025, and bear interest at a fixed rate of 5.75% per year, from and including June 30, 2015 to, but excluding July 1, 2020. From and including July 1, 2020 to the maturity date or early redemption date, the interest rate will reset quarterly to a level equal to the then current three-month LIBOR rate plus 393 basis points.

During January 2018, the Parent Corporation issued \$75 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "Notes") to certain accredited investors. The net proceeds from the sale of the Notes were used in the first quarter of 2018 for general corporate purposes, which included the Parent Corporation contributing \$65 million of the net proceeds to the Bank in the form of debt and common equity. The Notes are non-callable for five years, have a stated maturity of February 1, 2028 and bear interest at a fixed rate of 5.20% per year, from and including January 17, 2018 to, but excluding February 1, 2023. From and including February 1, 2023 to, but excluding the maturity date, or early redemption date, the interest rate will reset quarterly to a level equal to the then current three-month LIBOR rate plus 284 basis points.

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Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Interest Sensitivity

Market Risk

Interest rate risk management is our primary market risk. See “Item 7- Management’s Discussion and Analysis of Financial Condition and Results of Operation- Interest Rate Sensitivity Analysis” herein for a discussion of our management of our interest rate risk.

Item 8. Financial Statements and Supplementary Data

All Financial Statements:

The following financial statements are filed as part of this report under Item 8 - “Financial Statements and Supplementary Data.”

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Consolidated Statements of Changes in Stockholders’ Equity	53
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
ConnectOne Bancorp, Inc. and Subsidiaries
Englewood Cliffs, New Jersey

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated statements of financial condition of ConnectOne Bancorp, Inc. and Subsidiaries (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2019 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

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

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

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

Definition and Limitations of Internal Control over Financial Reporting

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

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

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that: (i) relate to accounts or disclosures that are material to the consolidated financial statements and (ii) involved especially challenging, subjective, or complex judgments. The communication of the critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing a separate opinion on the critical audit matters or on the accounts or disclosures to which they relate.

Allowance for Loan Losses – Exogenous Factors Related to Commercial, Commercial Real Estate, and Commercial Construction Loan Segments

The allowance for loan losses represents management's estimate of probable incurred credit losses inherent in the loan portfolio. As described in Notes 1 and 5 to the consolidated financial statements, the Company's consolidated allowance for loan losses was \$38,293,000 at December 31, 2019, which consisted of the allowance for loans losses allocated to 1) loans individually evaluated for impairment, representing \$1,267,000, 2) loans collectively evaluated for impairment ("general component"), representing \$35,685,000, and 3) loans acquired, representing \$1,242,000, as well as an unallocated allowance for loan losses of \$99,000. The general component can be further broken down as the general component related to the commercial, commercial real estate, and commercial construction loan segments of \$34,020,000 and the general component related to the residential real estate and consumer segments of \$1,665,000. The general component is based on historical loss experience adjusted for current factors. This actual loss experience is supplemented with exogenous factor adjustments based on the risks present for each loan category. Changes in these exogenous factor adjustments related to the commercial, commercial real estate, and commercial construction loan segments could have a material impact on the Company's financial results.

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The general component of the Company's allowance for loan losses involves consideration of the following exogenous factors: concentrations of credit; delinquency and nonaccrual trends; economic and business conditions including evaluation of the national and regional economies and industries with significant loan concentrations; external factors including legal, regulatory or competitive pressures that may impact the loan portfolio; changes in the experience, ability, or size of the lending staff, management, or board of directors that may impact the loan portfolio; changes in underwriting standards, collection procedures, charge-off practices, or other changes in lending policies and procedures that may impact the loan portfolio; loss and recovery trends; changes in portfolio size and mix; and trends in problem loans. The consideration of these factors contributes significantly to the general component of the allowance for loan losses for the commercial, commercial real estate, and commercial construction loan segments. Management's analysis of these exogenous factors requires significant judgment, and management's allocation of exogenous factors relies on a qualitative analysis to determine the quantitative impact the exogenous factors have on the general component for the commercial, commercial real estate, and commercial construction loan segments. We identified auditing management's analysis and allocation of the exogenous factors to the general component of the allowance for loan losses for the commercial, commercial real estate, and commercial construction loan segments as a critical audit matter as it involved especially subjective auditor judgment.

The primary audit procedures we performed to address this critical audit matter included:

- Testing the effectiveness of controls over the evaluation of the exogenous factors used to estimate the general component for the commercial, commercial real estate, and commercial construction loan segments, including controls addressing:
 - Management's review of the completeness and accuracy of data used as the basis for the adjustments relating to exogenous factors;
 - Management's judgments related to the qualitative and quantitative assessment of the data used in the determination of qualitative reserve factors and the resulting allocation to the allowance allocated to loans collectively evaluated for impairment; and,
 - Management's review of the exogenous factor reserve for mathematical accuracy.
- Substantively testing management's process, including evaluating their judgments and assumptions, for developing the exogenous factors used to estimate the general component for the commercial, commercial real estate, and commercial construction loan segments which included:
 - Evaluation of the completeness and accuracy of data used as a basis for the adjustments relating to exogenous factors;
 - Evaluation of the reasonableness of management's judgments related to the qualitative and quantitative assessment of the data used in the determination of exogenous factors and the resulting allocation to the allowance allocated to loans collectively evaluated for impairment. Among other procedures, our evaluation considered actual charge offs, loan portfolio performance and third-party data, and whether such assumptions were applied consistently period over period;
 - Analytically evaluating the exogenous factor allocation year over year for reasonableness; and,
 - Recalculation of the exogenous factor reserve.

Business Combinations – Fair Value of Acquired Non-Credit-Impaired Loans

As described in Note 2 to the consolidated financial statements, on January 2, 2019 the Company completed its acquisition of Greater Hudson Bank. The business combination was accounted under the acquisition method of accounting, with assets acquired and liabilities assumed recorded at fair value as of the acquisition date. The fair value of loans acquired in the acquisition totaled \$362,914,000, which included \$356,493,000 of non-credit-impaired loans and \$6,421,000 of credit-impaired loans. The fair values of loans acquired were estimated based on the value of the expected cash flows, which were projected based on the contractual terms of loans, including both maturity and contractual amortization. Projected cash flows were adjusted for expected losses and prepayments, where appropriate. Expected losses assumptions were developed using peer group loss data. Projected cash flows were then discounted to present value using a discount rate developed based on the relative risk of the cash flows, considering the loan type, liquidity risk, the maturity of the loans, servicing costs and a required return on capital. Changes in these estimates and assumptions could have a significant impact on the fair values of the acquired non-credit-impaired loans. We identified auditing the fair value of acquired non-credit-impaired loans as a critical audit matter as it involved especially subjective auditor judgment.

The primary audit procedures we performed to address this critical audit matter included:

- Testing the effectiveness of controls over the judgments, assumptions and data used to estimate the fair value of acquired non-credit-impaired loans, including controls addressing:
 - Management’s evaluation of the reasonableness of the judgments and assumptions used to estimate fair value; and,
 - Management’s review of the completeness and accuracy of the data used.
- Substantively testing management’s process, including evaluating their judgments and assumptions, for estimating the fair value of acquired non-credit-impaired loans which included:
 - Evaluation of the reasonableness of judgments and assumptions used by management;
 - Evaluation of the completeness and accuracy of the data used; and,
 - Utilization of a valuation specialist to evaluate the appropriateness of the judgments, assumptions and data used and overall reasonableness of the fair values.

/s/ Crowe LLP

We have served as the Company’s auditor since 2014.

New York, New York
March 2, 2020

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2019	2018
(in thousands, except share data)		
ASSETS		
Cash and due from banks	\$ 65,717	\$ 39,161
Interest-bearing deposits with banks	135,766	133,205
Cash and cash equivalents	201,483	172,366
Securities available-for-sale	404,701	412,034
Equity securities	11,185	11,460
Loans held-for-sale	33,250	-
Loans receivable	5,113,527	4,541,092
Less: Allowance for loan losses	38,293	34,954
Net loans receivable	5,075,234	4,506,138
Investment in restricted stock, at cost	27,397	31,136
Bank premises and equipment, net	19,236	19,062
Accrued interest receivable	20,949	18,214
Bank owned life insurance	137,961	113,820
Right of use operating lease assets	15,137	-
Goodwill	162,574	145,909
Core deposit intangibles	5,460	1,737
Other assets	59,465	30,216
Total assets	\$ 6,174,032	\$ 5,462,092
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 861,728	\$ 768,584
Interest-bearing	3,905,814	3,323,508
Total deposits	4,767,542	4,092,092
Borrowings	500,293	600,001
Operating lease liabilities	16,449	-
Subordinated debentures	128,885	128,556
Other liabilities	29,673	27,516
Total liabilities	5,442,842	4,848,165
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred Stock:		
Authorized 5,000,000 shares	-	-
Common stock, no par value:		
Authorized 55,000,000 shares; issued 37,676,006 shares at December 31, 2019 and 34,392,464 shares at December 31, 2018; outstanding 35,072,066 shares at December 31, 2019 and 32,328,542 at December 31, 2018	468,571	412,546
Additional paid-in capital	21,344	15,542
Retained earnings	271,782	211,345
Treasury stock, at cost (2,603,940 shares at December 31, 2019 and 2,063,922 shares at December 31, 2018)	(29,360)	(16,717)
Accumulated other comprehensive loss	(1,147)	(8,789)
Total stockholders' equity	731,190	613,927
Total liabilities and stockholders' equity	\$ 6,174,032	\$ 5,462,092

See the accompanying notes to the consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2019	2018	2017
(dollars in thousands, except for per share data)			
Interest income:			
Interest and fees on loans	\$ 255,479	\$ 201,524	\$ 168,824
Interest and dividends on investment securities:			
Taxable	9,131	8,482	6,799
Tax-exempt	3,929	3,276	3,569
Dividends	1,778	2,012	1,421
Interest on federal funds sold and other short-term investments	1,167	839	711
Total interest income	271,484	216,133	181,324
Interest expense:			
Deposits	65,570	39,936	23,670
Borrowings	19,595	18,982	12,585
Total interest expense	85,165	58,918	36,255
Net interest income	186,319	157,215	145,069
Provision for loan losses	8,100	21,100	6,000
Net interest income after provision for loan losses	178,219	136,115	139,069
Noninterest income:			
Annuity and insurance commissions	-	-	39
Income on bank owned life insurance	3,484	3,094	3,181
Net gains on sale of loans held-for-sale	512	61	708
Deposit, loan and other income	4,025	2,584	2,680
Net gains (losses) on equity securities	294	(266)	-
Net (losses) gains on sale of investment securities	(280)	-	1,596
Total noninterest income	8,035	5,473	8,204
Noninterest expense:			
Salaries and employee benefits	49,021	39,556	34,878
Occupancy and equipment	9,712	8,312	8,163
FDIC insurance	2,011	3,115	3,485
Professional and consulting	5,506	3,568	2,863
Marketing and advertising	1,353	980	996
Data processing	4,503	4,421	4,543
Merger expenses	8,955	1,335	-
Loss on extinguishment of debt	1,047	-	-
Amortization of core deposit intangible	1,408	627	724
Other components of net periodic pension expense	114	28	250
Increase in valuation allowance, loans held-for-sale	-	-	15,592
Other expenses	8,598	8,512	7,265
Total noninterest expenses	92,228	70,454	78,759
Income before income tax expense	94,026	71,134	68,514
Income tax expense	20,631	10,782	25,294
Net income	\$ 73,395	\$ 60,352	\$ 43,220
Earnings per common share:			
Basic	\$ 2.08	\$ 1.87	\$ 1.35
Diluted	2.07	1.86	1.34

See the accompanying notes to the consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,		
	2019	2018	2017
(dollars in thousands)			
Net income	\$ 73,395	\$ 60,352	\$ 43,220
Other comprehensive income:			
Unrealized gains and losses:			
Unrealized holding gains (losses) on available-for-sale securities arising during the period	11,286	(6,444)	(1,350)
Tax effect	(2,923)	1,638	532
Net of tax	8,363	(4,806)	(818)
Reclassification adjustment for realized losses (gains) included in net income	280	-	(1,596)
Tax effect	(79)	-	579
Net of tax	201	-	(1,017)
Unrealized (losses) gains on cash flow hedges	(755)	825	304
Tax effect	213	(228)	(124)
Net of tax	(542)	597	180
Reclassification adjustment for (gains) losses arising during this period	(677)	(464)	406
Tax effect	190	130	(166)
Net of tax	(487)	(334)	240
Unrealized pension plan (losses) gains:			
Unrealized pension plan gains (losses) before reclassifications	(209)	236	(2)
Tax effect	59	(67)	1
Net of tax	(150)	169	(1)
Reclassification adjustment for realized losses included in net income	358	359	412
Tax effect	(101)	(101)	(169)
Net of tax	257	258	243
Total other comprehensive income (loss)	7,642	(4,116)	(1,173)
Total comprehensive income	<u>\$ 81,037</u>	<u>\$ 56,236</u>	<u>\$ 42,047</u>

See the accompanying notes to the consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Preferred Stock	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
(in thousands, except share and per share data)							
Balance as of December 31, 2016	\$ -	\$ 412,726	\$ 11,407	\$ 126,462	\$ (16,717)	\$ (2,846)	\$ 531,032
Net income	-	-	-	43,220	-	-	43,220
Other comprehensive loss, net of taxes	-	-	-	-	-	(1,173)	(1,173)
Cash dividends declared on common stock (\$0.30 per share)	-	-	-	(9,657)	-	-	(9,657)
Issuance costs of common stock	-	(180)	-	-	-	-	(180)
Exercise of stock options (66,389 shares)	-	-	417	-	-	-	417
Restricted stock, net of forfeitures (57,164 shares)	-	-	-	-	-	-	-
Stock-based compensation expense	-	-	1,778	-	-	-	1,778
Balance as of December 31, 2017	\$ -	\$ 412,546	\$ 13,602	\$ 160,025	\$ (16,717)	\$ (4,019)	\$ 565,437
Reclassification of stranded tax effects (ASU 2018-02) (see Note 17)	-	-	-	709	-	(709)	-
Cumulative effect of adopting ASU 2016-01 (see Note 17)	-	-	-	(55)	-	55	-
Net income	-	-	-	60,352	-	-	60,352
Other comprehensive loss, net of tax	-	-	-	-	-	(4,116)	(4,116)
Cash dividends declared on common stock (\$0.30 per share)	-	-	-	(9,686)	-	-	(9,686)
Exercise of stock options (189,992 shares)	-	-	875	-	-	-	875
Restricted stock, net of forfeitures (24,018 shares)	-	-	-	-	-	-	-
Net shares issued in satisfaction of performance units earned (42,672 shares)	-	-	(819)	-	-	-	(819)
Stock-based compensation expense	-	-	1,884	-	-	-	1,884
Balance as of December 31, 2018	\$ -	\$ 412,546	\$ 15,542	\$ 211,345	\$ (16,717)	\$ (8,789)	\$ 613,927
Net income	-	-	-	73,395	-	-	73,395
Other comprehensive income, net of tax	-	-	-	-	-	7,642	7,642
Cash dividends declared on common stock (\$0.36 per share)	-	-	-	(12,958)	-	-	(12,958)
Repurchase of stock (540,018 shares)	-	-	-	-	(12,643)	-	(12,643)
Net shares issued in satisfaction of restricted stock units earned (4,904 shares)	-	-	-	-	-	-	-
Exercise of stock options (38,937 shares)	-	-	360	-	-	-	360
Restricted stock, net of forfeitures (56,772 shares)	-	-	-	-	-	-	-
Net shares issued in satisfaction of performance units earned (31,425 shares)	-	-	196	-	-	-	196
Stock issued (3,032,496 shares) in acquisition of GHB	-	56,025	-	-	-	-	56,025
Stock issued (119,008 shares) in acquisition of BoeFly, LLC	-	-	2,500	-	-	-	2,500
Stock-based compensation expense	-	-	2,746	-	-	-	2,746
Balance as of December 31, 2019	\$ -	\$ 468,571	\$ 21,344	\$ 271,782	\$ (29,360)	\$ (1,147)	\$ 731,190

See the accompanying notes to the consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
(dollars in thousands)	2019	2018	2017
Cash flows from operating activities			
Net income	\$ 73,395	\$ 60,352	\$ 43,220
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of premises and equipment	3,053	3,062	3,151
Provision for loan losses	8,100	21,100	6,000
Increase to valuation allowance, loans held-for-sale	-	-	15,592
Amortization of intangibles	1,408	627	724
Net accretion of loans	(5,056)	(1,127)	(2,073)
Accretion on bank premises	(86)	(67)	(74)
Accretion on deposits	(1,149)	(57)	(31)
Amortization (accretion) on borrowings	209	(76)	(203)
Net deferred income tax expense	104	926	3,699
Stock-based compensation	2,942	1,884	1,778
Losses (gains) on sales of investment securities, net	280	-	(1,596)
Change in fair value of equity securities, net	(294)	267	-
Gains on sale of loans held-for-sale, net	(512)	(61)	(708)
Loans originated for resale	(20,499)	(4,121)	(9,083)
Loss on extinguishment of debt	1,047	-	-
Proceeds from sale of loans held-for-sale	21,011	4,552	63,731
Net (gains) losses on disposition of premises and equipment	(8)	26	(8)
Net (gains) losses on sale of other real estate owned	(8)	192	82
Increase in cash surrender value of bank owned life insurance	(3,484)	(3,094)	(2,952)
Amortization of premiums and accretion of discounts on investments securities, net	4,299	3,233	2,631
Amortization of subordinated debt issuance costs	329	332	165
Increase in accrued interest receivable	(301)	(2,744)	(2,505)
Net change in operating leases	1,312	-	-
(Increase) decrease in other assets	(22,619)	(1,134)	5,706
(Decrease) increase in other liabilities	(2,785)	4,988	3,887
Net cash provided by operating activities	60,688	89,060	131,133
Cash flows from investing activities			
Investment securities available-for-sale:			
Purchases	(225,853)	(140,013)	(224,621)
Sales	183,728	-	29,543
Maturities, calls and principal repayments	178,116	141,859	109,104
Net redemptions (purchases) of restricted investment in bank stocks	3,739	2,361	(9,187)
Sales of equity securities	569	-	-
Loans held-for-sale payments	47	159	3,122
Net increase in loans	(243,430)	(362,625)	(714,159)
Purchases of premises and equipment	(1,527)	(2,051)	(2,661)
Purchases of bank owned life insurance	(10,000)	-	(10,000)
Proceeds from life insurance death benefits	-	585	-
Proceeds from sale of premises and equipment	18	1,627	8
Cash and cash equivalents acquired in acquisitions, net	11,211	-	-
Proceeds from sale of other real estate owned	915	884	1,124
Net cash used in investing activities	(102,467)	(357,214)	(817,727)
Cash flows from financing activities			
Net increase in deposits	260,489	297,021	450,888
Increase in subordinated debt	-	73,525	-
Advances of FHLB borrowings	2,597,000	1,733,000	1,280,000
Repayments of FHLB borrowings	(2,762,150)	(1,803,000)	(1,071,000)
Repayment of repurchase agreement	-	-	(15,000)
Cash dividends paid on common stock	(12,160)	(9,664)	(9,612)
Issuance cost of common stock	-	-	(180)
Purchase of treasury stock	(12,643)	-	-
Tax benefit of options exercised	-	-	264
Proceeds from exercise of stock options	360	875	417
Net shares issued in satisfaction of performance units earned	-	(819)	-
Net cash provided by financing activities	70,896	290,938	635,777
Net change in cash and cash equivalents	29,117	22,784	(50,817)
Cash and cash equivalents at beginning of period	172,366	149,582	200,399
Cash and cash equivalents at end of period	\$ 201,483	\$ 172,366	\$ 149,582

Supplemental disclosures of cash flow information:**Cash payments for:**

Interest paid	\$	88,522	\$	55,662	\$	36,721
Income taxes paid		18,497		9,092		16,205

Supplemental disclosures of noncash investing activities:

Transfer of loans to other real estate owned	907	538	1,118
Transfer of loan held-for-sale to loans held-for-investment	-	45,552	54,422
Transfer of loans held-for-investment to loans held-for-sale	33,297	21,236	73,916

Business combinations:

Fair value of net assets acquired, net of cash and cash equivalents	534,146	-	-
Fair value of liabilities assumed	488,475	-	-

See the accompanying notes to the consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a - Nature of Business, Basis of Financial Statement Presentation and Summary of Significant Accounting Policies

Business

ConnectOne Bancorp, Inc. (the “Parent Corporation”) is incorporated under the laws of the State of New Jersey and is a registered bank holding company. The Parent Corporation’s business currently consists of the operation of its wholly-owned subsidiary, ConnectOne Bank (the “Bank” and, collectively with the Parent Corporation and the Parent Corporation’s subsidiaries, the “Company”). The Bank’s subsidiaries include Union Investment Co. (a New Jersey investment company), Twin Bridge Investment Co. (a Delaware investment company), ConnectOne Preferred Funding Corp. (a New Jersey real estate investment trust), Center Financial Group, LLC (a New Jersey financial services company), Center Advertising, Inc. (a New Jersey advertising company), Morris Property Company, LLC, (a New Jersey limited liability company), Volosin Holdings, LLC, (a New Jersey limited liability company), NJCB Spec-1, LLC (a New Jersey limited liability company) and BoeFly, Inc. (a New Jersey online business lending marketplace).

