

**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, 2022

OR

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

For the Transition Period from to

Commission File Number: 001-40751



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
Depository Shares (each representing a 1/40th interest in a share of 5.25% Series A Non-Cumulative, perpetual preferred stock)	CNOBP	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 Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark 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 ☐

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 has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared its audit report. Yes ☒ No ☐

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). ☐

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 - \$1,026.4 million.

Shares Outstanding on February 24, 2023

Common Stock, no par value: 39,151,113 shares

DOCUMENTS INCORPORATED BY REFERENCE

Definitive proxy statement in connection with the 2023 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.

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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) the impact of the COVID-19 pandemic and the government’s response to the pandemic on our operations as well as those of our clients and on the economy generally and in our market area specifically, (2) competitive pressures among depository institutions may increase significantly; (3) changes in the interest rate environment may reduce interest margins; (4) prepayment speeds, loan origination and sale volumes, charge-offs and loan loss provisions may vary substantially from period to period; (5) general economic conditions may be less favorable than expected; (6) political developments, wars or other hostilities may disrupt or increase volatility in securities markets or other economic conditions; (7) legislative or regulatory changes or actions may adversely affect the businesses in which ConnectOne Bancorp, Inc. is engaged; (8) changes and trends in the securities markets may adversely impact ConnectOne Bancorp, Inc.; (9) a delayed or incomplete resolution of regulatory issues could adversely impact our planning; (10) 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; (11) 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 (12) 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.

On July 11, 2018, the Company entered into an Agreement and Plan of Merger with Greater Hudson Bank (“GHB”), under which GHB merged 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”). 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 were located in Bergen County, New Jersey. As part of this merger, the Company acquired approximately \$0.8 billion in loans and assumed approximately \$0.8 billion in deposits.

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 9 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 REIT 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. Additionally, within the Investor Relations section of the Company’s web site, charters for the Audit and Risk Committee, Nominating and Corporate Governance Committee and Compensation Committee can be found, along with the Company’s Corporate Governance Guidelines and Code of Ethics.

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 Bancorp, Inc. is a modern financial services company with over \$9.6 billion in assets. It operates primarily through its bank subsidiary, ConnectOne Bank.

ConnectOne Bank is a high-performing commercial bank offering a full suite of deposit and loan products and services to the general public, primarily to small and mid-sized businesses, local professionals and individuals residing, working and conducting business in the New York Metropolitan area and the South Florida market served by our West Palm Beach office. The Bank’s continuous investments in technology coupled with top talent allow ConnectOne to operate a “branch-lite” model, making for a highly efficient operating environment.

BoeFly, a wholly owned subsidiary of ConnectOne Bank, is a fintech marketplace that connects borrowers in the franchise space with funding solutions through a network of partner banks, including the Bank.

Our Market Area

ConnectOne Bank's offices are located primarily in the New York metro market and span New Jersey, New York City, Long Island, and the Hudson Valley, including Rockland, Orange, and Westchester counties. Through high tech tools and service, the Bank is able to extend its reach supporting clients as they move into new markets, such as South Florida where we opened an office in West Palm Beach in August 2022. Our market area includes some of the most affluent markets in the United States. The Bank's goal is to continue to expand and do business to support our clients as they grow. Advances in technology have created new delivery channels that allow us to service clients and maintain business relationships with a reduced-branch model, establishing regional offices that serve as business hubs. The Bank's 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.

BoeFly operates out of its main offices in Boston, Massachusetts and New York, and has a nationwide presence through its digital business marketplace.

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 and business checking accounts, money market accounts, time and savings accounts, credit cards, wire transfers, safe deposit boxes, access to automated teller services and telephone, internet and mobile banking. We offer Retirement accounts to Consumers and Cash Management services to business clients that include Treasury Direct, Automated Clearing House ("ACH") origination, Remote Deposit Capture (RDC) and Digital Invoicing.

Non-interest demand deposit products include "Totally Free Checking" and "Simply Better Checking" for consumer clients and "Small Business Checking" and "Analysis Checking" for commercial clients. Interest-bearing checking accounts require minimum balances for both consumer 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. Our savings accounts offer paper and/or electronic statements. Time deposits (TD) are for non-retirement and IRA accounts, generally with initial maturities ranging from 31 days to 60 months, and brokered TDs, 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 IntraFi Network LLC network, formerly known as Promontory Interfinancial Network. Clients, who are Federal Deposit Insurance Corporation ("FDIC") insurance sensitive, are able to place large dollar deposits with the Company and the Company utilizes 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 insured dollar amount. Unless certain conditions are satisfied, the FDIC 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, commercial and Small Business Administration ("SBA") loan originations and sales, loan servicing, late fees and merchant services.

We offer consumer 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 business assets including accounts receivable, inventory and equipment, and mortgages filed on commercial and residential real estate. Furthermore, cash balances, and marketable securities will be considered provided they are held by or under the control of the Bank.

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, condominium and Cooperative 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.