The Bank is a community-based, full-service New Jersey-chartered commercial bank that was founded in 2005. The Bank operates from its headquarters located at 301 Sylvan Avenue in the Borough of Englewood Cliffs, Bergen County, New Jersey and through its thirty other banking offices. Substantially all loans are secured with various types of collateral, including business assets, consumer assets and commercial/residential real estate. Each borrower’s ability to repay its loans is dependent on the conversion of assets, cash flows generated from the borrowers’ business, real estate rental and consumer wages.

Basis of Financial Statement Presentation

The consolidated financial statements of the Parent Corporation are prepared on an accrual basis and include the accounts of the Parent Corporation and the Company. All significant intercompany accounts and transactions have been eliminated from the accompanying consolidated financial statements.

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles.

Segments

FASB ASC 28, “Segment Reporting,” requires companies to report certain information about operating segments. The Company is managed as one segment: a community bank. All decisions including but not limited to loan growth, deposit funding, interest rate risk, credit risk and pricing are determined after assessing the effect on the totality of the organization. For example, loan growth is dependent on the ability of the organization to fund this growth through deposits or other borrowings. As a result, the Company is managed as one operating segment.

Use of Estimates

In preparing the consolidated financial statements, management has made estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of condition and that affect the results of operations for the periods presented. Actual results could differ significantly from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash, deposits with other financial institutions with maturities of less than 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other financial institutions, and federal funds purchased and repurchase agreements.

Investment Securities

The Company accounts for its investment securities in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 320-10-05. Investments are classified into the following categories: (1) held-to-maturity securities, for which the Company has both the positive intent and ability to hold until maturity, which are reported at amortized cost; (2) trading securities, which are purchased and held principally for the purpose of selling in the near term and are reported at fair value with unrealized gains and losses included in earnings; and (3) available-for-sale securities, which do not meet the criteria of the other two categories and which management believes may be sold prior to maturity due to changes in interest rates, prepayment risk, liquidity or other factors, and are reported at fair value, with unrealized gains and losses, net of applicable income taxes, reported as a component of accumulated other comprehensive income, which is included in stockholders’ equity and excluded from earnings.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a - Nature of Business, Basis of Financial Statement Presentation and Summary of Significant Accounting Policies – (continued)

Investment securities are adjusted for amortization of premiums and accretion of discounts as adjustments to interest income, which are recognized on a level yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Investment securities gains or losses are determined using the specific identification method.

Securities are evaluated on at least a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether a decline in their value is other-than-temporary. FASB ASC 320-10-65 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, FASB ASC 320-10-65 changed the presentation and amount of the other-than-temporary impairment recognized in the Consolidated Statement of Income. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized through earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized through other comprehensive income.

Equity Securities

The Company's equity securities are recorded at fair value, with unrealized gains and losses included in earnings beginning January 1, 2018 after adoption of Accounting Standards Update No. 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. Prior to January 1, 2018, unrealized gains and losses on equity securities were excluded from earnings and reported in other comprehensive income (loss), net of tax. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific-identification method.

Loans Held-for-Sale

Residential mortgage loans, originated and intended for sale in the secondary market, are carried at the lower of aggregate cost or estimated fair value as determined by outstanding commitments from investors. For these loans originated and intended for sale, gains and losses on loan sales (sale proceeds minus carrying value) are recorded in other income and direct loan origination costs and fees are deferred at origination of the loan and are recognized in other income upon sale of the loan.

Other loans held-for-sale are carried at the lower of aggregate cost or estimated fair value. Fair value on these loans is determined based on the terms of the loan, such as interest rate, maturity date, reset term, as well as sales of similar assets.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, purchase premium and discounts and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Loan segments are defined as a group of loans, which share similar initial measurement attributes, risk characteristics, and methods for monitoring and assessing credit risk. Management has determined that the Company has five segments of loans: commercial, commercial real estate, commercial construction, residential real estate (including home equity) and consumer.

Loans that are 90 days past due are placed on nonaccrual and previously accrued interest is reversed and charged against interest income unless the loans are both well-secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans 90 days or greater past due and still accruing include both smaller balance homogeneous loans that are collectively evaluated for impairment and loans individually evaluated for impairment.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a - Nature of Business, Basis of Financial Statement Presentation and Summary of Significant Accounting Policies – (continued)

The policy of the Company is to generally grant commercial, residential and consumer loans to residents and businesses within its New Jersey and New York market area. The borrowers' abilities to repay their obligations are dependent upon various factors including the borrowers' income and net worth, cash flows generated by the borrowers' underlying collateral, value of the underlying collateral, and priority of the lender's lien on the property. Such factors are dependent upon various economic conditions and individual circumstances beyond the control of the Company. The Company is therefore subject to risk of loss. The Company believes its lending policies and procedures adequately minimize the potential exposure to such risks and that adequate provisions for loan losses are provided for all known and inherent risks. Collateral and/or personal guarantees are required for a large majority of the Company's loans.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans for which the terms have been modified as a concession to the borrower due to the borrower experiencing financial difficulties are considered troubled debt restructurings ("TDR") and are classified as impaired. The impairment of a loan can be measured at (1) the fair value of the collateral less costs to sell, if the loan is collateral dependent, (2) at the value of expected future cash flows using the loan's effective interest rate, or (3) at the loan's observable market price. Generally, the Bank measures impairment of such loans by reference to the fair value of the collateral less costs to sell.

Loans of \$250,000 and over are individually evaluated for impairment. If a loan is identified as impaired and the individual test results in an impairment, a portion of the allowance is allocated so that the loan is reported, net, at the fair value of collateral less costs to sell if repayment is expected solely from the collateral or at the present value of estimated future cash flows using the loan's existing rate if the loan is dependent on cash flow. Loans with balances less than \$250,000 are collectively evaluated for impairment, and accordingly, are not separately identified for impairment disclosures.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience, the primary factor, is determined by loan segment and is based on the actual loss history experienced by the Bank over an actual three-year rolling calculation. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. This actual loss experience is supplemented with the exogenous factor adjustments based on the risks present for each loan category. These exogenous factors (nine total) include consideration of the following: concentrations of credit; delinquency & nonaccrual trends; economic & business conditions including evaluation of the national and regional economies and industries with significant loan concentrations; external factors including legal, regulatory or competitive pressures that may impact the loan portfolio; changes in the experience, ability, or size of the lending staff, management, or board of directors that may impact the loan portfolio; changes in underwriting standards, collection procedures, charge-off practices, or other changes in lending policies and procedures that may impact the loan portfolio; loss and recovery trends; changes in portfolio size and mix; and trends in problem loans.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a - Nature of Business, Basis of Financial Statement Presentation and Summary of Significant Accounting Policies – (continued)

Purchased Credit-Impaired Loans

The Company acquires groups of loans in conjunction with mergers, some of which have shown evidence of credit deterioration since origination. These purchased credit-impaired loans are recorded at their estimated fair value, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses.

Such purchased credit-impaired loans ("PCI") are identified on an individual basis. The Company estimates the amount and timing of expected cash flows for each loan and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

A PCI loan may be resolved either through a sale of the loan, by working with the customer and obtaining partial or full repayment, by short sale of the collateral, or by foreclosure. A gain or loss on resolution would be recognized based on the difference between the proceeds received and the carrying amount of the loan.

PCI loans that met the criteria for nonaccrual may be considered performing, regardless of whether the customer is contractually delinquent, if management can reasonably estimate the timing and amount of the expected cash flows on such loans and if management expects to fully collect the new carrying value of the loans. As such, management may no longer consider the loans to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable discount.

Derivatives

The Company records cash flow hedges at the inception of the derivative contract based on the Company's intentions and belief as to likely effectiveness as a hedge. Cash flow hedges represent a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. The changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Company formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a - Nature of Business, Basis of Financial Statement Presentation and Summary of Significant Accounting Policies – (continued)

Restricted Stock

The Bank is a member of the Federal Home Loan Bank (“FHLB”) of New York. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Cash dividends on the stock are reported as income.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and Equipment

Land is carried at cost and premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 4 to 30 years. Leasehold improvements are depreciated using the straight-line method over the terms of the respective leases, or the estimated useful lives of the improvements, whichever is shorter. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 10 years.

Leases are classified as operating or finance leases at the lease commencement date. Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. The Company includes lease extension and termination options in the lease term if, after considering relevant economic factors, it is reasonably certain the Company will exercise the option.

Right-of-use assets represent the Company’s right to use an underlying asset for the lease term and lease liabilities represent the Company’s obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of the lease payments over the lease term. The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company has elected not to recognize leases with original terms of 12 months or less on the consolidated balance sheet.

Other Real Estate Owned

Other real estate owned (“OREO”), representing property acquired through foreclosure and held-for-sale, is initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequently, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Costs relating to holding the assets are charged to expenses.

Employee Benefit Plans

The Company has a noncontributory pension plan that covered all eligible employees up until September 30, 2007, at which time the Company froze its defined benefit pension plan. As such, all future benefit accruals in this pension plan were discontinued and all retirement benefits that employees would have earned as of September 30, 2007 were preserved. The Company’s policy is to fund at least the minimum contribution required by the Employee Retirement Income Security Act of 1974. The costs associated with the plan are accrued based on actuarial assumptions and included in salaries and employee benefits expense.

The Company accounts for its defined benefit pension plan in accordance with FASB ASC 715-30. FASB ASC 715-30 requires that the funded status of defined benefit postretirement plans be recognized on the Company’s statement of financial condition and changes in the funded status be reflected in other comprehensive income. FASB ASC 715-30 also requires companies to measure the funded status of the plan as of the date of its fiscal year-end.

The Company maintains a 401(k) employee savings plan to provide for defined contributions which covers substantially all employees of the Company. Employee 401(k) and profit-sharing plan expense is the amount of matching contributions.

Stock-Based Compensation

Stock compensation accounting guidance (FASB ASC 718, “Compensation-Stock Compensation”) requires that the compensation cost related to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a - Nature of Business, Basis of Financial Statement Presentation and Summary of Significant Accounting Policies – (continued)

Stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. See Note 19 of the Notes to Consolidated Financial Statements for a further discussion.

Treasury Stock

Subject to limitations applicable to the Parent Corporation, treasury stock purchases may be made from time to time as, in the opinion of management, market conditions warrant, in the open market or in privately negotiated transactions. Shares repurchased are added to the corporate treasury and will be used for future stock dividends and other issuances. The repurchased shares are recorded as treasury stock, which results in a decrease in stockholders' equity. Treasury stock is recorded using the cost method and accordingly is presented as a reduction of stockholders' equity. During the year ended December 31, 2019, the Parent Corporation repurchased 540,018 shares under a board-approved share repurchase program. During the years ended December 31, 2018 and 2017, the Parent Corporation did not purchase any of its shares.

Goodwill

Goodwill arises from business combinations and is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Company has selected December 31 as the date to perform the annual impairment test. No impairment charge was deemed necessary for the years ended December 31, 2019, 2018 and 2017.

Other Intangible Assets

Other intangible assets consist of core deposit intangibles arising from business combinations that are amortized over their estimated useful lives to their estimated residual value.

Comprehensive Income

Total comprehensive income includes all changes in equity during a period from transactions and other events and circumstances from nonowner sources. The Company's other comprehensive income (loss) is comprised of unrealized holding gains and losses on securities available-for-sale, unrecognized actuarial gains and losses of the Company's defined benefit pension plan and unrealized gains and losses on cash flow hedges, net of taxes.

Restrictions on Cash

Cash on hand or on deposit with the Federal Reserve Bank is required to meet regulatory reserve and clearing requirements.

Dividend Restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Parent Corporation or by the Parent Corporation to the stockholders.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a - Nature of Business, Basis of Financial Statement Presentation and Summary of Significant Accounting Policies – (continued)

Bank Owned Life Insurance

The Company invests in Bank Owned Life Insurance (“BOLI”) to help offset the cost of employee benefits. The change in the cash surrender value of the BOLI is recorded as a component of noninterest income.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

Advertising Costs

The Company recognizes its marketing and advertising cost as incurred.

Reclassifications

Certain reclassifications have been made in the consolidated financial statements and footnotes for 2018 and 2017 to conform to the classifications presented in 2019. Such reclassifications had no impact on net income or stockholders’ equity.

Note 1b –Authoritative Accounting Guidance

Adoption of New Accounting Standards

Effective January 1, 2019, the Company implemented ASU No. 2016-02, “Leases (Topic 842)” (modified by ASU 2018-01 – Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842) and ASU 2018-20 – Leases (Topic 842) Narrow – Scope Improvements for Lessors). ASU 206-02 requires the recognition of a right of use asset and related lease liability by lessees for leases classified as operating leases under current GAAP. See Note 6 for further information regarding leases.

Effective January 1, 2018, the Company implemented ASU 2016-01, “*Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.*” The guidance affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements of financial instruments. The guidance also resulted in separate classification of equity securities previously included in available-for-sale securities on the consolidated statements of condition with changes in the fair value of the equity securities now being captured in the Consolidated Statement of Income. As a result, the Company recorded a cumulative-effect adjustment to the Consolidated Statement of Condition. See Note 17 - Comprehensive Income for further information. See Note 1 for the Company’s accounting policy on Equity Securities. Adoption of the standard also resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the Consolidated Statements of Condition. See Note 22 for further information regarding the valuation of these loans.

Effective January 1, 2018, the Company implemented ASU 2018-02, “*Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.*” Under ASU 2018-02, the FASB amended existing guidance to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from The Tax Cuts and Jobs Act of 2017. Please see Note 17 for further information.

Effective January 1, 2018, the Company implemented ASU 2017-07, “*Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.*” Under ASU 2017-07, the FASB requires employers to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. See Note 18 for further information.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1b. Authoritative Accounting Guidance – (continued)

Effective January 1, 2018, the Company adopted ASU 2014-09 *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, “ASC 606”), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. Please see Note 25 for further information.

Newly Issued, But Not Yet Effective Accounting Standards

ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Assets Measured at Amortized Cost.” (modified by ASU 2018-19, ASU 2019-04 and ASU 2019-05). ASU 2016-13 requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates and affects loans, debt securities, trade receivables, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. For SEC filers that are not smaller reporting companies, the amendments in this update are effective for the fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company will adopt Topic 326, as required, on January 1, 2020.

The Company’s CECL implementation efforts are continuing to focus on completion of model validation, developing new disclosures, establishing formal policies and procedures and other governance and control documentation. Based on the Company’s portfolio balances, including the level of acquired loans and nonaccretable credit marks on PCI loans, and forecasted economic conditions as of January 1, 2020, management believes the adoption of the CECL standard will result in a material increase to its total current reserves. However, the ultimate amount of the increase will be contingent upon continued validation of our model, testing and refinement of the model methodologies and judgments utilized to determine the estimate. Based on implementation progress to date, the Company believes the capital adequacy requirements to which it and the Bank are subject to, and its business strategies and practices, will not be materially impacted following the adoption on January 1, 2020.

ASU No. 2017-08, “*Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities.*” ASU No. 2017-08 shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 will be effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. We believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

ASU 2018-15, “*Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.*” These amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by these amendments. ASU 2018-15 is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2019. We believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1b. Authoritative Accounting Guidance – (continued)

ASU 2018-14, “*Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans.*” These amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2020. We believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

ASU 2018-13, “*Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.*” The amendments in this update modify disclosure requirements on fair value measurements by removing, modifying and adding certain disclosure requirements. The amendments primarily pertain to Level 3 fair value measurements and depending on the amendment are applied either prospectively or retrospectively. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. We believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

ASU No. 2017-04, “*Intangibles – Goodwill and Other (Topic 350).*” ASU 2017-04 aims to simplify the subsequent measurement of goodwill. Under these amendments, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax-deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. The Board also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets and still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2019. Although management continues to evaluate the potential impact of ASU 2017-04 on our consolidated financial statements, at this time, we believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

Note 2. Business Combinations

Greater Hudson Bank (“GHB”)

On July 11, 2018, the Company entered into an Agreement and Plan of Merger with GHB, under which GHB would merge with and into ConnectOne Bank, with ConnectOne Bank as the surviving bank. This transaction was completed effective January 2, 2019 (“Merger date”). As part of this merger, the Company acquired seven branch offices located in Rockland, Orange and Westchester Counties, New York. Pursuant to the merger agreement, holders of GHB common stock received 0.245 shares of common stock of ConnectOne with cash paid in lieu of fractional shares.

The acquisition of GHB was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration paid were recorded at their estimated fair values as of the acquisition date. The application of the acquisition method of accounting resulted in the recognition of goodwill of \$10.3 million and a core deposit intangible of \$5.1 million. The assets acquired and liabilities assumed and consideration paid in the acquisition of GHB were recorded at their estimated fair values based on management’s best estimates using information available at the date of the acquisition.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Business Combinations – (continued)

In connection with the acquisition, the consideration paid and the fair value of identifiable assets acquired and liabilities assumed as of the date of acquisition are summarized in the following table:

	As of January 2, 2019 (in thousands)
Consideration paid:	
Common stock issued in acquisition	\$ 56,025
Assets acquired:	
Cash and cash equivalents	13,741
Securities available-for-sale	121,672
Commercial loans, net	116,525
Commercial real estate loans, net	174,069
Construction loans, net	46,383
Residential loans, net	25,622
Consumer loans, net	315
Premises and equipment, net	1,624
Accrued interest receivable	2,434
Core deposit intangibles	5,131
Other assets	26,650
Total assets acquired	534,166
Liabilities assumed:	
Deposits	416,110
Borrowings	64,186
Other liabilities	8,179
Total liabilities assumed	488,475
Net assets acquired	45,691
 Goodwill recorded in acquisition	 \$ <u>10,334</u>

The amount of goodwill recorded represents the excess purchase price over the estimated fair value of the net assets acquired by ConnectOne and reflects the economies of scale, increased market share and lending capabilities, greater access to best-in-class banking technology, and related synergies that are expected to result from the acquisition.