During 2021 and 2020, we participated in the Small Business Administration's ("SBA") Paycheck Protection Program ("PPP") created under the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"). The PPP provided funds to guarantee forgivable loans originated by depository institutions to eligible small businesses through the SBA's 7(a) loan guaranty program. These loans are 100% federally guaranteed (principal and interest) and currently not subject to any allocation of allowance for credit losses. An eligible business could apply under the PPP during the applicable covered period and receive a loan up to 2.5 times its average monthly "payroll costs" limited to a loan amount of \$10.0 million. The proceeds of the loan could be used for payroll (excluding individual employee compensation over \$100,000 per year), mortgage, interest, rent, insurance, utilities and other qualifying expenses. PPP loans have: (a) an interest rate of 1.0%, (b) a two-year loan term (or five-year loan term for loans made after June 5, 2020) to maturity; and (c) principal and interest payments deferred until the date on which the SBA remits the loan forgiveness amount to the borrower's lender or, alternatively, notifies the lender no loan forgiveness is allowed. If the borrower did not submit a loan forgiveness application to the lender within 10 months following the end of the 24-week loan forgiveness covered period (or the 8-week loan forgiveness covered period with respect to loans made prior to June 5, 2020 if such covered period is elected by the borrower), the borrower would begin paying principal and interest on the PPP loan immediately after the 10-month period.

On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act (the "Economic Aid Act") became law. Among other things, the Economic Aid Act extended the PPP through March 31, 2021 and allocated additional funds for new PPP loans, to be guaranteed by the SBA. The extension included an authorization to make new PPP loans to existing PPP loan borrowers, and to make loans to parties that did not previously obtain a PPP loan. The Company participated in the extended PPP. Loans originated under the extended PPP have substantially the same terms as under the original PPP. As of December 31, 2022, the Company had \$11.4 million in total PPP loans outstanding and not yet forgiven.

The Board of Directors has approved a credit policy granting designated lending authorities to specific officers of the Bank. Those officers are comprised of the Chief Executive Officer, President, Chief Credit Officer, Chief Lending Officer, Senior Credit Officers, Managing Directors, 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, President, Chief Credit Officer and Chief Lending Officer) can approve loans up to \$35 million in aggregate loan exposure with no policy exceptions and up to \$30 million with policy exceptions. Furthermore, the Senior Lending Group has authority to approve unsecured loan amounts without policy exceptions up to \$10 million and up to \$5 million with an exception. 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 higher 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 credit losses) for most loans (\$158.1 million) and 25% of the capital base for loans secured by readily marketable collateral (\$263.5 million). As of December 31, 2022, the Bank's largest committed relationship (to several affiliated borrowers) was \$177.1 million and single largest loan outstanding was \$54.6 million.

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 faces 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.

Employees and Human Capital Resources

Our employees are one of our greatest assets and we believe they provide us with an advantage over our competitors. We believe we have a talented, diverse team of financial experts and relationship specialists who understand the demands of a successful business and are prepared to meet them.

As of December 31, 2022, we had 507 full-time employees, and 8 part-time employees. The employees are not represented by a collective bargaining unit.

We encourage and support the growth and development of our employees and, wherever possible, seek to fill positions by promotion and transfer from within the organization. We have formalized our commitment to training, education and mentoring through our ConnectOne University program.

ConnectOne University houses our training, leadership development, continuing education and mentorship programs. Through ConnectOne University, employees:

- Receive and complete required job training related to their position with the Company, such as compliance and ethics training and position specific training. Classes include an ABA approved curriculum as well as other third party and Company proprietary courses;
- May take classes to attain job specific certifications to help with career development;
- May take continuing education classes related to other positions and operations at the Company;
- May take business related continuing education classes at partner community colleges and other institutions through a New Jersey State grant program;
- May participate in career mentoring programs in which employees meet with senior officers of the Company to discuss career development; and
- May participate in a tuition reimbursement program under which the Company will reimburse employees for up to \$5,250 in tuition expense related to approved business-related course work at any school.

During 2022, 236 employees participated in our leadership and mentoring programs within ConnectOne University.

Through ConnectOne University, we also sponsor two employees each year to attend the Stonier Graduate School of Banking. This is a competitive process requiring an employee to be nominated by the employee's manager and then participate in a panel interview.

We continuously assess any skill gaps and are gearing learning for the banking positions of the future.

The safety, health and wellness of our employees is a top priority. The COVID-19 pandemic presented a unique challenge with regard to maintaining employee safety while continuing successful operations. Through our technology and teamwork, we were able to transition, over a short period of time, substantially all of our non-branch employees to a remote working environment while still servicing the needs of our clients. Branch locations have operated in a variety of ways: closed to lobby traffic, in person banking by appointment only, curbside banking and always with COVID-19 safety protocols at the forefront. When we were able to resume substantial in office employee participation, we took a number of steps to protect the health and safety of our employees, including adhering to the Center for Disease Control and Prevention and state guidelines for in-office work (limiting occupancy in the buildings, social distancing, mask requirements, limiting in person meetings). We also developed COVID-19 protocols as a resources for all employees in the event someone was exposed. Currently, the Bank is operating under a hybrid schedule that combines working remotely as well as the ability to work out of our offices. We feel the flexibility of a hybrid approach will aid in employee retention, as well as new employee recruitment. The Bank remains in compliance with all government requirements related to the pandemic.

Employee retention helps us operate efficiently and is key to our ability to compete against larger competitors. We focus on promoting employees from within and leveraging their knowledge of the organization as we continue to grow our Bank. In 2022, 73 employees were promoted into new roles.

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 and managerial 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-charted 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 will continue to be examined for compliance with the consumer laws by their primary bank regulators. Although the Bank currently has slightly less than \$10 billion in assets, and so is not subject to examination by the Bureau, it is likely that the Bank will exceed \$10 billion in total assets in the foreseeable future, and so will become subject to examination by the Bureau.
- *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 premium 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.