Loans acquired in the GHB acquisition were recorded at fair value, and there was no carryover related allowance for loan losses. The fair values of loans acquired from GHB were estimated based on the value of the expected cash flows, which were projected based on the contractual terms of the loans, including both maturity and contractual amortization. The monthly principal and interest cash flows were adjusted for expected losses and prepayments, where appropriate. Expected losses assumptions were developed using peer group loss data. Projected cash flows were then discounted to present value using a discount rate developed based on the relative risk of the cash flows, considering the loan type, liquidity risk, the maturity of the loans, servicing costs and a required return on capital.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 2. Business Combinations – (continued)

The following is a summary of the loans accounted for in accordance with ASC 310-30 that were acquired in the GHB acquisition as of the Merger date:

	As of January 2, 2019 (in thousands)
Contractually required principal and interest acquisition	\$ 19,874
Contractual cash flows not expected to be collected (non-accretable discount)	(12,167)
Expected cash flows at acquisition	7,707
Interest component of expected cash flows (accretable discount)	(1,286)
Fair value of purchased credit – impaired loans	\$ 6,421

Goodwill related to GHB is not amortized for book purposes; however, it is reviewed at least annually for impairment and is not deductible for tax purposes.

The fair value of retail demand and interest-bearing deposit accounts was assumed to approximate the carrying value as those accounts have no stated maturity and are payable on demand. The fair value of time deposits was estimated by discounting the contractual future cash flows using market rates offered for time deposits of similar remaining maturities. The fair value of borrowed funds was estimated by discounting the future cash flows using market rates for similar borrowings.

Direct acquisition and integration costs of the GHB acquisition were expensed as incurred. These items were recorded as merger-related expenses on the consolidated statement of income. Merger expenses related to the GHB acquisition were \$7.6 million for the year ended December 31, 2019.

BoeFly, LLC

On May 31, 2019, ConnectOne Bank, through a wholly owned subsidiary, completed the acquisition of certain assets of New York/Boston-based BoeFly, LLC, which operates an online business lending marketplace connecting small- to medium-sized businesses, largely related to the franchise business sector, with lenders and professional loan brokers across the United States. The business operates as BoeFly, Inc., a wholly owned subsidiary of ConnectOne Bank, and generates fee income and small business lending opportunities for the Bank. The consideration exchanged was a combination of cash, restricted stock and a potential cash earn-out based on predefined business origination targets. The Company recorded \$6.3 million as goodwill on its consolidated statement of condition as of the acquisition date. The acquisition of the assets of BoeFly, LLC were not material to the results of operations or financial condition of the Company.

Direct acquisition and integration costs of the BoeFly, LLC acquisition were expensed as incurred. These items were recorded as merger-related expenses on the consolidated statement of income. Merger expenses related to the BoeFly, LLC acquisition were \$0.3 million for the year ended December 31, 2019.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3. Earnings per Common Share

Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) No. 260-10-45 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (“EPS”). The restricted stock awards granted by the Company contain non-forfeitable rights to dividends and therefore are considered participating securities. The two-class method for calculating basic EPS excludes dividends paid to participating securities and any undistributed earnings attributable to participating securities.

Earnings per common share have been computed based on the following:

	Years Ended December 31,		
	2019	2018	2017
	(in thousands, except per share amounts)		
Net income available to common stockholders	\$ 73,395	\$ 60,352	\$ 43,220
Earnings allocated to participating securities	(295)	(139)	(141)
Income attributable to common stock	<u>\$ 73,100</u>	<u>\$ 60,213</u>	<u>\$ 43,079</u>
Weighted average common shares outstanding, including participating securities	35,289	32,198	31,943
Weighted average participating securities	(84)	(74)	(41)
Weighted average common shares outstanding	35,205	32,124	31,902
Incremental shares from assumed conversions of options, restricted stock units, performance units and restricted stock	88	233	335
Weighted average common and equivalent shares outstanding	<u>32,293</u>	<u>32,357</u>	<u>32,237</u>
Earnings per common share:			
Basic	\$ 2.08	\$ 1.87	\$ 1.35
Diluted	2.07	1.86	1.34

There were no antidilutive common share equivalents as of December 31, 2019, 2018 and 2017.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities

The Company's investment securities are classified as available-for-sale at December 31, 2019 and December 31, 2018. Investment securities available-for-sale are reported at fair value with unrealized gains or losses included in stockholders' equity, net of tax. Accordingly, the carrying value of such securities reflects their fair value as of December 31, 2019 and December 31, 2018. Fair value is based upon either quoted market prices, or in certain cases where there is limited activity in the market for a particular instrument, assumptions are made to determine their fair value. See Note 22 of the Notes to Consolidated Financial Statements for a further discussion.

The following tables present information related to the Company's portfolio of securities available-for-sale at December 31, 2019 and 2018.

	Amortized Cost	Gross Unrealized Gains (dollars in thousands)	Gross Unrealized Losses	Fair Value
December 31, 2019				
Investment securities available-for-sale				
Federal agency obligations	\$ 27,667	\$ 612	\$ (42)	\$ 28,237
Residential mortgage pass-through securities	199,611	1,528	(643)	200,496
Commercial mortgage pass-through securities	4,995	37	(35)	4,997
Obligations of U.S. states and political subdivisions	134,500	2,411	(392)	136,519
Corporate bonds and notes	28,142	285	(45)	28,382
Asset-backed securities	5,845	-	(65)	5,780
Certificates of deposit	148	2	-	150
Other securities	140	-	-	140
Total securities available-for-sale	<u>\$ 401,048</u>	<u>\$ 4,875</u>	<u>\$ (1,222)</u>	<u>\$ 404,701</u>

	Amortized Cost	Gross Unrealized Gains (dollars in thousands)	Gross Unrealized Losses	Fair Value
December 31, 2018				
Investment securities available-for-sale				
Federal agency obligations	\$ 45,509	\$ 51	\$ (605)	\$ 44,955
Residential mortgage pass-through securities	189,721	85	(4,602)	185,204
Commercial mortgage pass-through securities	3,919	-	(45)	3,874
Obligations of U.S. states and political subdivisions	141,496	1,091	(3,402)	139,185
Corporate bonds and notes	26,308	45	(540)	25,813
Asset-backed securities	9,685	22	(16)	9,691
Certificates of deposit	319	3	-	322
Other securities	2,990	-	-	2,990
Total securities available-for-sale	<u>\$ 419,947</u>	<u>\$ 1,297</u>	<u>\$ (9,210)</u>	<u>\$ 412,034</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities – (continued)

Investment securities having a carrying value of approximately \$111.5 million and \$151.5 million at December 31, 2019 and December 31, 2018, respectively, were pledged to secure public deposits, borrowings, repurchase agreements, Federal Reserve Discount Window borrowings and Federal Home Loan Bank advances and for other purposes required or permitted by law. As of December 31, 2019 and December 31, 2018, 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.

The following table presents information for investments in securities available-for-sale at December 31, 2019, based on scheduled maturities. Actual maturities can be expected to differ from scheduled maturities due to prepayment or early call options of the issuer. Securities not due at a single maturity date are shown separately.

	December 31, 2019	
	Amortized Cost	Fair Value
	(dollars in thousands)	
Investment Securities Available-for-Sale:		
Due in one year or less	\$ 4,119	\$ 4,131
Due after one year through five years	28,355	28,644
Due after five years through ten years	26,247	27,000
Due after ten years	137,581	139,293
Residential mortgage pass-through securities	199,611	200,496
Commercial mortgage pass-through securities	4,995	4,997
Other securities	140	140
Total securities available-for-sale	\$ 401,048	\$ 404,701

Gross gains and losses from the sales, calls, and maturities of investment securities for the years ended December 31, 2019, 2018 and 2017 were as follows:

	Years Ended December 31,		
	2019	2018	2017
	(dollars in thousands)		
Proceeds	\$ 183,728	\$ -	\$ 29,543
Gross gains on sales of investment securities	\$ 401	\$ -	\$ 1,596
Gross losses on sales of investment securities	(681)	-	-
Net (losses) gains on sales of investment securities	(280)	-	1,596
Tax provision on net gains	79	-	(579)
Net (losses) gains on sales of investment securities, after tax	\$ (201)	\$ -	\$ 1,017

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities – (continued)

Other-than-Temporarily Impaired Investments

The Company reviews all securities for potential recognition of other-than-temporary impairment. The Company maintains a watch list for the identification and monitoring of securities experiencing problems that require a heightened level of review. This could include credit rating downgrades.

The Company's assessment of whether an impairment in the portfolio is other-than temporary includes factors such as whether the issuer has defaulted on scheduled payments, announced a restructuring and/or filed for bankruptcy, has disclosed severe liquidity problems that cannot be resolved, disclosed deteriorating financial condition or sustained significant losses.

Temporarily Impaired Investments

The Company does not believe that any of the unrealized losses, which were comprised of 53 and 148 securities as of December 31, 2019 and December 31, 2018, respectively, represent an other-than-temporary impairment ("OTTI"). The gross unrealized losses associated with U.S. Treasury and agency securities, federal agency obligations, mortgage-backed securities, corporate bonds, tax-exempt securities, and asset-backed securities are not considered to be other-than-temporary because these unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer.

Factors which may contribute to unrealized losses include credit risk, market risk, changes in interest rates, economic cycles, and liquidity risk. The magnitude of any unrealized loss may be affected by the relative concentration of the Company's investment in any one issuer or industry. The Company has established policies to reduce exposure through diversification of the securities portfolio including limits on concentrations to any one issuer. The Company believes the securities portfolio is prudently diversified.

The unrealized losses included in the tables below are primarily related to changes in interest rates and credit spreads. All of the Company's securities are performing and are expected to continue to perform in accordance with their respective contractual terms and conditions. These are largely intermediate duration holdings and, in certain cases, monthly principal payments can further reduce loss exposure resulting from an increase in rates.

In determining whether or not securities are OTTI, the Company must exercise considerable judgment. Accordingly, there can be no assurance that the actual results will not differ from the Company's judgments and that such differences may not require the future recognition of OTTI charges that could have a material effect on the Company's financial position and results of operations. In addition, the value of, and the realization of any loss on, a security is subject to numerous risks as cited above.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities – (continued)

The following tables indicate gross unrealized losses not recognized in income and fair value, aggregated by investment category and the length of time individual securities have been in a continuous unrealized loss position at December 31, 2019 and 2018. There were no investments held-to-maturity as of December 31, 2019 and 2018.

	Total		December 31, 2019		12 Months or Longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(dollars in thousands)					
Investment Securities Available-for-Sale:						
Federal agency obligation	\$ 6,512	\$ (42)	\$ 6,498	\$ (42)	\$ 14	\$ -
Residential mortgage pass-through securities	94,980	(643)	49,154	(179)	45,826	(464)
Commercial mortgage pass-through securities	2,006	(35)	2,006	(35)	-	-
Obligations of U.S. states and political subdivisions	34,775	(392)	10,306	(8)	24,469	(384)
Corporate bonds and notes	5,437	(45)	2,478	(23)	2,959	(22)
Asset-backed securities	5,718	(65)	2,268	(22)	3,450	(43)
Total Temporarily Impaired Securities	\$ 149,428	\$ (1,222)	\$ 72,710	\$ (309)	\$ 76,718	\$ (913)

	Total		December 31, 2018			
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(dollars in thousands)					
Investment Securities Available-for-Sale:						
Federal agency obligation	\$ 35,472	\$ (605)	\$ 810	\$ (1)	\$ 34,662	\$ (604)
Residential mortgage pass-through securities	178,365	(4,602)	42,040	(393)	136,325	(4,209)
Commercial mortgage pass-through securities	3,874	(45)	-	-	3,874	(45)
Obligations of U.S. states and political subdivisions	64,367	(3,402)	7,765	(21)	56,602	(3,381)
Corporate bonds and notes	15,534	(540)	7,767	(133)	7,767	(407)
Asset-backed securities	3,957	(16)	2,219	(11)	1,738	(5)
Total Temporarily Impaired Securities	\$ 301,569	\$ (9,210)	\$ 60,601	\$ (559)	\$ 240,968	\$ (8,651)

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses

Loans Receivable: The following table sets forth the composition of the Company's loan portfolio segments, including net deferred fees, as of December 31, 2019 and December 31, 2018:

	2019	2018
	(dollars in thousands)	
Commercial	\$ 1,129,661	\$ 988,758
Commercial real estate	3,041,959	2,778,167
Commercial construction	623,326	465,389
Residential real estate	320,020	309,991
Consumer	3,328	2,594
Gross loans	5,118,294	4,544,899
Net deferred fees	(4,767)	(3,807)
Loans receivable	<u>\$ 5,113,527</u>	<u>\$ 4,541,092</u>

At December 31, 2019 and 2018, loan balances of approximately \$2.5 billion and \$2.3 billion, respectively, were pledged to secure borrowings from the Federal Home Loan Bank.

The loan segments in the above table have unique risk characteristics with respect to credit quality:

- The repayment of commercial loans is generally dependent on the creditworthiness and cash flow of borrowers, and if applicable, guarantors, which may be negatively impacted by adverse economic conditions. While the majority of these loans are secured, collateral type, marketing, coverage, valuation and monitoring is not as uniform as in other portfolio classes and recovery from liquidation of such collateral may be subject to greater variability.
- Payment on commercial mortgages is driven principally by operating results of the managed properties or underlying business and secondarily by the sale or refinance of such properties. Both primary and secondary sources of repayment, and value of the properties in liquidation, may be affected to a greater extent by adverse conditions in the real estate market or the economy in general.
- Properties underlying construction, land and land development loans often do not generate sufficient cash flows to service debt and thus repayment is subject to ability of the borrower and, if applicable, guarantors, to complete development or construction of the property and carry the project, often for extended periods of time. As a result, the performance of these loans is contingent upon future events whose probability at the time of origination is uncertain.
- The ability of borrowers to service debt in the residential and consumer loan portfolios is generally subject to personal income which may be impacted by general economic conditions, such as increased unemployment levels. These loans are predominately collateralized by first and/or second liens on single family properties. If a borrower cannot maintain the loan, the Company's ability to recover against the collateral in sufficient amount and in a timely manner may be significantly influenced by market, legal and regulatory conditions.
- The Company considers loan classes and loan segments to be one and the same.

Loans Held-For-Sale: The following table presents loans held-for-sale by loan segment as of December 31, 2019 and December 31, 2018:

	2019	2018
	(dollars in thousands)	
Commercial	\$ 2,285	\$ -
Commercial real estate	30,965	-
Total carrying amount	<u>\$ 33,250</u>	<u>\$ -</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

Purchased Credit-Impaired Loans: The Company holds purchased loans for which there was, at their acquisition date, evidence of deterioration of credit quality since their origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans is as follows as of December 31, 2019 and December 31, 2018.

	2019	2018
	(dollars in thousands)	
Commercial	\$ 5,452	\$ 2,509
Commercial real estate	1,101	-
Total carrying amount	<u>\$ 6,553</u>	<u>\$ 2,509</u>

For those purchased loans disclosed above, the Company did not increase the allowance for loan losses for the years ended December 31, 2019 and 2018. No allowances for loan losses were reversed during 2019 and 2018.

The accretible yield, or income expected to be collected, on the purchased credit-impaired loans above is as follows as of December 31, 2019 and December 31, 2018.

	2019	2018	2017
	(dollars in thousands)		
Balance at January 1,	\$ 1,134	\$ 1,387	2,860
New loans purchased	1,286	-	-
Accretion of income	(1,119)	(253)	(1,473)
Balance at December 31,	<u>\$ 1,301</u>	<u>\$ 1,134</u>	<u>\$ 1,387</u>

Loans Receivable on Nonaccrual Status: The following tables present nonaccrual loans included in loans receivable by loan class as of December 31, 2019 and December 31, 2018:

	2019	2018
	(dollars in thousands)	
Commercial	\$ 31,455	\$ 29,340
Commercial real estate	8,338	15,135
Commercial construction	6,773	2,934
Residential real estate	2,915	4,446
Consumer	-	-
Total loans receivable on nonaccrual status	<u>\$ 49,481</u>	<u>\$ 51,855</u>

Nonaccrual loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and loans individually evaluated for impairment.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

Credit Quality Indicators - The Company continuously monitors the credit quality of its loans receivable. In addition to its internal monitoring, the Company utilizes the services of a third-party loan review firm to periodically validate the credit quality of its loans receivable on a sample basis. Credit quality is monitored by reviewing certain credit quality indicators. Assets classified “Pass” are deemed to possess average to superior credit quality, requiring no more than normal attention. Assets classified as “Special Mention” have generally acceptable credit quality yet possess higher risk characteristics/circumstances than satisfactory assets. Such conditions include strained liquidity, slow pay, stale financial statements, or other conditions that require more stringent attention from the lending staff. These conditions, if not corrected, may weaken the loan quality or inadequately protect the Company’s credit position at some future date. Assets are classified “Substandard” if the asset has a well-defined weakness that requires management’s attention to a greater degree than for loans classified special mention. Such weakness, if left uncorrected, could possibly result in the compromised ability of the loan to perform to contractual requirements. An asset is classified as “Doubtful” if it is inadequately protected by the net worth and/or paying capacity of the obligor or of the collateral, if any, that secures the obligation. Assets classified as doubtful include assets for which there is a “distinct possibility” that a degree of loss will occur if the inadequacies are not corrected. All loans past due 90 days or greater and all impaired loans are included in the appropriate category below.

The following table presents information about the loan credit quality by loan class of gross loans (which exclude net deferred fees) at December 31, 2019 and December 31, 2018:

December 31, 2019					
	Pass	Special Mention	Substandard	Doubtful	Total
	(dollars in thousands)				
Commercial	\$ 1,059,852	\$ 22,159	\$ 47,650	\$ -	\$ 1,129,661
Commercial real estate	3,014,956	10,301	16,702	-	3,041,959
Commercial construction	604,298	4,609	14,419	-	623,326
Residential real estate	316,476	-	3,544	-	320,020
Consumer	3,328	-	-	-	3,328
Gross loans	<u>\$ 4,998,910</u>	<u>\$ 37,069</u>	<u>\$ 82,315</u>	<u>\$ -</u>	<u>\$ 5,118,294</u>

December 31, 2018					
	Pass	Special Mention	Substandard	Doubtful	Total
	(dollars in thousands)				
Commercial	\$ 951,610	\$ 3,371	\$ 33,777	\$ -	\$ 988,758
Commercial real estate	2,742,989	12,574	22,604	-	2,778,167
Commercial construction	453,598	5,515	6,276	-	465,389
Residential real estate	305,414	-	4,577	-	309,991
Consumer	2,576	-	18	-	2,594
Gross loans	<u>\$ 4,456,187</u>	<u>\$ 21,460</u>	<u>\$ 67,252</u>	<u>\$ -</u>	<u>\$ 4,544,899</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

The following table provides an analysis of the impaired loans by class as of and for the years ended December 31, 2019, 2018 and 2017.

December 31, 2019					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
No Related Allowance Recorded					
(dollars in thousands)					
Commercial	\$ 37,984	\$ 83,225		\$ 39,801	\$ 815
Commercial real estate	15,249	15,467		15,421	428
Commercial construction	8,649	8,649		8,394	332
Residential real estate	1,311	1,463		1,311	-
Consumer	-	-		-	-
Total	<u>\$ 63,193</u>	<u>\$ 108,804</u>	<u></u>	<u>\$ 64,927</u>	<u>\$ 1,575</u>
With An Allowance Recorded					
Commercial construction	\$ 3,530	3,530	1,244	3,530	91
Residential real estate	263	263	23	257	11
Total	<u>\$ 3,793</u>	<u>\$ 3,793</u>	<u>1,267</u>	<u>\$ 3,787</u>	<u>\$ 102</u>
Total					
Commercial	\$ 37,984	\$ 83,225	\$ -	\$ 39,801	\$ 815
Commercial real estate	15,249	15,467	-	15,421	428
Commercial construction	12,179	12,179	1,244	11,924	423
Residential real estate	1,574	1,726	23	1,568	11
Consumer	-	-	-	-	-
Total (including related allowance)	<u>\$ 66,986</u>	<u>\$ 112,597</u>	<u>\$ 1,267</u>	<u>\$ 68,714</u>	<u>\$ 1,677</u>
December 31, 2018					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
No Related Allowance Recorded					
(dollars in thousands)					
Commercial	\$ 29,896	\$ 83,596		\$ 31,721	\$ 66
Commercial real estate	16,839	17,935		17,676	149
Commercial construction	9,240	9,240		11,215	493
Residential real estate	2,209	2,521		2,284	-
Consumer	-	-		-	-
Total	<u>\$ 58,184</u>	<u>\$ 113,292</u>	<u></u>	<u>\$ 62,896</u>	<u>\$ 708</u>
With An Allowance Recorded					
Commercial real estate	\$ 1,488	1,488	7	1,511	46
Residential real estate	260	266	29	265	-
Total	<u>\$ 1,748</u>	<u>\$ 1,754</u>	<u>36</u>	<u>\$ 1,776</u>	<u>\$ 46</u>
Total					
Commercial	\$ 29,896	\$ 83,596	\$ -	\$ 31,721	\$ 66
Commercial real estate	18,327	19,423	7	19,187	195
Commercial construction	9,240	9,240	-	11,215	493
Residential real estate	2,469	2,787	29	2,549	-
Consumer	-	-	-	-	-
Total (including related allowance)	<u>\$ 59,932</u>	<u>\$ 115,046</u>	<u>\$ 36</u>	<u>\$ 64,672</u>	<u>\$ 754</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

No Related Allowance Recorded	Recorded Investment	Unpaid Principal Balance	December 31, 2017		Interest Income Recognized
			Related Allowance	Average Recorded Investment	
			(dollars in thousands)		
Commercial	\$ 49,761	\$ 101,066		\$ 10,552	\$ 161
Commercial real estate	23,905	23,976		24,099	585
Commercial construction	6,662	6,662		5,509	322
Residential real estate	3,203	3,442		3,255	-
Consumer	-	-		-	-
Total	\$ 83,531	\$ 135,146		\$ 43,415	\$ 1,068
With An Allowance Recorded					
Commercial real estate	\$ 1,133	\$ 1,133	\$ 39	\$ 1,152	\$ 51
Total					
Commercial	\$ 49,761	\$ 101,066	\$ -	\$ 10,552	\$ 161
Commercial real estate	25,038	25,109	39	25,251	636
Commercial construction	6,662	6,662	-	5,509	322
Residential real estate	3,203	3,442	-	3,255	-
Consumer	-	-	-	-	-
Total (including related allowance)	\$ 84,664	\$ 136,279	\$ 39	\$ 44,567	\$ 1,119

Included in impaired loans at December 31, 2019 and December 31, 2018 are loans that are deemed troubled debt restructurings. Cash basis interest and interest income recognized on accrual basis approximate each other.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

Aging Analysis: The following table provides an analysis of the aging of the loans by class, excluding net deferred fees, that are past due at December 31, 2019 and December 31, 2018 (dollars in thousands):

December 31, 2019							
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans Receivable
Commercial	\$ 239	\$ -	\$ 3,107	\$ 31,455	\$ 34,801	\$ 1,094,860	\$ 1,129,661
Commercial real estate	1,980	490	-	8,338	10,808	3,031,151	3,041,959
Commercial construction	-	-	-	6,773	6,773	616,553	623,326
Residential real estate	3,357	143	-	2,915	6,415	313,605	320,020
Consumer	-	-	-	-	-	3,328	3,328
Total	<u>\$ 5,576</u>	<u>\$ 633</u>	<u>\$ 3,107</u>	<u>\$ 49,481</u>	<u>\$ 58,797</u>	<u>\$ 5,059,497</u>	<u>\$ 5,118,294</u>

Included in the 90 days or greater past due and still accruing category as of December 31, 2019 are purchased credit-impaired loans, net of fair value marks, which accretes income per the valuation at date of acquisition.

December 31, 2018							
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans Receivable
Commercial	\$ 1,673	\$ -	\$ 1,647	\$ 29,340	\$ 32,660	\$ 956,098	\$ 988,758
Commercial real estate	6,162	1,840	-	15,135	23,137	2,755,030	2,778,167
Commercial construction	2,496	564	-	2,934	5,994	459,395	465,389
Residential real estate	3,455	119	-	4,446	8,020	301,971	309,991
Consumer	-	-	-	-	-	2,594	2,594
Total	<u>\$ 13,786</u>	<u>\$ 2,523</u>	<u>\$ 1,647</u>	<u>\$ 51,855</u>	<u>\$ 69,811</u>	<u>\$ 4,475,088</u>	<u>\$ 4,544,899</u>

Included in the 90 days or greater past due and still accruing category as of December 31, 2018 are purchased credit-impaired loans, net of fair value marks, which accretes income per the valuation at date of acquisition.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

The following tables detail, at the period-end presented, the amount of gross loans (excluding loans held-for-sale) that are evaluated individually, and collectively, for impairment, those acquired with deteriorated quality, and the related portion of the allowance for loan losses that are allocated to each loan portfolio segment:

	December 31, 2019						
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Allowance for loan losses							
Individually evaluated for impairment	\$ -	\$ -	\$ 1,244	\$ 23	\$ -	\$ -	\$ 1,267
Collectively evaluated for impairment	8,309	19,967	5,744	1,662	3	99	35,784
Acquired portfolio	40	886	316	-	-	-	1,242
Acquired with deteriorated credit quality	-	-	-	-	-	-	-
Total	\$ 8,349	\$ 20,853	\$ 7,304	\$ 1,685	\$ 3	\$ 99	\$ 38,293
Gross loans							
Individually evaluated for impairment	\$ 37,984	\$ 15,249	\$ 12,179	\$ 1,574	\$ -		\$ 66,986
Collectively evaluated for impairment	1,011,708	2,669,999	578,620	276,177	3,064		4,539,568
Acquired portfolio	74,517	355,610	32,527	42,269	264		505,187
Acquired with deteriorated credit quality	5,452	1,101	-	-	-		6,553
Total	\$ 1,129,661	\$ 3,041,959	\$ 623,326	\$ 320,020	\$ 3,328		\$ 5,118,294
	December 31, 2018						
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Allowance for loan losses							
Individually evaluated for impairment	\$ -	\$ 7	\$ -	\$ 29	\$ -	\$ -	\$ 36
Collectively evaluated for impairment	9,675	17,840	4,519	1,237	2	445	33,718
Acquired portfolio	200	1,000	-	-	-	-	1,200
Acquired with deteriorated credit quality	-	-	-	-	-	-	-
Total	\$ 9,875	\$ 18,847	\$ 4,519	\$ 1,266	\$ 2	\$ 445	\$ 34,954
Gross loans							
Individually evaluated for impairment	\$ 29,896	\$ 18,327	\$ 9,240	\$ 2,469	\$ -		\$ 59,932
Collectively evaluated for impairment	949,129	2,500,132	456,149	263,449	2,484		4,171,343
Acquired portfolio	7,224	259,708	-	44,073	110		311,115
Acquired with deteriorated credit quality	2,509	-	-	-	-		2,509
Total	\$ 988,758	\$ 2,778,167	\$ 465,389	\$ 309,991	\$ 2,594		\$ 4,544,899

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

The Company's allowance for loan losses is analyzed quarterly. Many factors are considered, including growth in the portfolio, delinquencies, nonaccrual loan levels, and other factors inherent in the extension of credit.

A summary of the activity in the allowance for loan losses by loan segment is as follows:

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance at January 1, 2019	\$ 9,875	\$ 18,847	\$ 4,519	\$ 1,266	\$ 2	\$ 445	\$ 34,954
Loan charge-offs	(1,029)	(3,470)	-	(557)	(20)	-	(5,076)
Recoveries	265	30	-	3	17	-	315
Provision for loan losses	(762)	5,446	2,785	973	4	(346)	8,100
Balance at December 31, 2019	<u>\$ 8,349</u>	<u>\$ 20,853</u>	<u>\$ 7,304</u>	<u>\$ 1,685</u>	<u>\$ 3</u>	<u>\$ 99</u>	<u>\$ 38,293</u>

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance at January 1, 2018	\$ 8,233	\$ 17,112	\$ 4,747	\$ 1,050	\$ 1	\$ 605	\$ 31,748
Loan charge-offs	(17,066)	(915)	-	(23)	(7)	-	(18,011)
Recoveries	109	-	-	2	6	-	117
Provision for loan losses	18,599	2,650	(228)	237	2	(160)	21,100
Balance at December 31, 2018	<u>\$ 9,875</u>	<u>\$ 18,847</u>	<u>\$ 4,519</u>	<u>\$ 1,266</u>	<u>\$ 2</u>	<u>\$ 445</u>	<u>\$ 34,954</u>

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance at January 1, 2017	\$ 6,632	\$ 12,583	\$ 4,789	\$ 958	\$ 3	\$ 779	\$ 25,744
Loan charge-offs	(70)	(155)	-	-	(14)	-	(239)
Recoveries	178	51	-	12	2	-	243
Provision for loan losses	1,493	4,633	(42)	80	10	(174)	6,000
Balance at December 31, 2017	<u>\$ 8,233</u>	<u>\$ 17,112</u>	<u>\$ 4,747</u>	<u>\$ 1,050</u>	<u>\$ 1</u>	<u>\$ 605</u>	<u>\$ 31,748</u>

For the year ended December 31, 2018, the loan charge-offs within the commercial loan segment were primarily made up of \$17.0 million in charge-offs related to the taxi medallion portfolio.

Troubled Debt Restructurings

Loans are considered to have been modified in a troubled debt restructuring ("TDRs") when due to a borrower's financial difficulties, the Company makes certain concessions to the borrower that it would not otherwise consider. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Generally, a nonaccrual loan that has been modified in a troubled debt restructuring remains on nonaccrual status for a period of six months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on nonaccrual status.

At December 31, 2019, there were no commitments to lend additional funds to borrowers whose loans were on nonaccrual status or were contractually past due 90 days or greater and still accruing interest, or whose terms have been modified in troubled debt restructurings.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

As of December 31, 2019, TDRs totaled \$52.0 million, of which \$30.6 million were on nonaccrual status and \$21.4 million were performing under their restructured terms. As of December 31, 2018, TDRs totaled \$34.5 million, of which \$23.3 million were on nonaccrual status and \$11.2 million were performing under their restructured terms. The Company has allocated \$1.3 million and \$0- million of specific allowance as of December 31, 2019 and December 31, 2018, respectively. There were no charge-offs in connection with a loan modification at the time of modification during the year ended December 31, 2019, 2018 and 2017. There were no TDRs for which there was a payment default within twelve months following the modification during the year ended December 31, 2019.

The following table presents loans by class modified as TDRs that occurred during the year ended December 31, 2019:

	Number of Loans	Pre-Modification Outstanding Recorded Investment (dollars in thousands)	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	11	\$ 14,558	\$ 14,558
Commercial real estate	3	5,863	5,863
Commercial construction	3	5,630	5,630
Total	17	\$ 26,051	\$ 26,051

Included in the commercial loan segment of the troubled debt restructurings is one taxi medallion loan totaling \$0.3 million. This taxi medallion loan was on nonaccrual status prior to modification, and will remain on nonaccrual status post-modification. All loan modifications during the year ended December 31, 2019 included interest rate reductions and/or maturity extensions.

The following table presents loans by class modified as TDRs that occurred during the year ended December 31, 2018:

	Number of Loans	Pre-Modification Outstanding Recorded Investment (dollars in thousands)	Post-Modification Outstanding Recorded Investment
TDRs			
Commercial	32	\$ 16,017	\$ 16,017
Commercial real estate	3	1,422	1,422
Commercial construction	3	4,773	4,773
Residential real estate	2	454	454
Total	40	\$ 22,666	\$ 22,666

Included in the commercial loan segment of the troubled debt restructurings are 27 taxi medallion loans totaling \$11.2 million. All 27 taxi medallion loans included above were on nonaccrual status prior to modification, and remain on nonaccrual status post-modification. All loan modifications during the year ended December 31, 2018 included interest rate reductions and/or maturity extensions.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans and the Allowance for Loan Losses – (continued)

The following table presents loans by class modified as TDRs that occurred during the year ended December 31, 2017:

	Number of Loans	Pre-Modification Outstanding Recorded Investment (dollars in thousands)	Post-Modification Outstanding Recorded Investment
TDRs			
Commercial	1	\$ 692	\$ 692
Commercial real estate	2	3,007	3,007
Commercial construction	2	6,662	6,662
Residential real estate	1	17	17
Consumer	-	-	-
Total	6	\$ 10,378	\$ 10,378

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Premises and Equipment

Premises and equipment are summarized as follows:

	Estimated Useful Life (Years)	2019 (dollars in thousands)	2018
Land	-	\$ 2,403	\$ 2,403
Buildings	10-25	15,159	15,277
Furniture, fixtures and equipment	3-7	35,637	29,991
Leasehold improvements	10-20	16,842	14,076
Subtotal		70,041	61,747
Less: accumulated depreciation, amortization and fair value adjustments		50,805	42,685
Total premises and equipment, net		<u>\$ 19,236</u>	<u>\$ 19,062</u>

Depreciation and amortization expense of premises and equipment was \$3.1 million, \$3.1 million and \$3.2 million for 2019, 2018 and 2017, respectively.

Finance Leases: The Company acquired a lease agreement for a building under a finance lease. The lease arrangement requires monthly payments through 2028.

The Company has included this lease in premises and equipment as follows:

	2019 (dollars in thousands)	2018
Finance Lease	\$ 3,408	\$ 3,408
Less: accumulated amortization	1,867	1,696
	<u>\$ 1,541</u>	<u>\$ 1,712</u>

The following is a schedule by year of future minimum lease payments under the finance lease, together with the present value of net minimum lease payments at December 31, 2019 (dollars in thousands):

2020	321
2021	321
2022	321
2023	323
2024	353
Thereafter	1,381
Total minimum lease payments	3,020
Less amount representing interest	700
Present value of net minimum lease payments	<u>\$ 2,320</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Premises and Equipment – (continued)

The Company leases certain premises and equipment under operating leases. At December 31, 2019, the Company had lease liabilities totaling \$16.4 million and right-of-use assets totaling \$15.1 million. As of December 31, 2019, the weighted average remaining lease term for operating leases was 7.2 years and the weighted average discount rate used in the measurement of operating lease liabilities was 3.0%. Total lease costs for the year ended December 31, 2019 was \$3.1 million.

Rent expense for both the years ended December 31, 2018 and 2017 prior to adoption of ASU 2016-02, was \$2.3 million.

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total operating lease liability is as follows:

	December 31, 2019 (dollars in thousands)
Lease payments due:	
Less than 1 year	\$ 3,223
1 year through less than 2 years	2,787
2 years through less than 3 years	2,302
3 years through less than 4 years	2,080
4 years through 5 years	1,795
After 5 years	6,287
Total undiscounted cash flows	18,474
Impact of discounting	(2,025)
Total lease liability	<u>\$ 16,449</u>

Note 7 - Goodwill and Other Intangible Assets

A goodwill impairment test is required under ASC 350, Intangibles – Goodwill and Other, and the FASB issued ASU No. 2011-08, “Testing Goodwill for Impairment,” allowing an initial qualitative assessment of goodwill commonly known as step zero impairment testing. In general, the step zero test allows an entity to first assess qualitative factors to determine whether it is more likely than not (i.e., more than 50%) that the fair value of a reporting unit is less than its carrying value. If a step zero impairment test results in the conclusion that it is more likely than not that the fair value of the reporting unit exceeds its carrying value, then no further testing is required.

Step zero impairment testing is an assessment of qualitative factors that affect the likelihood of impairment. Based upon management’s review, the Company’s intangible assets were not impaired and there has been no impairment through December 31, 2019. Management concludes that the ASC 350 goodwill step zero test has been passed, and no further testing is required.

Goodwill

The change in goodwill during the year is as follows:

	2019 (dollars in thousands)	2018
Balance, January 1	\$ 145,909	\$ 145,909
Acquired goodwill	16,665	-
Impairment	-	-
Balance, December 31	<u>\$ 162,574</u>	<u>\$ 145,909</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Goodwill and Other Intangible Assets – (continued)

Acquired Intangible Assets

The table below provides information regarding the carrying amounts and accumulated amortization of total amortized intangible assets as of the dates set forth below.

	Gross Carrying Amount	Accumulated Amortization (dollars in thousands)	Net Carrying Amount
As of December 31, 2019			
Core deposit intangibles	<u>\$ 11,142</u>	<u>\$ (5,682)</u>	<u>\$ 5,461</u>
As of December 31, 2018			
Core deposit intangibles	<u>\$ 6,011</u>	<u>\$ (4,274)</u>	<u>\$ 1,737</u>

Aggregate amortization expense was approximately \$1.4 million, \$0.6 million and \$0.7 million for 2019, 2018 and 2017, respectively. Estimated amortization expense for each of the next five years (dollars in thousands):

2020	\$ 1,135
2021	918
2022	768
2023	619
2024	493

Note 8 – Deposits

Time Deposits

As of December 31, 2019 and 2018, the Company's total time deposits were \$1.6 billion and \$1.4 billion, respectively. Included in time deposits were brokered time deposits of \$399.2 million and \$405.6 million as of December 31, 2019 and 2018, respectively. As of December 31, 2019, the contractual maturities of these time deposits were as follows (dollars in thousands):

2020	\$ 1,086,493
2021	308,622
2022	124,184
2023	31,630
2024	1,732
Sub-Total	\$ 1,552,661
Fair value premium	1,060
Total	\$ 1,553,721

The amount of time deposits with balances of \$250,000 or more was \$331.6 million and \$272.2 million as of December 31, 2019 and 2018, respectively. Included in time deposits with balances of \$250,000 or more were brokered time deposits with balances of \$250,000 or more of \$-0- million and \$8.8 million as of December 31, 2019 and 2018, respectively.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 – FHLB Borrowings

The Company's FHLB borrowings and weighted average interest rates are summarized below:

	December 31, 2019		December 31, 2018	
	Amount	Rate	Amount	Rate
	(dollars in thousands)			
Total FHLB borrowings	\$ 500,293	1.96%	\$ 600,001	2.59%
By remaining period to maturity:				
Less than 1 year	\$ 400,000	1.84%	\$ 405,000	2.57%
1 year through less than 2 years	62,000	2.26%	110,000	2.75%
2 years through less than 3 years	10,737	2.45%	60,000	2.27%
3 years through less than 4 years	25,000	2.92%	-	
4 years through 5 years	-		25,000	2.92%
After 5 Years	2,882	2.43%	-	
Total FHLB borrowings	500,619	1.96%	600,000	2.59%
Fair value (discount) premium	(326)		1	
FHLB borrowings, net	\$ 500,293		\$ 600,001	

The FHLB borrowings are secured by pledges of certain collateral including, but not limited to, U.S. government and agency mortgage-backed securities and a blanket assignment of qualifying first lien mortgage loans, consisting of both residential mortgages and commercial real estate loans.