Although a significant number of the rules and regulations mandated by the Dodd-Frank Act have been finalized, many of the requirements called for have yet to be fully 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 mid-sized 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.

Certain of the regulations needed to implement the EGRRCPA have yet to be promulgated by the federal banking agencies, and others have not been fully implemented or enforced 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% of the loan value, 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

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.

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 and was fully phased in on January 1, 2019.

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”). Under the CARES Act, the effective date for the implementation of ASU No. 2016-13 was delayed until the earlier of the end of the health crises caused by the COVID-19 Pandemic or December 31, 2020. The Economic Aid Act then further delayed implementation until the earlier of the end of the health crises caused by the COVID-19 Pandemic or January 1, 2022. The final rule also 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 adopted the CECL standard effective January 1, 2021.

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 took effect January 1, 2020, and qualifying community banking organizations could 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

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 \$2.8 million and \$2.9 million in total FDIC assessments in 2022 and 2021, respectively.

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%.

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 client 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.

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 clients.

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 regulations 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, including our required capital conservation buffer. 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.

The Parent Corporation has outstanding a series of perpetual preferred stock, our 5.25% Fixed-Rate Reset Non-Cumulative Perpetual Preferred Stock, Series A. The rights of the preferred stockholders to receive dividends are senior to the rights of our common holders, although the preferred dividend rights are non-cumulative. Therefore, unless all dividends due on our outstanding preferred stock have been declared and paid for the most recent dividend period, we may not pay a dividend on our common stock or repurchase shares of our common stock.

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 securities 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 securities. 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 securities may decline, and stockholders may lose part or all of their investment in our securities.

Risks Applicable to Our Business:

The ongoing COVID-19 pandemic and measures intended to prevent its spread could have a material adverse effect on our business, results of operations and financial condition, and such effects will depend on future developments, which are highly uncertain and are difficult to predict.

Global health concerns relating to the COVID-19 outbreak and its variants and related government actions taken to reduce the spread of the virus have weighed on the macroeconomic environment in our New Jersey/New York metropolitan market trade area, and the outbreak has significantly increased economic uncertainty and reduced economic activity. The outbreak has resulted in authorities implementing numerous measures to try to mitigate the virus, and such measures, even as certain of them have been eased, have impacted consumer and business spending.

In addition, the pandemic has changed consumer and employee behavior, such as through the rise in working from home, in ways that may negatively impact the overall economy of our Metropolitan New York economy and the businesses of our customers. The United States government has taken steps to attempt to mitigate some of the more severe anticipated economic effects of the virus, including the passage of the CARES Act and the Economic Aid Act, but there can be no assurance that such steps will be effective or achieve their desired results in a timely fashion.

The outbreak has adversely impacted and is likely to further adversely impact our workforce and operations and the operations of our borrowers, clients and business partners. In particular, we may experience financial losses due to a number of operational factors impacting us or our borrowers, clients or business partners, including but not limited:

- o to credit losses resulting from financial stress being experienced by our borrowers as a result of the outbreak and related governmental actions, particularly in the hospitality, energy and retail industries, but across other industries as well. As of December 31, 2022, the bank had no loans on deferrals;
- o declines in collateral values;
- o third party disruptions, including outages at network providers and other suppliers;
- o increased cyber and payment fraud risk, as cybercriminals attempt to profit from the disruption, given increased online and remote activity; and
- o operational failures due to changes in our normal business practices necessitated by the outbreak and related governmental actions.

These factors may remain prevalent for a significant period of time and may continue to adversely affect our business, results of operations and financial condition even after the COVID-19 outbreak has subsided.

The extent to which the coronavirus outbreak impacts our business, results of operations and financial condition will depend on future developments, which are highly uncertain and are difficult to predict, including, but not limited to, the duration and spread of the outbreak, its severity, new variants of the virus and their impact, the actions to contain the virus or treat its impact, and how quickly and to what extent normal economic and operating conditions resume. Even after the COVID-19 outbreak has subsided, we may continue to experience materially adverse impacts to our business as a result of the virus's global economic impact, including the availability of credit, adverse impacts on our liquidity and any recession that has occurred or may occur in the future.

There are no comparable recent events that provide guidance as to the effect the spread of COVID-19 as a global pandemic may have, and, as a result, the ultimate impact of the outbreak is highly uncertain and subject to change. We do not yet know the full extent of the impacts on our business, our operations or the global economy as a whole. However, the effects could have a material impact on our results of operations and heighten many of our known risks described in this "Risk Factors" section.

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 client 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 clients or a significant default by our clients would materially and adversely affect us.

As of December 31, 2022, we had \$6.2 billion of commercial real estate loans (nonowner-occupied, owner-occupied and multifamily), including construction loans, which represented 76.3% of loans receivable. Concentrations in commercial real estate are 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 483% of the Bank's Tier 1 capital plus the allowance for credit losses on loans.

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 may be more susceptible to the general impact on the economic environment affecting those operating companies as well as the real estate.

The impact of the COVID-19 pandemic and the development of remote work or hybrid work models on the metropolitan New York area commercial real estate market is uncertain, causing volatility in rents in certain core urban markets. Many other factors, including the exchange rate for the U.S. dollar, potential international trade tariffs, inflation and changes in federal tax laws affecting the deductibility of state and local taxes and mortgage interest could negatively impact 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.

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 continue to 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, 2022, we had \$5.8 billion in commercial real estate loans outstanding. Approximately 67.4% of the loans, or \$3.9 billion, had been originated in the past three years. 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.

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 clients and caring about our clients 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, including online “fintech” companies. 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. As of December 31, 2022, governmental and municipal deposits accounted for approximately \$797.6 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 faces 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 on 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 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, 2022, we had approximately \$634.9 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 not be able to pay dividends on our common stock if we have not made required dividend payments on our outstanding, noncumulative preferred stock.

We have a series of outstanding perpetual preferred stock, our 5.25% Fixed-Rate Reset Non-Cumulative Perpetual Preferred Stock, Series A. The rights of the preferred stockholders to receive dividends are senior to the rights of our common holders, although the preferred dividend rights are non-cumulative. Therefore, unless all dividends due on our outstanding preferred stock have been declared and paid for the most recent dividend period provided for under the terms of the preferred stock, we may not pay a dividend on our common stock or repurchase shares of our common stock during that period.

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 and BNJ. To be successful as a larger institution, we must successfully integrate the operations and retain the clients 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 clients of those institutions. If we are unable to successfully manage the integration of the separate cultures, client 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.

In addition, to successfully manage substantial growth, we may need to increase noninterest 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 client 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 target companies 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 credit losses. Finally, health related events, such as a viral pandemic, could adversely affect the business of our clients and our local economies, thereby adversely affecting our results of operations.

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

The Company's total assets were \$9.6 billion as of December 31, 2022. 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 proposed merger, 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.

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 U.S. bank regulatory agencies have directed U.S. insured depository institutions to cease using LIBOR in new loan or other financial agreements effective December 31, 2021. Certain LIBOR maturity rates will no longer be published after December 31, 2021, with publication of the remaining maturity rates ending in 2023. The Federal Reserve Bank commenced publication of SOFR rates on April 2, 2018. The uncertainty as to the nature and effect of such reforms and actions 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.

Risks Applicable to the Banking Industry Generally:

Our allowance for credit losses may not be adequate to cover actual losses.

Like all financial institutions, we maintain an allowance for credit losses and 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, as well as 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 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 credit losses. Further increases to the allowance could adversely affect our earnings.

Changes in interest rates, including increases to address inflation, as well as other actions the Federal Reserve may take to address inflation, 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, such as has been in effect during the second half of 2022, 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 increases.

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.

In addition to increases in interest rates, the FOMC has also changed its stance on monetary policy as an additional effort to reduce inflation. Beginning in the second half of 2022, the FOMC began reducing its balance sheet, implementing a program of quantitative tightening to reduce the overall money supply. As a result, we may face greater competition for deposits, resulting in a higher cost of funds and a reduced net interest margin, as well as greater liquidity risk to continue to fund our loan originations. We are unable to predict the duration and ultimate impact of the FOMC's quantitative tightening program. However, if the program significantly tightens the nation's money supply, it may 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, implementation of all required regulations under 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. Ultimately, final implementation the Dodd-Frank Act 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.

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.

The ultimate effect of certain 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”;
- Remote deposit capture;
- Artificial Intelligence;
- Cryptocurrency; and
- Use of Blockchain.

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 clients 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 clients 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.

Item 2. Properties

The Bank operates seven banking offices in Bergen County, NJ, in Fort Lee, Englewood Cliffs, Hackensack, Cresskill, Haworth, Ridgewood and Saddle River; four banking offices in Union County, NJ, consisting of two offices in Union Township, and one office each in Springfield Township, and Summit; one banking office in Morristown in Morris County, NJ; one office in Newark in Essex County, NJ; one office in West New York in Hudson County, NJ; one office in Holmdel in Monmouth County, NJ; 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 five branches in the Hudson Valley, including in White Plains and Tarrytown, in Westchester County, NY, Bardonia and Blauvelt, in Rockland County, NY and in Middletown, in Orange County, NY, and one financial center in West Palm Beach in Palm Beach County, FL. 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 operating locations.

Banking Office Location	Term
301 Sylvan Avenue, Englewood Cliffs, NJ	Term expires November 2028
156 Piermont Rd, Cresskill, NJ.....	Term expires July 2023
142 John Street, Hackensack, NJ	Term expires December 2026
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
545 Morris Avenue, Summit, NJ	Term expires February 2024
217 Chestnut Street, Newark, NJ	Term expires February 2024
5914 Park Avenue, West New York, NJ	Term expires September 2023
963 Holmdel Road, Holmdel, NJ.....	Term expires September 2026
551 Madison Avenue, Suite 202, NY, NY	Term expires October 2028
48 South Service Rd, 2nd 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
715 Route 304, Bardonia NY.....	Term Expires August 2028
567 North Broadway, White Plains NY.....	Term Expires September 2028
155 White Plains Rd., Tarrytown NY	Term Expires December 2026
170 East Erie St, Blauvelt NY	Term Expires February 2028
625 N Flagler Dr Ste 1002, West Palm Beach, FL	Term Expires June 2027

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, 2022, the Company had 679 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.

In March 2019, the Board of Directors of the Company approved a share repurchase program for up to 1,200,000 shares. In September 2021, the Board of Directors had authorized the repurchase of up to an additional 2,000,000 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, 2022, the Company repurchased a total of 447,108 shares. As of December 31, 2022, shares remaining for repurchase under the program were 1,827,640.