Advances are payable at stated maturity, with a prepayment penalty for fixed rate advances. All FHLB advances are fixed rates. The advances at December 31, 2019 were primarily collateralized by approximately \$1.9 billion of commercial mortgage and residential loans, net of required over collateralization amounts, under a blanket lien arrangement. At December 31, 2019 the Company had remaining borrowing capacity of approximately \$1.0 billion at FHLB.

Note 10 – Securities Sold under Agreements to Repurchase

The Company has entered into agreements under which it has sold securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. The obligation to repurchase the securities is reflected as a liability in the Company's Consolidated Statement of Condition, while the securities underlying the securities sold under agreements to repurchase remain in the respective asset accounts and are delivered to and held as collateral by third party trustees.

Repurchase agreements are secured borrowings. The Company pledges investment securities to secure those borrowings. Information concerning repurchase agreements is summarized as follows (dollars in thousands):

	2019	2018	2017
Average daily balance during the year	\$ -	\$ -	\$ 6,781
Average interest rate during the year			5.95%
Maximum month-end balance during the year	\$ -	\$ -	\$ 15,000
Weighted average interest rate during the year	-	-	5.95%

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Subordinated Debentures

During 2003, the Company formed a statutory business trust, which exists for the exclusive purpose of (i) issuing Trust Securities representing undivided beneficial interests in the assets of the Trust; (ii) investing the gross proceeds of the Trust securities in junior subordinated deferrable interest debentures (subordinated debentures) of the Company; and (iii) engaging in only those activities necessary or incidental thereto. On December 19, 2003, Center Bancorp Statutory Trust II, a statutory business trust and wholly-owned subsidiary of the Parent Corporation issued \$5.0 million of, MMCapS capital securities to investors due on January 23, 2034. The capital securities presently qualify as Tier 1 capital. The trust loaned the proceeds of this offering to the Company and received in exchange \$5.2 million of the Parent Corporation's subordinated debentures. The subordinated debentures are redeemable in whole or in part prior to maturity. The floating interest rate on the subordinate debentures is three-month LIBOR plus 2.85% and reprices quarterly. The rate at December 31, 2019 was 4.79%. These subordinated debentures and the related income effects are not eliminated in the consolidated financial statements as the statutory business trust is not consolidated in accordance with FASB ASC 810-10. Distributions on the subordinated debentures owned by the subsidiary trust have been classified as interest expense in the Consolidated Statements of Income.

The following table summarizes the mandatory redeemable trust preferred securities of the Company's Statutory Trust II at December 31, 2019 and December 31, 2018.

Issuance Date	Securities Issued	Liquidation Value	Coupon Rate	Maturity	Redeemable by Issuer Beginning
12/19/2003	\$ 5,000,000	\$1,000 per Capital Security	Floating 3-month LIBOR + 285 Basis Points	01/23/2034	01/23/2009

In June 2015, the Parent Corporation issued \$50.0 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "Notes"). The Notes are non-callable for five years, have a stated maturity of July 1, 2025, and bear interest at a fixed rate of 5.75% per year, from and including June 30, 2015 to, but excluding July 1, 2020. From and including July 1, 2020 to the maturity date or early redemption date, the interest rate will reset quarterly to a level equal to the then current three-month LIBOR rate plus 393 basis points. As of December 31, 2019, unamortized costs related to the debt issuance were approximately \$0.1 million.

On January 11, 2018, the Parent Corporation issued \$75 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "2018 Notes"). The 2018 Notes bear interest at 5.20% annually from, and including, the date of initial issuance to, but excluding, February 1, 2023, payable semi-annually in arrears. From and including February 1, 2023 through maturity or earlier redemption, the interest rate shall reset quarterly to an interest rate per annum equal to the then current three-month LIBOR rate plus 284 basis points (2.84%) payable quarterly in arrears. If three-month LIBOR is not available for any reason, then the rate for that interest period will be determined by such alternate method as provided in the Supplemental Indenture. Interest on the 2018 Notes will be paid on February 1, and August 1, commencing August 1, 2018 to but not including February 1, 2023, and from and including February 1, 2023, on February 1, May 1, August 1, and November 1, of each year to but excluding the stated maturity date, unless in any case previously redeemed. As of December 31, 2019, unamortized costs related to this debt issuance were approximately \$1.2 million.

Note 12 - Income Taxes

The current and deferred amounts of income tax expense for 2019, 2018 and 2017 are as follows (dollars in thousands):

	2019	2018	2017
Current:			
Federal	\$ 15,509	\$ 8,902	\$ 21,090
State	5,018	954	505
Subtotal	20,527	9,856	21,595
Deferred:			
Federal	916	2,455	3,876
State	(812)	(1,529)	(177)
Subtotal	104	926	3,699
Income tax expense	\$ 20,631	\$ 10,782	\$ 25,294

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Income Taxes – (continued)

On July 1, 2018 New Jersey Governor Phil Murphy signed Assembly Bill 4202 (“the Bill”) into law. The legislation imposes a temporary surtax on corporations earning New Jersey allocated income in excess of \$1 million of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and of 1.5% for tax years beginning on or after January 1, 2020 through December 31, 2021. The legislation also requires combined filing for members of an affiliated group for tax years beginning on or after January 1, 2019, changing New Jersey’s current status as a separate return state, and limits the deductibility of dividends received. These changes are not temporary. Although regulations implementing the legislative changes have not yet been issued, it is possible that the Company will lose the benefit of at least certain of its tax management strategies, and, if so, our total tax expense will likely increase. As a result of the Bill the Company recorded a net tax benefit of \$0.6 million primarily due to a re-measurement of deferred tax assets and liabilities. Actual income tax expense differs from the tax computed based on pre-tax income and the applicable statutory federal tax rate for the following reasons (dollars in thousands):

	2019	2018	2017
Income before income tax expense	\$ 94,026	\$ 71,134	\$ 68,514
Federal statutory rate	21%	21%	35
Computed “expected” Federal income tax expense	19,745	14,938	23,980
State tax, net of federal tax benefit	3,436	1,104	213
Impact of the Tax Cuts and Jobs Act	-	(790)	5,623
Impact of “the Bill”	-	(618)	-
Bank owned life insurance	(732)	(650)	(1,113)
Tax-exempt interest and dividends	(2,519)	(1,521)	(2,123)
Tax benefits from stock-based compensation	(27)	(1,100)	(348)
Other, net	728	(581)	(938)
Income tax expense	<u>\$ 20,631</u>	<u>\$ 10,782</u>	<u>\$ 25,294</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax asset and deferred tax liability at December 31, 2019 and 2018 are presented in the following table:

	2019	2018
	(dollars in thousands)	
Deferred tax assets		
Allowance for loan losses	\$ 11,333	\$ 10,358
Purchase accounting	4,543	307
Pension actuarial losses	-	2,203
New Jersey net operating loss	3,424	2,796
Deferred compensation	1,440	1,234
Unrealized losses on securities and swaps	1,509	1,620
Deferred loan costs, net of fees	20	19
Accrued rent	-	426
Capital lease	230	232
Nonaccrual interest	69	95
Other	2,240	-
Total deferred tax assets	\$ 24,808	\$ 19,290
Deferred tax liabilities		
Employee benefit plans	\$ (2,131)	\$ (2,167)
Pension actuarial gains	(1,062)	-
Depreciation	(1,146)	(512)
Prepaid expenses	(173)	(185)
Market discount accretion	(32)	(414)
Unrealized gains on securities and swaps	-	(366)
Other	-	(198)
Total deferred tax liabilities	(4,544)	(3,842)
Net deferred tax assets	<u>\$ 20,264</u>	<u>\$ 15,448</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Income Taxes – (continued)

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all the deferred tax assets will not be realized. The ultimate realization of deferred tax assets for state purposes is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible, while for Federal purposes the deferred tax assets can also be realized through tax carrybacks. Management considers the scheduled reversal of deferred tax liabilities, the projected future taxable income, and tax planning strategies in making this assessment. During 2019 and 2018, based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, the Company believes the net deferred tax assets are more likely than not to be realized. There are no unrecorded tax benefits and the Company does not expect the total amount of unrecognized income tax benefits to significantly increase in the next twelve months.

The Company's federal income tax returns are open and subject to examination from the 2016 tax return year and forward. The Company's state income tax returns are generally open from the 2015 and later tax return years based on individual state statutes of limitations.

Note 13 – Offsetting Assets and Liabilities

Certain financial instrument-related assets and liabilities may be eligible for offset on the consolidated statements of condition because they are subject to master netting agreements or similar agreements. However, the Company does not elect to offset such arrangements on the consolidated financial statements. The Company enters into interest rate swap agreements with financial institution counterparties. For additional detail regarding interest rate swap agreements refer to Note 21 within this section. In the event of default on, or termination of, any one contract, both parties have the right to net settle multiple contracts. Also, certain interest rate swap agreements may require the Company to receive or pledge cash or financial instrument collateral based on the contract provisions.

The following table presents information about financial instruments that are eligible for offset as of December 31, 2019 and December 31, 2018:

		Gross Amounts Not Offset				
	Gross Amounts Recognized	Gross Amounts Offset in the Statement of Financial Condition	Net Amounts of Assets Presented in the Statement of Financial Condition (dollars in thousands)	Financial Instruments Recognized	Cash or Financial Instrument Collateral	Net Amount
December 31, 2019						
Assets:						
Interest rate swaps	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Liabilities:						
Interest rate swaps	\$ (273)	\$ -	\$ (273)	\$ -	\$ (273)	\$ -
December 31, 2018						
Assets:						
Interest rate swaps	\$ 1,159	\$ -	\$ 1,159	\$ -	\$ -	\$ 1,159

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14 - Commitments, Contingencies and Concentrations of Credit Risk

In the normal course of business, the Company has outstanding commitments and contingent liabilities, such as standby and commercial letters of credit, unused portions of lines of credit and commitments to extend various types of credit. Commitments to extend credit and standby letters of credit generally do not exceed one year.

These financial instruments involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the consolidated financial statements. The commitment or contract amount of these financial instruments is an indicator of the Company's level of involvement in each type of instrument as well as the exposure to credit loss in the event of nonperformance by the other party to the financial instrument.

The Company controls the credit risk of these financial instruments through credit approvals, limits and monitoring procedures. To minimize potential credit risk, the Company generally requires collateral and other credit-related terms and conditions from the customer. In the opinion of management, the financial condition of the Company will not be materially affected by the final outcome of these commitments and contingent liabilities. A substantial portion of the Bank's loans are secured by real estate located in New Jersey and New York. Accordingly, the collectability of a substantial portion of the loan portfolio of the Bank is susceptible to changes in the metropolitan New York real estate market.

The following table provides a summary of financial instruments with off-balance sheet risk at December 31, 2019 and 2018:

	2019	2018
	(dollars in thousands)	
Commitments under commercial loans and lines of credit	\$ 564,444	\$ 425,189
Home equity and other revolving lines of credit	47,278	39,965
Outstanding commercial mortgage loan commitments	392,225	355,914
Standby letters of credit	32,155	36,141
Overdraft protection lines	752	836
Total	<u>\$ 1,036,854</u>	<u>\$ 858,045</u>

The Company is subject to claims and lawsuits that arise in the ordinary course of business. Based upon the information currently available in connection with such claims, it is the opinion of management that the disposition or ultimate determination of such claims will not have a material adverse impact on the consolidated financial position, results of operations, or liquidity of the Company.

Note 15 – Transactions with Executive Officers, Directors and Principal Stockholders

Loans to principal officers, directors, and their affiliates during the years ended December 31, 2019 and 2018 were as follows:

	2019	2018
	(dollars in thousands)	
Balance, January 1	\$ 56,903	\$ 56,300
New loans	8,684	5,041
Repayments	(8,178)	(4,438)
Balance, December 31	<u>\$ 57,409</u>	<u>\$ 56,903</u>

Deposits from principal officers, directors, and their affiliates at December 31, 2019 and 2018 were \$24.5 million and \$39.7 million respectively.

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties). The Company leases banking offices from related party entities. In addition, the Company also utilizes an advertising and public relations agency at which one of the Company's directors is President and CEO and a principal owner. For these transactions, the expenses are not significant to the operations of the Company.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Stockholders' Equity and Regulatory Requirements

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing the Basel Committee on Banking Supervisions' capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased on by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2019, the Bank and the Parent Corporation meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If an institution is classified as adequately capitalized or lower, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is growth and expansion, and capital restoration plans are required. As of December 31, 2019, and 2018, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

The following is a summary of the Bank's and the Parent Corporation's actual capital amounts and ratios as of December 31, 2019 and 2018, compared to the FRB and FDIC minimum capital adequacy requirements and the FDIC requirements for classification as a well-capitalized institution.

	Amount	Ratio	Minimum Capital Adequacy Amount	Ratio	For Classification Under Corrective Action Plan as Well Capitalized Amount	Ratio
The Bank						
December 31, 2019						
Leverage (Tier 1) capital	\$ 637,824	10.81%	\$ 236,188	4.00%	\$ 295,235	5.00%
Risk-Based Capital:						
CET 1	\$ 637,824	11.37%	\$ 252,432	4.50%	\$ 364,625	6.50%
Tier 1	637,824	11.37%	336,577	6.00%	448,769	8.00%
Total	708,367	12.63%	448,769	8.00%	560,961	10.00%
December 31, 2018						
Leverage (Tier 1) capital	\$ 552,311	10.78%	\$ 204,973	4.00%	\$ 256,217	5.00%
Risk-Based Capital:						
CET 1	\$ 552,311	11.37%	\$ 218,589	4.50%	\$ 315,740	6.50%
Tier 1	552,311	11.37%	291,452	6.00%	388,603	8.00%
Total	619,515	12.75%	388,603	8.00%	485,754	10.00%

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Stockholders' Equity and Regulatory Requirements – (continued)

			Minimum Capital Adequacy		For Classification as Well Capitalized			
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
The Company								
(dollars in thousands)								
December 31, 2019								
Leverage (Tier 1) capital	\$	563,464	9.54%	\$	236,259	4.00%	N/A	N/A
Risk-Based Capital:								
CET 1	\$	558,309	9.95%	\$	252,439	4.50%	N/A	N/A
Tier 1		563,464	10.04%		336,586	6.00%	N/A	N/A
Total		726,757	12.96%		448,781	8.00%	N/A	N/A
December 31, 2018								
Leverage (Tier 1) capital	\$	478,876	9.34%	\$	204,995	4.00%	N/A	N/A
Risk-Based Capital:								
CET 1	\$	473,721	9.75%	\$	218,585	4.50%	N/A	N/A
Tier 1		478,876	9.86%		291,446	6.00%	N/A	N/A
Total		638,830	13.15%		388,595	8.00%	N/A	N/A

The new Basel III rules require a “capital conservation buffer,” for both the Company and the Bank. As of January 1, 2019, the Company and the Bank are required to maintain a 2.5% capital conservation buffer, above and beyond the capital levels otherwise required under applicable regulation. Under this guidance banking institutions with a CET1, Tier 1 Capital Ratio and Total Risk Based Capital Ratio above the minimum regulatory adequate capital ratios but below the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers, based on the amount of the shortfall.

As of December 31, 2019, both the Company and Bank satisfy the capital conservation buffer requirements applicable to them. The lowest ratio at the Company is the Tier 1 Ratio which was 1.54% above the minimum buffer ratio and, at the Bank, the lowest ratio was the Total Risk Based Capital Ratio which was 2.13% above the minimum buffer ratio.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Comprehensive Income

Total comprehensive income includes all changes in equity during a period from transactions and other events and circumstances from nonowner sources. The Company's other comprehensive income (loss) is comprised of unrealized holding gains and losses on securities available-for-sale, obligations for defined benefit pension plan and an adjustment to reflect the curtailment of the Company's defined benefit pension plan, net of taxes.

Details about Accumulated Other Comprehensive Income (Loss) Components	Amounts Reclassified from Accumulated Other Comprehensive Income (Loss)			Affected Line Item in the Consolidated Statements of Income
	Year ended December 31,			
(dollars in thousands)	2019	2018	2017	
Sale of investment securities available-for-sale	\$ (280)	\$ -	\$ 1,596	Net (losses) gains on sale of securities available-for-sale
	79	-	(579)	Income tax benefit (expense)
	(201)	-	1,017	
Net interest income (expense) on swaps	677	464	(406)	Interest expense
	(190)	(130)	166	Income tax expense (benefit)
	487	334	(240)	
Amortization of pension plan net actuarial losses	(358)	(359)	(412)	Other components of net periodic pension expense
	101	101	169	Income tax benefit
	(257)	(258)	(243)	
Total reclassification	<u>\$ 29</u>	<u>\$ 76</u>	<u>\$ 534</u>	

Accumulated other comprehensive loss at December 31, 2019 and 2018 consisted of the following:

	2019	2018
	(dollars in thousands)	
Investment securities available-for-sale, net of tax	\$ 2,724	\$ (5,841)
Cash flow hedge, net of tax	(193)	837
Defined benefit pension and post-retirement plans, net of tax	(3,678)	(3,785)
Total	<u>\$ (1,147)</u>	<u>\$ (8,789)</u>

Effective January 1, 2018, the Company implemented ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." Under ASU 2018-02, the FASB amended existing guidance to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Act. In order to comply with this new ASU, the Company recorded an adjustment to the Consolidated Statement of Condition on January 1, 2018 of approximately \$709 thousand that increased retained earnings and increased accumulated other comprehensive loss.

Effective January 1, 2018, the Company implemented ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." Under ASU 2016-01, equity securities, with certain exceptions, are to be measured at fair value with changes in fair value recognized in net income. In order to comply with this new ASU, the Company recorded a cumulative-effect adjustment to the Consolidated Statement of Condition of approximately \$55 thousand.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Pension and Other Benefits

Defined Benefit Plans

The Company maintains a frozen noncontributory pension plan covering employees of the Company prior to the merger with Legacy ConnectOne. The benefits are based on years of service and the employee's compensation over the prior five-year period. The plan's benefits are payable in the form of a ten-year certain and life annuity. The plan is intended to be a tax-qualified defined benefit plan under Section 401(a) of the Internal Revenue Code. Payments may be made under the Pension Plan once attaining the normal retirement age of 65 and are generally equal to 44% of a participant's highest average compensation over a 5-year period.

The following table sets forth changes in projected benefit obligation, changes in fair value of plan assets, funded status, and amounts recognized in the consolidated statements of condition for the Company's pension plans at December 31, 2019 and 2018.