The following table details share repurchases for the year 2022:

	<u>Shares Authorized</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Cumulative Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</u>
					2,274,748
First quarter 2022.....	-	144,793	\$ 32.82	144,793	2,129,955
Second quarter 2022	-	302,315	27.29	447,108	1,827,640
Third quarter 2022	-	-	-	447,108	1,827,640
Fourth quarter 2022	-	-	-	447,108	1,827,640

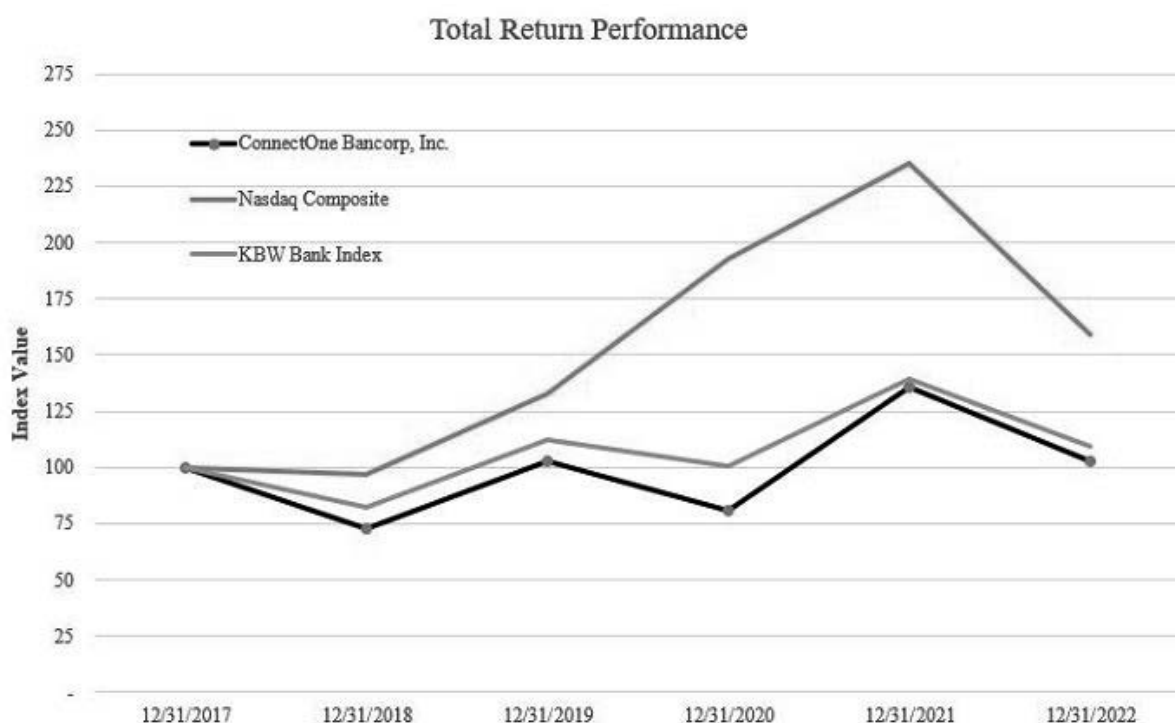
Dividends

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 18 and Note 21 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, 2017 through December 31, 2022.

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



**Assumes \$100 Invested on December 31, 2017, with Dividends Reinvested
Year Ended December 31, 2022**

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

Company/Index/Market	Fiscal Year Ending					
	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021	12/31/2022
ConnectOne Bancorp, Inc.....	100.00	72.57	102.70	80.71	135.48	102.45
NASDAQ.....	100.00	97.19	132.88	192.74	235.56	158.97
KBW Bank Index.....	100.00	82.29	112.15	100.47	138.99	109.25

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, 2022 and 2021 and the selected consolidated summary of income data for the years ended December 31, 2022, 2021 and 2020 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, 2020 and the selected consolidated summary of income data 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

(\$ in thousands except per share amounts)	As of and for the years ended December 31,		
	2022	2021	2020
Selected Statement of Financial Condition Data			
Total assets	\$ 9,644,948	\$ 8,129,480	\$ 7,547,339
Loans receivable.....	8,099,689	6,828,622	6,236,307
Allowance for credit losses - loans.....	90,513	78,773	79,226
Investment securities	634,884	534,507	487,955
Goodwill and other intangible assets.....	215,684	217,369	219,349
Borrowings.....	857,622	468,193	425,954
Subordinated debt (net of issuance costs)	153,255	152,951	202,648
Deposits.....	7,356,622	6,332,953	5,959,224
Tangible common stockholders' equity(1).....	852,140	795,916	695,961
Total stockholders' equity	1,178,751	1,124,212	915,310
Average total assets.....	8,782,741	7,735,228	7,453,474
Average common stockholders' equity	1,039,468	965,995	880,720
Common Dividends			
Cash dividends paid on common stock	\$ 23,428	\$ 17,493	\$ 14,317
Common dividend payout ratio	18.97%	13.60%	20.08%
Cash dividends per common share	0.595	0.48	0.27
Selected Statement of Income Data			
Interest income	\$ 373,746	\$ 301,738	\$ 308,200
Interest expense	(71,627)	(38,860)	(70,209)
Net interest income.....	302,119	262,878	237,991
(Provision for) reversal of credit losses.....	(17,750)	5,500	(41,000)
Net interest income after provision for credit losses	284,369	268,378	196,991
Noninterest income	13,243	15,691	14,400
Noninterest expense	(126,388)	(109,011)	(121,001)
Income before income tax expense	171,224	175,058	90,390
Income tax expense	(46,013)	(44,705)	(19,101)
Net income	125,211	130,353	71,289
Preferred stock dividends	6,037	1,717	-
Net income available to common stockholders	<u>\$ 119,174</u>	<u>\$ 128,636</u>	<u>\$ 71,289</u>

- (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.