	2019	2018
	(dollars in thousands)	
Change in Benefit Obligation:		
Projected benefit obligation at January 1,	\$ 10,969	\$ 13,129
Interest cost	453	427
Actuarial (gain) loss	1,909	(1,716)
Benefits paid	(798)	(871)
Projected benefit obligation at December 31,	<u>\$ 12,533</u>	<u>\$ 10,969</u>
Change in Plan Assets:		
Fair value of plan assets at January 1,	\$ 13,023	\$ 12,609
Actual return on plan assets	2,391	(715)
Employer contributions	-	2,000
Benefits paid	(798)	(871)
Fair value of plan assets at December 31,	<u>\$ 14,616</u>	<u>\$ 13,023</u>
Funded status	<u>\$ 2,083</u>	<u>\$ 2,054</u>

The accumulated benefit obligation was \$12.5 million and \$11.0 million as of the year ended December 31, 2019 and 2018, respectively.

Amounts recognized as a component of accumulated other comprehensive loss as of year-end that have not been recognized as a component of the net periodic pension expense for the plan are presented in the following table. The Company expects to recognize approximately \$301,000 of the net actuarial loss reported in the following table as of December 31, 2019 as a component of net periodic pension expense during 2020.

	2019	2018
	(dollars in thousands)	
Net actuarial loss recognized in accumulated other comprehensive income	<u>\$ 5,116</u>	<u>\$ 5,265</u>

The net periodic pension expense and other comprehensive income (before tax) for 2019, 2018 and 2017 includes the following:

	2019	2018	2017
	(dollars in thousands)		
Interest cost	\$ 453	\$ 427	\$ 478
Expected return on plan assets	(697)	(765)	(640)
Net amortization	358	366	412
Total net periodic pension expense	\$ 114	\$ 28	\$ 250
Total gain recognized in other comprehensive income	(150)	(595)	(410)
Total recognized in net periodic expense and other comprehensive income (before tax)	<u>\$ (36)</u>	<u>\$ (567)</u>	<u>\$ (160)</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Pension and Other Benefits – (continued)

Effective January 1, 2018, the Company implemented ASU 2017-07, “*Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.*” Under ASU 2017-07, the FASB requires employers to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The table above details the affected line items within the Consolidated Statements of Income related to the net periodic pension costs for the following periods.

This ASU is also required to be applied retrospectively to all periods presented. The following table summarizes the impact of retrospective application to the Consolidated Statement of Condition for the period presented:

	2017
Other components of net periodic pension expense	
As previously reported	\$ -
As reported under the new guidance	250
Salaries and employee benefits	
As previously reported	\$ 35,128
As reported under the new guidance	34,878

The following table presents the weighted average assumptions used to determine the pension benefit obligations at December 31, for the following three years.

	2019	2018	2017
Discount rate	2.99%	4.05%	3.41%
Rate of compensation increase	N/A	N/A	N/A

The following table presents the weighted average assumptions used to determine net periodic pension cost for the following three years:

	2019	2018	2017
	(dollars in thousands)		
Discount rate	2.99%	4.05%	3.41%
Expected long-term return on plan assets	5.50%	5.50%	5.50%
Rate of compensation increase	N/A	N/A	N/A

The process of determining the overall expected long-term rate of return on plan assets begins with a review of appropriate investment data, including current yields on fixed income securities, historical investment data, historical plan performance and forecasts of inflation and future total returns for the various asset classes. This data forms the basis for the construction of a best-estimate range of real investment return for each asset class. An average, weighted real-return range is computed reflecting the plan’s expected asset mix, and that range, when combined with an expected inflation range, produces an overall best-estimate expected return range. Specific factors such as the plan’s investment policy, reinvestment risk and investment volatility are taken into consideration during the construction of the best estimate real return range, as well as in the selection of the final return assumption from within the range.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Pension and Other Benefits – (continued)

Plan Assets

The general investment policy of the Pension Trust is for the fund to experience growth in assets that will allow the market value to exceed the value of benefit obligations over time. The Company's pension plan asset allocation as of December 31, 2019 and 2018, target allocation, and expected long-term rate of return by asset are as follows:

	Target Allocation	% of Plan Assets – Year Ended 2019	% of Plan Assets – Year Ended 2018	Weighted Average Expected Long-Term Rate of Return
Equity Securities				
Domestic	50%	47%	53%	3.4%
International	10%	7%	7%	0.7%
Debt and/or fixed income securities	36%	37%	36%	1.2%
Cash and other alternative investments, including real estate funds, commodity funds, hedge funds and equity structured notes	4%	9%	4%	0.2%
Total	<u>100%</u>	<u>\$ 100%</u>	<u>\$ 100%</u>	<u>\$ 5.5%</u>

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Pension and Other Benefits – (continued)

The fair values of the Company's pension plan assets at December 31, 2019 and 2018, by asset class, are as follows:

Asset Class	December 31, 2019		Fair Value Measurements at Reporting Date Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(dollars in thousands)		
Cash	\$	1,171	\$	1,171	\$ - \$ -
Equity securities:					
U.S. companies		6,896		6,896	- -
International companies		1,023		1,023	- -
Debt and/or fixed income securities		5,355		5,355	
Commodity funds		115		115	
Real estate funds		56		56	- -
Total	\$	<u>14,616</u>	\$	<u>14,616</u>	\$ - \$ -
Asset Class	December 31, 2018		Fair Value Measurements at Reporting Date Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(dollars in thousands)		
Cash	\$	298	\$	298	\$ - \$ -
Equity securities:					
U.S. companies		6,957		6,957	- -
International companies		901		901	- -
Debt and/or fixed income securities		4,651		4,651	
Commodity funds		161		161	
Real estate funds		55		55	- -
Total	\$	<u>13,023</u>	\$	<u>13,023</u>	\$ - \$ -

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Pension and Other Benefits – (continued)***Fair Value of Plan Assets***

The Company used the following valuation methods and assumptions to estimate the fair value of assets held by the plan (for further information on fair value methods, see Note 22):

Equity securities and real estate funds: The fair values for equity securities and real estate funds are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2).

Debt and fixed income securities: Certain debt securities are valued at the closing price reported in the active market in which the bond is traded (Level 1 inputs). Other debt securities are valued based upon recent bid prices or the average of recent bid and asked prices when available (Level 2 inputs) and, if not available, they are valued through matrix pricing models developed by sources considered by management to be reliable. Matrix pricing, which is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

The investment manager is not authorized to purchase, acquire or otherwise hold certain types of market securities (subordinated bonds, real estate investment trusts, limited partnerships, naked puts, naked calls, stock index futures, oil, gas or mineral exploration ventures or unregistered securities) or to employ certain types of market techniques (margin purchases or short sales) or to mortgage, pledge, hypothecate, or in any manner transfer as security for indebtedness, any security owned or held by the Plan.

Cash Flows***Contributions***

The Bank does not expect to make a contribution in 2020.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, for the following years are as follows (dollars in thousands):

2020	\$ 722
2021	725
2022	702
2023	684
2024	670
2025-2029	3,489

401(k) Plan

The Company maintains a 401(k) plan to provide for defined contributions which covers substantially all employees of the Company. Beginning with the 2014 plan year, the 401(k) plan was amended to provide for a match of 50% of elective contributions, up to 6% of an employee's contribution. In 2018, the 401 (k) plan was amended to provide for 100% matching of employee contributions up to 5% of employee contributions. For 2019, 2018 and 2017, employer contributions amounted to \$1.3 million, \$0.9 million and \$0.4 million, respectively.

Supplemental Executive Retirement Plan ("SERP")

During 2019 the Company adopted supplemental executive retirement plans ("SERP's") for the benefit of several of its executive officers. Each SERP is a non-qualified plan which provides supplemental retirement benefits to the participating officers of the Company. SERP compensation expense was \$0.3 million for the year ended December 31, 2019.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 19 - Stock Based Compensation

The Company's stockholders approved the 2017 Equity Compensation Plan ("the Plan") on May 23, 2017. The Plan eliminates all remaining issuable shares under previous plans and is the only outstanding plan as of December 31, 2019. The maximum number of shares of common stock or equivalents which may be issued under the Plan, is 750,000. Grants under the Plan can be in the form of stock options (qualified or non-qualified), restricted shares, restricted share units or performance units. Shares available for grant and issuance under the Plan as of December 31, 2019 are approximately 400,593. The Company intends to issue all shares under the Plan in the form of newly issued shares.

Restricted stock, options and restricted stock units typically have a three-year vesting period starting one year after the date of grant with one-third vesting each year. The options generally expire ten years from the date of grant. Restricted stock granted to new employees and board members may be granted with shorter vesting periods. Grants of performance units typically have a cliff vesting after three years or upon a change of control. All issuances are subject to forfeiture if the recipient leaves or is terminated prior to the awards vesting. Restricted shares have the same dividend and voting rights as common stock, while options, performance units and restricted stock units do not.

All awards are issued at the fair value of the underlying shares at the grant date. The Company expenses the cost of the awards, which is determined to be the fair market value of the awards at the date of grant, ratably over the vesting period. Forfeiture rates are not estimated but are recorded as incurred. Stock-based compensation expense was \$2.9 million, \$1.9 million and \$1.8 million for the years ended December 31, 2019, 2018 and 2017 respectively.

Activity under the Company's options for the year ended December 31, 2019 was as follows:

	Number of Stock Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2018	108,463	\$ 8.35		
Granted	-	-		
Exercised	(38,937)	8.46		
Forfeited/cancelled/expired	-	-		
Outstanding at December 31, 2019	<u>69,526</u>	8.29	2.1	\$ 1,243,231
Exercisable at December 31, 2019	<u>69,526</u>	\$ 8.29	2.1	\$ 1,243,231

The aggregate intrinsic value of outstanding and exercisable options above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on December 31, 2019 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2019. This amount changes based on the fair market value of the Company's stock.

Activity under the Company's restricted shares for year ended December 31, 2019 was as follows:

	Nonvested Shares	Weighted- Average Grant Date Fair Value
Nonvested at December 31, 2018	68,428	\$ 23.04
Granted	59,551	20.30
Vested	(48,599)	21.90
Forfeited/cancelled/expired	(2,779)	24.56
Nonvested December 31, 2019	<u>76,601</u>	\$ 21.58

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 19 - Stock-Based Compensation – (continued)

As of December 31, 2019, there was approximately \$0.7 million of total unrecognized compensation cost related to nonvested restricted shares granted. The cost is expected to be recognized over a weighted average period of 1.3 years.

A summary of the status of unearned performance unit awards and the change during the period is presented in the table below:

	Units (expected)	Units (maximum)	Weighted Average Grant Date Fair Value
Unearned at December 31, 2018	86,009		\$ 22.06
Awarded	35,636		20.79
Change in estimate	20,960		19.86
Vested	(52,508)		21.26
Unearned at December 31, 2019	<u>90,097</u>	<u>120,212</u>	\$ 23.85

At December 31, 2019, the specific number of shares related to performance units that were expected to vest was 90,097, determined by actual performance in consideration of the established range of the performance targets, which is consistent with the level of expense currently being recognized over the vesting period. Should this expectation change, additional compensation expense could be recorded in future periods or previously recognized expense could be reversed. At December 31, 2019 the maximum amount of performance units that ultimately could vest if performance targets were exceeded is 120,212. A total of 21,083 shares were netted from the vested shares to satisfy tax obligations. The net shares issued from vesting of performance units during the year ended December 31, 2019 were 31,425 shares.

At December 31, 2019, compensation cost of approximately \$0.8 million related to non-vested performance units not yet recognized is expected to be recognized over a weighted-average period of 1.7 years.

A summary of the status of unearned restricted stock units and the changes in restricted stock units during the period is presented in the table below:

	Units (expected)	Weighted Average Grant Date Fair Value
Unearned at December 31, 2018	29,423	\$ 31.35
Awarded	53,454	20.79
Vested	(9,808)	31.35
Unearned at December 31, 2019	<u>73,069</u>	\$ 23.62

Any forfeitures would result in previously recognized expense being reversed. A portion of the shares that vest will be netted out to satisfy the tax obligations of the recipient. During the year ended December 31, 2019, a total of 4,904 shares were netted out to satisfy tax obligations, resulting in net issuance of 4,904 shares.

At December 31, 2019, compensation cost of approximately \$1.2 million related to non-vested restricted stock units, not yet recognized, is expected to be recognized over a weighted-average period of 1.9 years.

Note 20 - Dividends and Other Restrictions

Certain restrictions, including capital requirements, exist on the availability of undistributed net profits of the Bank for the future payment of dividends to the Parent Corporation. A dividend may not be paid if it would impair the capital of the Bank. At December 31, 2019, approximately \$259.6 million was available for payment of dividends based on regulatory guidelines.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Derivatives

The Company utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swap does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements. Interest rate swaps were entered into on April 13, 2017 and August 24, 2015, each with a respective notional amount of \$25.0 million and were designated as a cash flow hedge of a Federal Home Loan Bank advance. In addition, interest rate swaps were entered into on June 4, 2019 and August 6, 2019, each with a respective notional amount of \$50.0 million and were designated as a cash flow hedge of a Federal Home Loan Bank advance. The swaps were determined to be fully effective during the period presented and therefore no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swaps is recorded in other assets (liabilities) with changes in fair value recorded in other comprehensive income (loss). The amount included in accumulated other comprehensive income (loss) would be reclassified to current earnings should the hedges no longer be considered effective. The Company expects the hedges to remain fully effective during the remaining term of the swaps. Summary information about the interest rate swap designated as a cash flow hedges as of year-end is as follows:

	December 31, 2019	December 31, 2018
	(dollars in thousands)	
Notional amount	\$ 150,000	\$ 75,000
Weighted average pay rates	1.82%	1.70%
Weighted average receive rates	2.37%	2.19%
Weighted average maturity	1.5 years	2.0 years
Fair value	\$ (273)	\$ 1,159

Interest expense recorded on these swap transactions totaled approximately \$(0.7) million, \$(0.5) million, and \$0.4 million during 2019, 2018, and 2017 is reported as a component of interest expense on FHLB Advances.

Cash Flow Hedge

The following table presents the net gains (losses), recorded in accumulated other comprehensive income and the Consolidated Statements of Income relating to the cash flow derivative instruments for the years ended December 31:

	Amount of gain (loss) recognized in OCI (Effective Portion)	2019 Amount of (gain) loss reclassified from OCI to interest expense	Amount of gain (loss) recognized in other Noninterest income (Ineffective Portion)
(dollars in thousands)			
Interest rate contracts	\$ (756)	\$ (677)	\$ -

	Amount of gain (loss) recognized in OCI (Effective Portion)	2018 Amount of (gain) loss reclassified from OCI to interest expense	Amount of gain (loss) recognized in other Noninterest income (Ineffective Portion)
(dollars in thousands)			
Interest rate contracts	\$ 825	\$ (464)	\$ -

The following table reflects the cash flow hedges included in the Consolidated Statements of Condition as of December 31, 2019 and December 31, 2018:

	2019 Notional Amount	Fair Value	2018 Notional Amount	Fair Value
(dollars in thousands)				
Included in other assets/(liabilities):				
Interest rate swaps related to FHLB Advances	\$ 150,000	\$ (273)	\$ 75,000	\$ 1,159

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Derivatives – (continued)

There were no net gains (losses) recorded in accumulated other comprehensive income or in the Consolidated Statement of Income relating to cash flow derivative instruments for the years ended December 31, 2019, December 31, 2018 and December 31, 2017.

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

FASB ASC 820-10-05 defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurements and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

FASB ASC 820-10-65 provides additional guidance for estimating fair value in accordance with FASB ASC 820-10-05 when the volume and level of activity for the asset or liability have significantly decreased. This ASC also includes guidance on identifying circumstances that indicate a transaction is not orderly.

FASB ASC 820-10-05 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820-10-05 are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (for example, supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a recurring basis at December 31, 2019 and December 31, 2018:

Securities Available-for-Sale: Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 inputs include securities that have quoted prices in active markets for identical assets. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of instruments, which would generally be classified within Level 2 of the valuation hierarchy include municipal bonds and certain agency collateralized mortgage obligations. In certain cases where there is limited activity in the market for a particular instrument, assumptions must be made to determine the fair value of the instruments and these are classified as Level 3. When measuring fair value, the valuation techniques available under the market approach, income approach and/or cost approach are used. The Company's evaluations are based on market data and the Company employs combinations of these approaches for its valuation methods depending on the asset class.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Derivatives: The fair value of derivatives are based on valuation models using observable market data as of the measurement date (level 2). Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rate, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2019 and December 31, 2018 are as follows:

		December 31, 2019						
		Fair Value Measurements at Reporting Date Using						
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)				
Total Fair Value								
(dollars in thousands)								
Recurring fair value measurements:								
Assets								
Investment securities:								
Available-for-sale:								
Federal agency obligations	\$	28,237	\$	-	\$	28,237	\$	-
Residential mortgage pass-through securities		200,496		-		200,496		-
Commercial mortgage pass-through securities		4,997		-		4,997		-
Obligations of U.S. states and political subdivision		136,519		-		127,405		9,114
Corporate bonds and notes		28,382		-		28,382		-
Asset-backed securities		5,780		-		5,780		-
Certificates of deposit		150		-		150		-
Other securities		140		140		-		-
Total available-for-sale	\$	404,701	\$	140	\$	395,447	\$	9,114
Equity securities		11,185		11,185		-		-
Total assets	\$	415,886	\$	11,325	\$	395,447	\$	9,114
Liabilities								
Derivatives	\$	(273)	\$	-	\$	(273)	\$	-
Total liabilities	\$	(273)		-		(273)		-

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2019 and 2018.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

		December 31, 2018		
		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Total Fair Value			
(dollars in thousands)				
Recurring fair value measurements:				
Assets				
Investment securities:				
Available-for-sale:				
Federal agency obligations	\$ 44,955	\$ -	\$ 44,955	\$ -
Residential mortgage pass-through securities	185,204	-	185,204	-
Commercial mortgage pass-through securities	3,874	-	3,874	-
Obligations of U.S. states and political subdivision	139,185	-	129,808	9,377
Corporate bonds and notes	25,813	-	25,813	-
Asset-backed securities	9,691	-	9,691	-
Certificates of deposit	322	-	322	-
Other securities	2,990	2,990	-	-
Total available-for-sale	\$ 412,034	\$ 2,990	\$ 399,667	\$ 9,377
Equity securities	11,460	11,460	-	-
Derivatives	1,159	-	1,159	-
Total assets	\$ 424,653	\$ 14,450	\$ 400,826	\$ 9,377

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2018 and 2017.

Assets Measured at Fair Value on a Non-Recurring Basis

The Company may be required periodically to measure certain assets at fair value on a non-recurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of lower of cost or fair value accounting or impairment write-downs of individual assets. The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a non-recurring basis at December 31, 2019 and December 31, 2018:

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Impaired Loans: The Company may record adjustments to the carrying value of loans based on fair value measurements, generally as partial charge-offs of the uncollectible portions of these loans. These adjustments also include certain impairment amounts for collateral dependent loans calculated in accordance with GAAP. Impairment amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated impairment amount applicable to that loan does not necessarily represent the fair value of the loan. Real estate collateral is valued using independent appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable by market participants. However, due to the substantial judgment applied and limited volume of activity as compared to other assets, fair value is based on Level 3 inputs. Estimates of fair value used for collateral supporting commercial loans generally are based on assumptions not observable in the market place and are also based on Level 3 inputs.