As of and for the years ended December 31,				
	2022	2021	2020	
Per Common Share Data				
Basic earnings per share	\$ 3.03	\$ 3.24	\$ 1.80	
Diluted earnings per share	3.01	3.22	1.79	
Book value per common share	27.21	25.61	23.01	
Tangible book value per common share(1)	21.71	20.12	17.49	
Selected Performance Ratios				
Return on average assets	1.36%	1.69%	0.96%	
Return on average common stockholders' equity	11.46	13.32	8.09	
Return on average tangible common equity(1)	14.48	17.21	10.80	
Net interest margin	3.69	3.66	3.46	
Selected Asset Quality Ratios				
As a % of Loans Receivable:				
Nonaccrual loans	0.55%	0.90%	0.99%	
Loans 90 days or greater past due and still accruing	0.07	0.20	0.21	
Performing TDRs	0.63	0.64	0.38	
Allowance for credit losses - loans	1.12	1.15	1.27	
Nonperforming assets(2) to total assets	0.46%	0.76%	0.82%	
Allowance for credit losses for loans to nonaccrual loans	203.6	127.7	128.4	
Net loan charge-offs to average loans	0.07	0.03	0.00	
Company Capital Ratios				
Leverage ratio	10.68%	11.65%	9.51%	
Common equity Tier 1 risk-based ratio	10.30	10.64	10.79	
Risk-based Tier 1 capital ratio	11.66	12.19	10.87	
Risk-based capital ratio	14.45	15.26	15.08	
Tangible common equity to tangible assets(1)	9.04	10.06	9.50	

-
- (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 and other real estate owned.

Non-GAAP Reconciliation Table (\$ in thousands, except per share amounts)

	As of December 31,		
	2022	2021	2020
Tangible common equity and tangible common equity/tangible assets			
Stockholders' equity	\$ 1,178,751	\$ 1,124,212	\$ 915,310
Less: Preferred stock	110,927	110,927	-
Common stockholders' equity	\$ 1,067,824	\$ 1,013,285	\$ 915,310
Less: Goodwill and other intangible assets	215,684	217,369	219,349
Tangible common stockholders' equity	<u>\$ 852,140</u>	<u>\$ 795,916</u>	<u>\$ 695,961</u>
Total assets	\$ 9,644,948	\$ 8,129,480	\$ 7,547,339
Less: goodwill and other intangible assets	215,684	217,369	219,349
Tangible assets	<u>\$ 9,429,264</u>	<u>\$ 7,912,111</u>	<u>\$ 7,327,990</u>
Tangible common equity ratio	9.04%	10.06%	9.50%
Tangible book value per common share			
Book value per common share	\$ 27.21	\$ 25.61	\$ 23.01
Less: goodwill and other intangible assets	5.50	5.49	5.52
Tangible book value per common share	<u>\$ 21.71</u>	<u>\$ 20.12</u>	<u>\$ 17.49</u>
Return on average tangible common equity			
Net income available to common stockholders	\$ 119,174	\$ 128,636	\$ 71,289
Average stockholders' equity	\$ 1,150,395	\$ 1,007,023	\$ 880,720
Less: average preferred stock	110,927	41,028	-
Average common stockholders' equity	1,039,468	965,995	880,720
Less: goodwill and other intangible assets	216,575	218,417	220,570
Average tangible common stockholders' equity	<u>\$ 822,893</u>	<u>\$ 747,578</u>	<u>\$ 660,150</u>
Return on average common stockholders' equity	11.46%	13.32%	8.09%
Return on average tangible common stockholders' equity	14.48%	17.21%	10.80%

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. The Company considers the allowance for credit losses and related provision to be critical to our financial results. For information on our significant accounting policies, see Note 1a in the Notes to Consolidated Financial Statements.

Allowance for Credit Losses and Related Provision

The allowance for credit losses is an estimate of current expected credit losses considering available information relevant to assessing collectability of cash flows over the contractual term of the financial assets necessary to cover lifetime expected credit losses inherent in financial assets at the balance sheet date. The methodology for determining the allowance for credit losses is considered a critical accounting policy by management because of the high degree of judgment involved, the subjectivity of the assumptions used, and the potential for changes in the forecasted economic environment that could result in changes to the amount of the recorded allowance for credit losses. The loan portfolio also represents the largest asset type on the Company’s Consolidated Statements of Condition.

Management believes the following information may enable investors to better understand the changes in our allowance for credit losses for loans. The Company’s allowance for credit losses for loans totaled \$90.5 million and \$78.8 million as of December 31, 2022 and 2021, respectively. The \$11.7 million increase in our allowance for credit losses for loans was primarily driven by our collectively evaluated loans and offset by allowance for credit losses on individually analyzed loans.

The quantitative component of our allowance for credit losses on collectively evaluated loans, which is largely based on a selection of various economic forecasts, increased by \$19.4 million as of December 31, 2022 when compared to December 31, 2021. This increase was primarily attributable to both organic growth of \$1.4 billion in collectively evaluated loans and deterioration in periodic economic forecasts throughout the year. The qualitative component of our ACL, which is largely based on management’s judgment of qualitative loss factors, was relatively unchanged, on an absolute basis, over the same period-of-time, as qualitative factor trends improved over 2022.

The Company’s allowance for credit losses for collectively evaluated loans totaled \$78.0 million as of December 31, 2022, which included \$70.1 million of allowance related to commercial and commercial real estate loans. Included in that \$70.1 million of allowance related to commercial and commercial real estate loans, \$24.7 million was attributable to qualitative loss factors. Changes in managements’ judgement of qualitative loss factors could result in a significant change to the allowance for credit losses for loans. As described in Note 1a, to our financial statements filed as part of this Annual Report on Form 10-K, qualitative loss factors are applied to each portfolio segment with the amounts judgmentally determined by the relative risk to the most severe loss periods identified in the historical loan charge-offs of a peer group of similar-sized regional banks. As of December 31, 2022, on a weighted average basis the most severe historical loss rate for our commercial and commercial real estate loans were 2.20% and 1.85%, respectively.

The Company's quantitative component of allowance for credit losses for collectively evaluated loans is calculated with an economic forecast sourced from Moody's. Management performed a hypothetical sensitivity analysis to understand the impact of changes in the economic forecast as a key input on our allowance for credit losses for collectively evaluated loans. Within the various economic scenarios considered for this hypothetical sensitivity analysis, as of December 31, 2022, the quantitative estimate of the allowance for credit loss for collectively evaluated loans would increase by approximately \$40 million under sole consideration of an adverse Moody's economic forecast. The hypothetical sensitivity calculation reflects the sensitivity of the modeled allowance estimate to macroeconomic forecast data but lacks other qualitative overlays and other qualitative adjustments that are part of the quarterly reserving process. As such, this does not necessarily reflect the nature and extent of future changes in the allowance for reasons including increases or decreases in qualitative adjustments, changes in the risk profile and size of the portfolio, changes in the severity of the macroeconomic scenario and the range of scenarios under management consideration.

Our allowance for credit losses for individually analyzed loans is determined on an individual basis using the present value of expected cash flows discounted using the loan's effective interest rate or, for collateral-dependent loans, the fair value of the collateral, less estimated selling costs, as applicable. As of December 31, 2022, the Company's allowance for credit losses on individually analyzed loans decreased \$7.7 million from December 31, 2021. This decrease was primarily due to reductions in individually analyzed loans, increases in charge-offs, and increases in the fair value of collateral for collateral-dependent loans, partially offset by increases to the allowance on existing individually analyzed loans.

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 clients 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 clients relationships start with referrals from existing clients. We then seek to cross sell our products to clients to grow the client relationship. For example, we will frequently offer an interest rate concession on credit products for clients 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 continued growth and 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 present the more significant factors affecting the Company's financial condition as of December 31, 2022 and 2021 and results of operations for each of the years in the three-year period ended December 31, 2022. 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 available to common stockholders for the year ended December 31, 2022 was \$119.2 million, a decrease of \$9.5 million, or 7.4%, compared to net income of \$128.6 million for 2021. Diluted earnings per share were \$3.01 for 2022, a 6.5% decrease from \$3.22 for 2021.

The change in net income from 2021 to 2022 was attributable to the following:

- Increased provision for credit losses of \$23.2 million. The increase was primarily due to organic loan growth, as well as changes in forecasted macroeconomic conditions.
- Increase in noninterest expenses of \$17.4 million, primarily due to increase in salaries and employee benefits of \$16.9 million attributable to increased staff in both the revenue and back-office areas of the Bank, base salary increases and incentive compensation accruals. Additionally, there were increases in acquisition expenses related to BoeFly of \$1.5 million, other expenses of \$1.1 million, marketing and advertising of \$0.4 million, and FDIC insurance of \$0.2 million, partially offset by decreases in occupancy and equipment of \$1.8 million, amortization of core deposit intangibles of \$0.3 million, professional and consulting of \$0.2 million and information technology and communication of \$0.2 million.
- Decrease in noninterest income of \$2.4 million, primarily due to decreases in net gains on loans-held-for-sale of \$2.1 million, gains on sales of branches of \$0.7 million in 2021, decreases in net gains on sale/redemption of investment securities of \$0.2 million and an increase in net losses on equity securities of \$1.1 million, partially offset by increases in deposit, loan and other income of \$0.9 million and income on bank owned life insurance of \$0.8 million.
- Increase in income tax expense of \$1.3 million resulting primarily from higher state tax rates and a slightly higher percentage of income being derived from taxable sources.

Net income available to common stockholders for the year ended December 31, 2021 was \$128.6 million, an increase of \$57.3 million, or 80.4%, compared to net income of \$71.3 million for 2020. Diluted earnings per share were \$3.22 for 2021, a 79.9% increase from \$1.79 for 2020.