For assets measured at fair value on a non-recurring basis, the fair value measurements at December 31, 2019 and December 31, 2018 are as follows:

Assets measured at fair value on a nonrecurring basis:	December 31,	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:		(dollars in thousands)		
Commercial construction	\$ 2,286	\$ -	\$ -	\$ 2,286
Residential	240	-	-	240

Assets measured at fair value on a nonrecurring basis:	December 31,	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:		(dollars in thousands)		
Commercial real estate	\$ 1,481	\$ -	\$ -	\$ 1,481
Residential	231	-	-	231

Impaired Loans - Collateral dependent impaired loans at December 31, 2019 that required a valuation allowance were \$3.8 million with a related valuation allowance of \$1.3 million, compared to \$1.7 million with a related valuation allowance of \$36 thousand at December 31, 2018.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Assets Measured With Significant Unobservable Level 3 Inputs

Recurring basis

The tables below present a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2019 and year ended December 31, 2018:

	Municipal Securities (dollars in thousands)
Beginning balance, January 1, 2019	\$ 9,377
Principal paydowns	(263)
Ending balance, December 31, 2019	<u>\$ 9,114</u>

	Municipal Securities (dollars in thousands)
Beginning balance, January 1, 2018	\$ 9,632
Principal paydowns	(255)
Ending balance, December 31, 2018	<u>\$ 9,377</u>

The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a recurring basis at December 31, 2019 and December 31, 2018. The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 hierarchy.

December 31, 2019

	Fair Value	Valuation Techniques (dollars in thousands)	Unobservable Input	Range
Securities available-for-sale:				
Municipal securities	\$ 9,114	Discounted cash flows	Discount rate	2.9%

December 31, 2018

	Fair Value	Valuation Techniques (dollars in thousands)	Unobservable Input	Range
Securities available-for-sale:				
Municipal securities	\$ 9,377	Discounted cash flows	Discount rate	2.9%

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Non-recurring basis

The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a non-recurring basis for the periods presented. The tables below provide quantitative information about significant unobservable inputs used in fair value measurements within Level 3 hierarchy.

December 31, 2019

(dollars in thousands)	Fair Value	Valuation Techniques	Unobservable Input	Range (weighed average)
Impaired loans:				
Commercial construction	\$ 2,286	Appraisals of collateral value	Comparable sales	0% - 5% (3%)
Residential	\$ 240	Appraisals of collateral value	Comparable sales	2% - 14% (9%)

December 31, 2018

(dollars in thousands)	Fair Value	Valuation Techniques	Unobservable Input	Range (weighed average)
Impaired loans:				
Commercial real estate	\$ 1,481	Appraisals of collateral value	Comparable sales	6% - 9% (8%)
Residential	\$ 231	Appraisals of collateral value	Comparable sales	0% - 10% (5%)

Fair Value of Financial Instruments

FASB ASC 825-10 requires all entities to disclose the estimated fair value of their financial instrument assets and liabilities. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments as defined in FASB ASC 825-10. Many of the Company's financial instruments, however, lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. It is also the Company's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities except for loans held-for-sale and investment securities available-for-sale. Therefore, significant estimations and assumptions, as well as present value calculations, were used by the Company for the purposes of this disclosure.

Fair values for financial instruments must be estimated by management using techniques such as discounted cash flow analysis and comparison to similar instruments. These estimates are highly subjective and require judgments regarding significant matters, such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes. Fair values disclosed in accordance with ASC Topic 825 do not reflect any premium or discount that could result from the sale of a large volume of a particular financial instrument, nor do they reflect possible tax ramifications or estimated transaction costs.

Cash and cash equivalents. The carrying amounts of cash and short-term instruments approximate fair values.

FHLB stock. It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Loans. The fair value of portfolio loans, net is determined using an exit price methodology. The exit price methodology continues to be based on a discounted cash flow analysis, in which projected cash flows are based on contractual cash flows adjusted for prepayments for certain loan types (*e.g.* residential mortgage loans and multi-family loans) and the use of a discount rate based on expected relative risk of the cash flows. The discount rate selected considers loan type, maturity date, a liquidity premium, cost to service, and cost of capital, which is a Level 3 fair value estimate.

Deposits. The carrying amounts of deposits with no stated maturities (*i.e.*, noninterest-bearing, savings, NOW, and money market deposits) are assigned fair values equal to the carrying amounts payable on demand. The fair value of time deposits is based on the discounted value of contractual cash flows using estimated rates currently offered for alternative funding sources of similar remaining maturity.

Term Borrowings and Subordinated Debentures. The fair value of the Company's long-term borrowings and subordinated debentures were calculated using a discounted cash flow approach and applying discount rates currently offered based on weighted remaining maturities.

Accrued Interest Receivable/Payable. The carrying amounts of accrued interest approximate fair value resulting in a level 2 or level 3 classification based on the level of the asset or liability with which the accrual is associated.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of December 31, 2019 and December 31, 2018:

		Fair Value Measurements			
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1) (dollars in thousands)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019					
Financial assets:					
Cash and due from banks	\$ 201,483	\$ 201,483	\$ 201,483	\$ -	\$ -
Investment securities available-for-sale	404,701	404,701	140	395,447	9,114
Restricted investment in bank stocks	27,397	n/a	n/a	n/a	n/a
Equity securities	11,185	11,185	11,185	-	-
Net loans	5,075,234	5,096,669	-	-	5,096,669
Accrued interest receivable	20,949	20,949	-	2,187	18,762
Financial liabilities:					
Noninterest-bearing deposits	861,728	861,728	861,728	-	-
Interest-bearing deposits	3,905,814	3,917,405	2,352,093	1,565,312	-
Borrowings	500,293	502,026	-	502,026	-
Subordinated debentures	128,885	134,973	-	134,973	-
Derivatives	273	273	-	273	-
Accrued interest payable	4,018	4,018	-	4,018	-
December 31, 2018					
Financial assets:					
Cash and due from banks	\$ 172,366	\$ 172,366	\$ 172,366	\$ -	\$ -
Investment securities available-for-sale	412,034	412,034	2,990	399,667	9,377
Restricted investment in bank stocks	31,136	n/a	n/a	n/a	n/a
Equity securities	11,460	11,460	11,460	-	-
Net loans	4,506,138	4,402,878	-	-	4,402,878
Derivatives	1,159	1,159	-	1,159	-
Accrued interest receivable	18,214	18,214	-	2,064	16,150
Financial liabilities:					
Noninterest-bearing deposits	768,584	768,584	768,584	-	-
Interest-bearing deposits	3,323,508	3,320,640	1,957,503	1,363,137	-
Borrowings	600,001	598,598	-	598,598	-
Subordinated debentures	128,556	132,426	-	132,426	-
Accrued interest payable	6,764	6,764	-	6,764	-

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 - Fair Value Measurements and Fair Value of Financial Instruments – (continued)

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date. The fair value of commitments to originate loans is immaterial and not included in the tables above.

Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values.

The Company's remaining assets and liabilities, which are not considered financial instruments, have not been valued differently than has been customary with historical cost accounting. No disclosure of the relationship value of the Company's core deposit base is required by FASB ASC 825-10.

Fair value estimates are based on existing balance sheet financial instruments, without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, there are certain significant assets and liabilities that are not considered financial assets or liabilities, such as the brokerage network, deferred taxes, premises and equipment, and goodwill. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

Management believes that reasonable comparability between financial institutions may not be likely, due to the wide range of permitted valuation techniques and numerous estimates which must be made, given the absence of active secondary markets for many of the financial instruments. This lack of uniform valuation methodologies also introduces a greater degree of subjectivity to these estimated fair values.

Note 23 - Parent Corporation Only Financial Statements

The Parent Corporation operates its wholly-owned subsidiary, the Bank. The earnings of this subsidiary are recognized by the Parent Corporation using the equity method of accounting. Accordingly, earnings are recorded as increases in the Parent Corporation's investment in the subsidiaries and dividends paid reduce the investment in the subsidiaries. The ability of the Parent Corporation to pay dividends will largely depend upon the dividends paid to it by the Bank. Dividends payable by the Bank to the Parent Corporation are restricted under supervisory regulations (see Note 20 of the Notes to Consolidated Financial Statements).

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 23 - Parent Corporation Only Financial Statements – (continued)

Condensed financial statements of the Parent Corporation only are as follows:

Condensed Statements of Condition

	At December 31,	
	2019	2018
	(dollars in thousands)	
ASSETS		
Cash and cash equivalents	\$ 21,392	\$ 22,071
Investment in subsidiaries	810,705	692,516
Receivable due from subsidiaries	32,250	32,250
Securities available-for-sale	155	176
Equity securities	-	607
Other assets	1,282	1,282
Total assets	<u>\$ 865,784</u>	<u>\$ 748,902</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Other liabilities	\$ 5,709	\$ 6,419
Subordinated debentures	128,855	128,556
Stockholders' equity	731,190	613,927
Total liabilities and stockholders' equity	<u>\$ 865,784</u>	<u>\$ 748,902</u>

Condensed Statements of Income

	For Years Ended December 31,		
	2019	2018	2017
	(dollars in thousands)		
Income:			
Dividend income from subsidiaries	\$ 30,050	\$ 16,700	\$ 13,000
Other income	1,652	1,618	13
Total Income	31,702	18,318	13,013
Expenses	(7,386)	(7,201)	(3,251)
Income before equity in undistributed earnings of subsidiaries	24,316	11,117	9,762
Equity in undistributed earnings of subsidiaries	49,079	49,235	33,458
Net Income	\$ 73,395	\$ 60,352	\$ 43,220

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 23 - Parent Corporation Only Financial Statements – (continued)

Condensed Statements of Cash Flows

	2019	For Years Ended December 31		2017
		2018		
		(dollars in thousands)		
<u>Cash flows from operating activities:</u>				
Net income	\$ 73,395	\$ 60,352	\$	43,220
Adjustments to reconcile net income to net cash provided by operating activities:				
Equity in undistributed earnings of subsidiary	(49,079)	(49,235)		(33,458)
Loss on equity securities, net	38	4		-
Amortization of subordinated debt issuance costs	329	332		165
(Increase) decrease in other assets	-	(959)		104
(Decrease) increase in other liabilities	(1,509)	3,843		(151)
Net cash provided by operating activities	23,174	14,337		9,880
<u>Cash flows from investing activities:</u>				
Purchase of available-for-sale securities	(2)	(8)		(7)
Sales of available-for-sale securities	23	-		-
Sales of equity securities	569	-		-
Capital infusion to subsidiary	-	(64,500)		-
Net cash provided by (used) in investing activities	590	(64,508)		(7)
<u>Cash flows from financing activities:</u>				
Proceeds from subordinated debt	-	73,525		-
Cash dividends on common stock	(12,160)	(9,664)		(9,612)
Secondary offering and issuance of common stock	-	-		(180)
Repurchase of stock	(12,643)	-		-
Proceeds from exercise of stock options	360	875		417
Net cash (used in) provided by financing activities	(24,443)	64,736		(9,375)
(Decrease) increase in cash and cash equivalents	(679)	14,565		498
Cash and cash equivalents at January 1,	22,071	7,506		7,008
Cash and cash equivalents at December 31,	\$ 21,392	\$ 22,071	\$	7,506

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 24 - Quarterly Financial Information of ConnectOne Bancorp, Inc. (unaudited)

	2019			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	(dollars in thousands, except per share data)			
Total interest income	\$ 68,008	\$ 70,389	\$ 67,878	\$ 65,209
Total interest expense	20,577	21,983	22,348	20,257
Net interest income	47,431	48,406	45,530	44,952
Provision for loan losses	500	2,000	1,100	4,500
Total other income, net of securities gains	2,246	2,109	1,942	1,738
Other expenses	22,197	20,379	21,590	28,062
Income before income taxes	26,980	28,136	24,782	14,128
Income tax expense	6,197	6,440	5,501	2,493
Net income	<u>\$ 20,783</u>	<u>\$ 21,696</u>	<u>\$ 19,281</u>	<u>\$ 11,635</u>
Earnings per share:				
Basic	\$ 0.59	\$ 0.60	\$ 0.55	\$ 0.33
Diluted	0.59	0.60	0.54	0.33

	2018			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	(dollars in thousands, except per share data)			
Total interest income	\$ 57,223	\$ 55,351	\$ 53,084	\$ 50,475
Total interest expense	17,062	15,389	14,139	12,328
Net interest income	40,161	39,962	38,945	38,147
Provision for loan losses	1,100	1,100	1,100	17,800
Total other income, net of securities gains	1,515	1,429	1,388	1,407
Other expenses	18,266	18,287	17,108	17,059
Income before income taxes	22,310	22,004	22,125	4,695
Income tax expense	3,638	2,102	4,598	444
Net income	<u>\$ 18,672</u>	<u>\$ 19,902</u>	<u>\$ 17,527</u>	<u>\$ 4,251</u>
Earnings per share:				
Basic	\$ 0.58	\$ 0.62	\$ 0.54	\$ 0.13
Diluted	0.58	0.61	0.54	0.13

Note: Due to rounding, quarterly earnings per share may not sum to reported annual earnings per share.

Other expenses for the first quarter of 2019 includes merger expenses related to the acquisition of GHB.

The provision for loan losses for the first quarter 2018 was a notable increase that was mainly attributable to specific allocations to the taxi medallion loans and concurrent partial charge-off of \$17.0 million.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 25. Revenue Recognition

All of the Company's revenue from contracts with customers within the scope of ASC 606 is recognized within noninterest income. The following table presents the Company's sources of noninterest income for the year ended December 31, 2019 and 2018. Items outside of ASC 606 are noted as such.

	Year Ended December 31, 2019	Year Ended December 31, 2018
	(dollars in thousands)	
Noninterest income		
Service charges on deposits		
Overdraft fees	\$ 1,264	\$ 847
Other	871	607
Interchange income	761	628
Net gains on sales of loans ⁽¹⁾	512	61
Net gains on equity securities ⁽¹⁾	294	(266)
Net gains on sales of available-for-sale securities ⁽¹⁾	(280)	-
Wire transfer fees ⁽¹⁾	481	309
Loan servicing fees ⁽¹⁾	515	94
Bank owned life insurance ⁽¹⁾	3,484	3,094
Other	133	99
Total noninterest income	<u>\$ 8,035</u>	<u>\$ 5,473</u>

(1) Not within scope of ASC 606.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 25. Revenue Recognition – (continued)

A description of the Company's revenue streams accounted for under ASC 606 is as follows:

Service Charges on Deposit Accounts: The Company earns fees from deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed at the point in the time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Interchange Income: The Company earns interchange fees from debit and credit card holder transactions conducted through various payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided by the cardholder.

Gains/Losses on Sales of OREO: The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether the collectability of the transaction prices is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

Note 26 – Subsequent Event

On January 2, 2019, Bancorp of New Jersey, Inc. merged with and into ConnectOne Bank, with ConnectOne Bank as the surviving bank. As a result of the merger, the Company acquired approximately \$0.8 billion in loans, assumed approximately \$0.8 billion in deposits and acquired nine branch offices all located in Bergen County, New Jersey. Subject to the allocation and proration procedures set forth in the merger agreement, shareholders of BNJ common stock had the right to elect, with respect to each share of BNJ common stock, to receive either (i) \$16.25 in cash or (ii) 0.780 of a share of CNOB common stock (plus cash in lieu of any fractional shares of CNOB common stock to which such holder would otherwise be entitled). The allocation and proration procedures set forth in the merger agreement required that approximately 20% of the shares of BNJ common stock be converted into cash and the remaining approximately 80% of BNJ common shares be converted into shares of ConnectOne common stock. Given the initial accounting for this business combination is incomplete, management is not yet able to disclose the preliminary fair value of the assets acquired and liabilities assumed.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports filed or submitted pursuant to the Securities Exchange Act of 1934, as amended (“Exchange Act”), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that information required to be disclosed by the Company in its Exchange Act reports is accumulated and communicated to management, including the Company’s Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of its management, including the Company’s Chief Executive Officer and Chief Financial Officer, the Company evaluated the effectiveness of the design and operation of the Company’s disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) and 15d-15(e) as of December 31, 2019. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of such date.

(b) Management’s Report on Internal Control over Financial Reporting

The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) of the Exchange Act. The Company’s internal control system is a process designed to provide reasonable assurance to the Company’s management, Board of Directors and shareholders regarding the reliability of financial reporting and the preparation and fair presentation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on our financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As part of the Company’s program to comply with Section 404 of the Sarbanes-Oxley Act of 2002, our management assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2019 (the “Assessment”). In making this Assessment, management used the control criteria framework of the Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission published in its report entitled Internal Control - Integrated Framework (2013). Management’s Assessment included an evaluation of the design of the Company’s internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its Assessment with the Audit Committee.

Based on this Assessment, management determined that, as of December 31, 2019, the Company’s internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Crowe LLP, the independent registered public accounting firm that audited the Company’s consolidated financial statements included in this Annual Report on Form 10-K, has issued an audit report on the Company’s internal control over financial reporting as of December 31, 2019. The report is included in this item under the heading “Report of Independent Registered Public Accounting Firm.”

(c) Changes in Internal Controls over Financial Reporting

There have been no changes in the Company’s internal controls over financial reporting that occurred during the Company’s last fiscal quarter to which this report relates that have materially affected, or are reasonable likely to materially affect, the Company’s internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information required by this part is included in the definitive Proxy Statement for the Company's 2020 Annual Meeting under the captions "ELECTION OF DIRECTORS" and "SECTION 16(A) BENEFICIAL OWNERSHIP REPORTS COMPLIANCE," each of which is incorporated herein by reference. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 10, 2020.

Item 11. Executive Compensation

Information concerning executive compensation is included in the definitive Proxy Statement for the Company's 2020 Annual Meeting under the captions "EXECUTIVE COMPENSATION" and "DIRECTOR COMPENSATION", which is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2020.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information concerning security ownership of certain beneficial owners and management is included in the definitive Proxy statement for the Company's 2020 Annual Meeting under the caption "SECURITY OWNERSHIP OF MANAGEMENT", which is incorporated herein by reference. It is expected that such Proxy statement will be filed with the Securities and Exchange Commission no later than April 29, 2020.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information concerning certain relationships and related transactions is included in the definitive Proxy Statement for the Company's 2020 Annual Meeting under the caption "INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS", which is incorporated herein by reference. It is expected that such Proxy statement will be filed with the Securities and Exchange Commission no later than April 29, 2020.

Item 14. Principal Accounting Fees and Services

The information concerning principal accountant fees and services as well as related pre-approval policies under the caption "RATIFICATION OF INDEPENDENT AUDITORS" in the Proxy Statement for the Company's 2020 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2020.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) (1) Financial Statements and Schedules:

The following Financial Statements and Supplementary Data are filed as part of this annual report:

Report of Independent Registered Public Accounting Firm	46
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Consolidated Statements of Comprehensive Income	52
Consolidated Statements of Changes in Stockholders' Equity	53
Consolidated Statements of Cash Flows	54
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(b) Exhibits (numbered in accordance with Item 601 of Regulation S-K) filed herewith or incorporated by reference as part of this annual report.

<u>Exhibit No.</u>	<u>Description</u>
3.1	The Registrant's Restated Certificate of Incorporation is incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on July 1, 2014.
3.2	The Registrant's Amended and Restated By-Laws are incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 21, 2018.
4	The Registrant's Capital Stock
10.1	Center Bancorp, Inc. 2009 Equity Incentive Plan is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 1, 2009.
10.2	Indenture dated as of December 19, 2003, between the Registrant and Wilmington Trust Company relating to \$5.0 million aggregate principal amount of floating rate debentures is incorporated by reference to Exhibit 10.16 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.
10.3	Amended and restated Declaration of Trust of Center Bancorp Statutory Trust II, dated as of December 19, 2003 is incorporated by reference to Exhibit 10.17 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.
10.4	Guarantee Agreement between Registrant and Wilmington Trust Company dated as of December 19, 2003 is incorporated by reference to Exhibit 10.18 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.
10.5	The Registrant's Amended and Restated 2003 Non-Employee Director Stock Option Plan, as amended and restated, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated March 5, 2008.
10.6	Open Market Share Purchase Incentive Plan is incorporated by reference to exhibit 10.1 to the Registrant's Current Report on Form 8-K dated January 26, 2006.
10.7	Amendment to 2003 Amended and Restated Non-Employee Director Stock Option Plan is incorporated by reference to Exhibit 10.8 to the Registrant's Current Report on Form 8-K filed with the SEC on January 21, 2014.
10.8	Second Amended and Restated Employment Agreement, dated as of June 1, 2017, by and among the Registrant, ConnectOne Bank and Frank Sorrentino III, is incorporated by reference to Exhibit 10.1 to the Registrant's Current report on Form 8-K filed with the SEC on June 5, 2017. *

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<u>Exhibit No.</u>	<u>Description</u>
<u>10.9</u>	<u>Amended and Restated Employment Agreement dated as of June 1, 2017, by and among the Registrant, ConnectOne Bank and William S. Burns, is incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on June 5, 2017 *</u>
<u>10.10</u>	<u>Form of Change in Control Agreement by and between the Company and Laura Criscione dated December 19, 2013 is incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on December 20, 2013. *</u>
<u>10.11</u>	<u>North Jersey Community Bank 2006 Equity Compensation Plan ⁽¹⁾</u>
<u>10.12</u>	<u>North Jersey Community Bank 2008 Equity Compensation Plan ⁽¹⁾</u>
<u>10.13</u>	<u>North Jersey Community Bank 2009 Equity Compensation Plan ⁽¹⁾</u>
<u>10.14</u>	<u>2012 Equity Compensation Plan ⁽¹⁾</u>
<u>10.15</u>	<u>Indenture dated June 30, 2015 with U.S. Bank, National Association as Trustee ⁽²⁾</u>
<u>10.16</u>	<u>Indenture dated January 17, 2018, between the Company and U.S. Bank National Association as Trustee ⁽³⁾</u>
<u>10.17</u>	<u>Employment Agreement by and among the Registrant, ConnectOne Bank and Elizabeth Magennis dated June 1, 2017 is incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on June 5, 2017. *</u>
<u>10.18</u>	<u>Employment Agreement by and among the Registrant, ConnectOne Bank and Christopher Ewing dated June 1, 2017 is incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the SEC on June 5, 2017. *</u>
<u>10.19</u>	<u>First Supplemental Indenture dated January 17, 2018, between the Company and U.S. Bank National Association as Trustee ⁽³⁾</u>
<u>10.20</u>	<u>2017 Equity Compensation Plan ⁽⁴⁾</u>
<u>10.21</u>	<u>Form of Supplemental Executive Retirement Plan between the Registrant and each of Frank Sorrentino, III, William S. Burns, Elizabeth Magennis, Christopher Ewing and Michael McGrover ⁽⁵⁾</u>
<u>10.22</u>	<u>Form of Split Dollar Life Insurance Agreement between the Registrant and each of Frank Sorrentino, III, William S. Burns, Elizabeth Magennis, Christopher Ewing and Michael McGrover ⁽⁵⁾</u>
<u>21.1</u>	<u>Subsidiaries of the Registrant</u>
<u>23.1</u>	<u>Consent of Crowe LLP</u>
<u>31.1</u>	<u>Personal certification of the chief executive officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>31.2</u>	<u>Personal certification of the chief financial officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>32</u>	<u>Personal certification of the chief executive officer and the chief financial officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002.</u>
101 .INS**	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101 .SCH**	XBRL Taxonomy Extension Schema Document
101 .CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101 .DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101 .LAB**	XBRL Taxonomy Extension Label Linkbase Document
101 .PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

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<u>Exhibit No.</u>	<u>Description</u>
*	Management contract on compensatory plan or arrangement.
(1)	Incorporated by reference from Exhibits 10.15, 10.16, 10.17 and 10.18, the Registrant's Annual Report on Form 10-K for the year ending December 31, 2014
(2)	Incorporated by reference from Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed July 2, 2015
(3)	Incorporated by reference from Exhibit 4.1 of Registrant's Current Report on Form 8-K filed January 17, 2018
(4)	Incorporated by reference from Exhibit A to the Registrant's Definitive Proxy Statement on Schedule 14A filed April 27, 2017
(5)	Incorporated by reference from Exhibits 10.1 and 10.2 of the Registrant's Current Report on Form 8-K filed December 16, 2019

All financial statement schedules are omitted because they are either inapplicable or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

** Filed herewith.

SIGNATURES

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

March 2, 2020

CONNECTONE BANCORP, INC.

By:

/s/ Frank Sorrentino III
Frank Sorrentino III
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, the following persons on behalf of the Registrant, in the capacities described below on March 2, 2020, have signed this report below.

/s/ Frank Sorrentino III Frank Sorrentino III	Chairman of the Board & Chief Executive Officer (principal executive officer)
/s/ William S. Burns William S. Burns	Executive Vice President & Chief Financial Officer (principal financial and accounting officer)
/s/ Stephen Boswell Stephen Boswell	Director
/s/ Frank Baier Frank Baier	Director
/s/ Frank Huttie III Frank Huttie III	Director
/s/ Michael Kempner Michael Kempner	Director
/s/ Joseph Parisi, Jr. Joseph Parisi, Jr.	Director
/s/ Nicholas Minoia Nicholas Minoia	Director
/s/ William A. Thompson William A. Thompson	Director
/s/ Alexander Bol Alexander Bol	Director
/s/ Katherin Nukk-Freeman Katherin Nukk-Freeman	Director
/s/ Daniel Rifkin Daniel Rifkin	Director
/s/ Mark Sokolich Mark Sokolich	

The Registrant's Capital Stock

As of December 31, 2019, ConnectOne Bancorp, Inc. ("ConnectOne"), the registrant and the registered banking holding Company or ConnectOne Bank ("ConnectOne Bank") had one class of security registered under Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our common stock, no par value per share ("Common Stock").

AUTHORIZED CAPITAL STOCK

ConnectOne's authorized capital stock consists of 55,000,000 common shares, without par value ("common shares" or "common stock") and 5,000,000 preferred shares, with or without par value as determined by ConnectOne's board of directors ("preferred shares" or "preferred stock"). As of December 31, 2019, 35,072,066 of ConnectOne's common shares were outstanding, 2,603,940 of ConnectOne's common shares were held by ConnectOne in treasury, and none of ConnectOne's preferred shares were issued or outstanding.

COMMON STOCK

The following description contains certain general terms of ConnectOne's common stock.

Dividend Rights

The holders of ConnectOne's common stock are entitled to dividends when, as, and if declared by the ConnectOne board of directors out of funds legally available for the payment of dividends. Generally, New Jersey law prohibits corporations from paying dividends or any other distributions to shareholders, if after giving effect to the distribution, either the corporation would be unable to pay its debts as they become due in the usual course of its business or the corporation's total assets would be less than its total liabilities.

The primary source of dividends paid to the ConnectOne's shareholders is dividends paid to ConnectOne by ConnectOne Bank. Thus, as a practical matter, any restrictions on the ability of ConnectOne Bank to pay dividends will act as restrictions on the amount of funds available for payment of dividends by ConnectOne. Under the New Jersey Banking Act of 1948, as amended, dividends may be paid by ConnectOne Bank only if, after the payment of each such dividend, the capital stock of ConnectOne Bank will be unimpaired and either ConnectOne Bank will have a surplus of not less than 50% of its capital stock or the payment of such dividend will not reduce ConnectOne Bank's surplus. The payment of dividends is also dependent upon the Bank's ability to maintain adequate capital ratios pursuant to applicable regulatory requirements. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The dividend rights of holders of ConnectOne's common stock are qualified and subject to the dividend rights of holders of ConnectOne's preferred stock that may be issued in the future as described below in the section titled "Preferred Stock".

Voting Rights

Each holder of ConnectOne's common stock is entitled to one vote for each share held on all matters voted upon by the shareholders, including the election of directors. There is no cumulative voting in the election of directors.

Preemptive Rights

Holders of shares of ConnectOne's common stock are not entitled to preemptive rights with respect to any shares of the common stock that may be issued.

Liquidation Rights

In the event of any liquidation, dissolution or winding up of the affairs of ConnectOne, subject to the rights and preferences, if any, of the holders of preferred stock, holders of ConnectOne's common stock are entitled to share, ratably in proportion to the number of shares of common stock held by them, in the remaining assets of ConnectOne available for distribution to its shareholders.

Assessment and Redemption

All outstanding shares of ConnectOne's common stock are fully paid and non-assessable. ConnectOne's common stock is not redeemable at the option of the issuer or the holders thereof.

Transfer Agent

Broadridge Financial Solutions, Inc. is presently the transfer agent for ConnectOne's common stock.

Listing

ConnectOne's common stock is listed on the NASDAQ Global Select Market under the symbol "CNOB".

PREFERRED STOCK

ConnectOne has 5,000,000 authorized shares of preferred stock typically referred to as "blank check" preferred stock. This term refers to stock for which the rights and restrictions are determined by the board of directors of a corporation. ConnectOne's certificate of incorporation authorizes ConnectOne's Board of Directors to issue new shares of ConnectOne's preferred stock without further shareholder action.

ConnectOne's certificate of incorporation gives the board of directors of ConnectOne authority to issue preferred stock from time to time in one or more classes or series thereof, each such class or series to have voting powers (if any), conversion rights (if any), designations, preferences and relative, participating, optional or other special rights, and such qualifications, limitations or restrictions thereof, as shall be determined by the board of directors of ConnectOne and stated and expressed in a resolution or resolutions thereof providing for the issuance of such preferred stock.

With respect to any class or series of preferred stock, ConnectOne's certificate of incorporation allows the board of directors of ConnectOne at any time to determine:

- the dividend rate on shares of such class or series and any restrictions, limitations or conditions upon the payment of such dividends, and whether dividends are cumulative, and the dates on which dividends, if declared, would be payable;
 - whether the shares of such class or series would be redeemable and, if so, the terms of redemption;
 - the rights of holders of shares of such class or series in the event of the liquidation, dissolution or winding up of ConnectOne, whether voluntary or involuntary, or any other distribution of its assets;
 - whether the shares of such class or series would be subject to the operation of a purchase, retirement or sinking fund and, if so, the terms and conditions thereof;
-

- whether the shares of such class or series would be convertible into shares of any other class or series of the same or any other class, and if so, the terms of such conversion; and
- the extent of voting powers, if any, of the shares of such class or series.

The issuance of additional common or preferred stock may be viewed as having adverse effects upon the holders of common stock. Holders of ConnectOne's common stock do not have preemptive rights with respect to any newly issued stock. ConnectOne's board could adversely affect the voting power of holders of ConnectOne's common stock by issuing shares of preferred stock with certain voting, conversion and/or redemption rights. In the event of a proposed merger, tender offer or other attempt to gain control of ConnectOne that the board does not believe to be in the best interests of its shareholders, the board could issue additional preferred stock which could make any such takeover attempt more difficult to complete. Blank check preferred stock may also be used in connection with the issuance of a shareholder rights plan, sometimes called a poison pill.

ANTI-TAKEOVER PROVISIONS

Provisions of New Jersey and federal law and the terms of the certificate of incorporation of ConnectOne contain provisions which could make a takeover or purchase of ConnectOne more difficult, even if a significant percentage of ConnectOne's shareholders believe any such transaction is in their best interests. The following is a summary of these provisions:

Certificate of Incorporation

Provisions of ConnectOne's certificate of incorporation may have anti-takeover effects. These provisions may discourage attempts by others to acquire control of ConnectOne without negotiation with ConnectOne's board of directors. The effect of these provisions is discussed briefly below.

The shares of ConnectOne's common stock authorized by its certificate of incorporation but not issued provide ConnectOne's board of directors with the flexibility to effect financings, acquisitions, stock dividends, stock splits and stock-based grants without the need for a shareholder vote. ConnectOne's board of directors, consistent with its fiduciary duties, could also authorize the issuance of shares of preferred stock, and could establish voting conversion, liquidation and other rights for ConnectOne's preferred stock being issued, in an effort to deter attempts to gain control of ConnectOne.

ConnectOne's certificate of incorporation provides that no merger, consolidation, liquidation or dissolution of the corporation nor any action that would result in the sale or other disposition of all or substantially all of the assets of the corporation shall be valid unless approved by a vote of two-thirds of ConnectOne's outstanding shares of common stock.

New Jersey Shareholders Protection Act

A provision of New Jersey law, the New Jersey Shareholders' Protection Act (the "Shareholders' Protection Act"), prohibits certain transactions involving an "interested stockholder" and a resident domestic corporation. When used in reference to any such corporation, an "interested stockholder" is generally defined as one who is the beneficial owner, directly or indirectly, of 10% or more of the voting power of the outstanding voting stock of that corporation or who is an affiliate or associate of that corporation and at any time within the five-year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of 10% or more of the voting power of the then outstanding stock of that corporation.

The Shareholders' Protection Act generally prohibits any business combination between an interested stockholder and a resident domestic corporation for a period of five years following that interested stockholder's stock acquisition date unless: (a) that business combination is approved by the corporation's board of directors prior to that interested stockholder's stock acquisition date or (b) the transaction(s) which caused the person to become an interested stockholder was approved by the corporation's board of directors prior to that interested stockholder's stock acquisition date and any subsequent business combinations with that interested stockholder are approved by the corporation's board of directors, provided that any such subsequent business combination is approved by (1) the board of directors, or a committee thereof, consisting solely of persons who are not employees, officers, directors, stockholders, affiliates or associates of that interested stockholder, and (2) the affirmative vote of the holders of a majority of the voting stock not beneficially owned by such interested stockholder at a meeting called for such purpose. After the five-year period expires, the prohibition on business combinations with an interested stockholder continues unless certain conditions are met. Subject to further limitations, these conditions include: (a) a business combination approved by the corporation's board of directors prior to that interested stockholder's stock acquisition date; (b) a business combination approved by a vote of two-thirds of the voting stock not owned by the interested stockholder; (c) a business combination whereby its shareholders receive consideration in accordance with the Shareholders' Protection Act; and (d) a business combination approved by the corporation's board of directors, or a committee thereof, consisting solely of persons who are not employees, officers, directors, stockholders, affiliates or associates of that interested stockholder prior to the consummation of the business combination and by the affirmative vote of the holders of a majority of the voting stock not beneficially owned by such interested stockholder at a meeting called for such purpose if the transaction(s) with the interested stockholder which caused the person to become an interested stockholder was approved by the corporation's board of directors prior to the consummation of such transaction(s).

Shareholders' Nominations and Proposals

The procedures governing the submission of nominations for directors and other proposals by shareholders for consideration at a meeting may also have a deterrent effect on shareholder actions designed to result in a change of control of ConnectOne. ConnectOne's bylaws require advance notice to ConnectOne's corporate secretary regarding shareholder proposals and the nomination, other than by or at the direction of the ConnectOne board of directors or one of its committees, of candidates for election as directors. Such advance notice must be received by the corporate secretary not less than 50 days nor more than 75 days prior to the meeting, irrespective of any deferrals, postponements or adjournments thereof to a later date; provided, however, that in the event that less than 60 days' notice or prior public disclosure of the date of the meeting is given or made to shareholders, notice by the shareholder to be timely must be so received not later than the close of business on the 10th day following the day on which such notice of the date of meeting was mailed or such public disclosure was made, whichever first occurs.

Each such notice to the corporate secretary shall set forth: (i) the name and address of record of the shareholder who intends to make the nomination; (ii) a representation that the shareholder is a holder of record of shares of the corporation entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (iii) the name, age, business and residence addresses, and principal occupation or employment of each nominee if the proposal is a nomination to the board of directors; (iv) a description of all arrangements or understandings between the shareholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the shareholder; (v) such other information regarding each nominee proposed by such shareholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the SEC, as then in effect; (vi) the consent of each nominee to serve as a director of the corporation if so elected and (vii) the name, address, principal occupation and ownership of the corporation of any other party having an interest in the proposal. ConnectOne may require any proposed nominee to furnish such other information as may reasonably be required by ConnectOne to determine the eligibility of such proposed nominee to serve as a director of ConnectOne.

Failure of any shareholder to provide the notice or information required by the foregoing provisions in a timely and proper manner shall authorize ConnectOne's board of directors to reject any such proposal or nomination.

Restrictions on Ownership

The Bank Holding Company Act requires any bank holding company (as defined therein) to obtain the approval of the Federal Reserve Board prior to acquiring more than five percent (5%) of ConnectOne's outstanding common stock. Any person other than a bank holding company is required to obtain prior approval of the Federal Reserve Board to acquire ten percent (10%) or more of ConnectOne's outstanding common stock under the Change in Bank Control Act. Any holder of twenty-five percent (25%) or more of ConnectOne's outstanding common stock, other than an individual, is subject to regulation as a bank holding company, under the Bank Holding Company Act.

Subsidiaries of the Registrant as of December 31, 2019

The following table sets forth the names of the registrant's direct and indirect subsidiaries and the state or other jurisdiction of incorporation of each such entity. In each case, the names of the listed subsidiaries are the same as the names under which such subsidiaries do business.

Name	Incorporation
ConnectOne Bank	New Jersey
Center Bancorp Statutory Trust II	Delaware
Union Investment Co.	New Jersey
Center Financial Group, LLC	New Jersey
Center Advertising Corporation	New Jersey
Morris Property Company, LLC	New Jersey
Twin Bridge Investment Co.	Delaware
Volosin Holdings, LLC	New Jersey
ConnectOne Preferred Funding Corp.	New Jersey
NJCB Spec-1, LLC	New Jersey
BoeFly, Inc.	New Jersey
*Greenbrook Consulting, LLC	New Jersey
*ConnectOne Bank owns 49% interest in Greenbrook Title Agency, LLC	

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement Nos. 333-221705 on Form S-3 and Registration Statement Nos. 333-224575, 333-197239, and 333-160111 on Form S-8 of ConnectOne Bancorp, Inc. of our report dated March 2, 2020, relating to the consolidated financial statements of ConnectOne Bancorp, Inc. and Subsidiaries and the effectiveness of internal control over financial reporting, which report appears in this Annual Report on Form 10-K of ConnectOne Bancorp, Inc. for the year ended December 31, 2019.

/s/ Crowe LLP

Crowe LLP
New York, New York
March 2, 2020

CERTIFICATIONS

I, Frank Sorrentino III, certify that:

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

Date: March 2, 2020

By: /s/ Frank Sorrentino III
Frank Sorrentino III
Chairman and Chief Executive Officer

CERTIFICATIONS

I, William S. Burns, certify that:

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

Date: March 2, 2020

By: /s/ William S. Burns
William S. Burns
Executive Vice President and
Chief Financial Officer

**CERTIFICATION PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned, Frank Sorrentino III and William S. Burns hereby jointly certify as follows:

They are the Chief Executive Officer and the Chief Financial Officer, respectively, of ConnectOne Bancorp, Inc. (the “Company”);

To the best of their knowledge, the Company’s Annual Report on Form 10-K for the year ended December 31, 2019 (the “Report”) complies in all material respects with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and

To the best of their knowledge, based upon a review of the Report, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 2, 2020

By: /s/ Frank Sorrentino III
Frank Sorrentino III
Chairman and Chief Executive Officer

Date: March 2, 2020

By: /s/ William S. Burns
William S. Burns
Executive Vice President and
Chief Financial Officer