The change in net income from 2020 to 2021 was attributable to the following:

- Decreased provision for credit losses of \$46.5 million. The decrease was primarily due to the elevated provision for loan losses during 2020 due to the economic uncertainties surrounding COVID-19 pandemic.
- Increase in net interest income of \$24.9 million.
- Increase in noninterest income of \$1.3 million, primarily due to increases in net gains on loans-held-for-sale of \$1.7 million, gain on sale of branches of \$0.7 million and net gains on sale/redemption of investment securities of \$0.2 million, offset by decreases in deposit, loan and other income of \$0.5 million, income on bank owned life insurance of \$0.2 million and net gains on equity securities of \$0.6 million. The increase in net gains on loans held-for-sale resulted from mortgage loan sales, SBA loan sales and elevated commercial loan sales. The increase in gain on sale of branches was the result of the Bank selling two branches during the first quarter of 2021 related to the BNJ acquisition.
- Decrease in noninterest expenses of \$12.0 million, primarily due to decreases in merger expenses of \$14.6 million, change in value of acquisition price of \$2.3 million, occupancy and equipment of \$2.2 million, and FDIC insurance of \$1.3 million, partially offset by increases in salaries and employee benefits of \$5.5 million, other expenses of \$2.6 million and professional and consulting of \$0.9 million.
- Increase in income tax expense of \$25.6 million resulting primarily from a higher percentage of income being derived from taxable sources.

Net Interest Income

Fully taxable equivalent net interest income for 2022 totaled \$304.6 million, an increase of \$39.9 million, or 15.1%, from 2021. The increase in net interest income was due to an increase in average interest-earning assets, which grew by 14.3% to \$8.3 billion and a widening of 3 basis-points in the net interest margin. The widening of the net interest margin was mainly attributable to higher yields on loans and securities and lower average cash balances, offset by a higher cost of funds. Average total loans, which includes loans held-for-sale, increased by 15.0% to \$7.4 billion in 2022 from \$6.4 billion in 2021. The increase in average total loans is primarily attributable to higher loan originations.

Fully taxable equivalent net interest income for 2021 totaled \$264.7 million, an increase of \$24.8 million, or 10.3%, from 2020. The increase in net interest income was due to an increase in average interest-earning assets, which grew by 4.2% to \$7.2 billion and a widening of 20 basis-points in the net interest margin. The widening of the net interest margin was mainly attributable to lower cost of funds, offset by higher average cash balances and lower yields on loans and securities. Average total loans, which includes loans held-for-sale, increased by 3.6% to \$6.4 billion in 2021 from \$6.2 billion in 2020. The increase in average total loans is primarily attributable to higher, non PPP, loan originations.

Average Balance Sheets

The following table sets forth certain information relating to our average assets and liabilities for the years ended December 31, 2022, 2021 and 2020 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,								
	2022			2021			2020		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
(dollars in thousands)									
ASSETS									
Interest-earning assets:									
Investment securities (1) (2)	\$ 660,760	\$ 17,640	2.67%	\$ 464,342	\$ 7,455	1.61%	\$ 444,070	\$ 9,996	2.25%
Loans receivable and loans held-for-sale (2) (3) (4)	7,380,584	354,450	4.80%	6,419,610	294,686	4.59%	6,198,753	297,756	4.80%
Federal funds sold and interest-earning deposits with banks	186,205	2,493	1.34%	322,692	405	0.13%	267,824	694	0.22%
Restricted investment in bank stocks	36,744	1,655	4.50%	20,797	971	4.67%	27,185	1,642	6.04%
Total interest-earning assets	8,264,293	376,238	4.55%	7,227,441	303,517	4.20%	6,937,832	310,088	4.47%
Noninterest-earning assets:									
Allowance for credit losses	(84,209)			(79,863)			(59,271)		
Noninterest-earning assets	602,657			587,650			574,913		
Total assets	\$ 8,782,741			\$ 7,735,228			\$ 7,453,474		
LIABILITIES & STOCKHOLDERS' EQUITY									
Time deposits	\$ 1,449,826	\$ 21,331	1.47%	\$ 1,300,270	\$ 14,813	1.14%	\$ 1,792,568	\$ 34,813	1.94%
Other interest-bearing deposits	3,702,773	29,230	0.79%	3,451,765	9,955	0.29%	2,819,908	17,573	0.62%
Total interest-bearing deposits	5,152,599	50,561	0.98%	4,752,035	24,768	0.52%	4,612,476	52,386	1.14%
Borrowings	661,729	12,188	1.84%	318,700	5,300	1.66%	537,773	8,435	1.57%
Subordinated debentures	153,092	8,759	5.72%	153,199	8,669	5.66%	169,139	9,254	5.47%
Finance obligation	1,838	119	6.47%	2,041	123	6.03%	2,233	134	6.00%
Total interest-bearing liabilities	5,969,258	71,627	1.20%	5,225,975	38,860	0.74%	5,321,621	70,209	1.32%
Noninterest-bearing deposits	1,612,040			1,454,148			1,195,547		
Other liabilities	51,048			48,082			55,586		
Stockholders' equity	1,150,395			1,007,023			880,720		
Total liabilities and stockholders' equity	\$ 8,782,741			\$ 7,735,228			\$ 7,453,474		
Net interest income/interest rate spread (5)		304,611	3.35%		264,657	3.46%		239,879	3.15%
Tax-equivalent adjustment		(2,492)			(1,779)			(1,888)	
Net interest income as reported		\$ 302,119			\$ 262,878			\$ 237,991	
Net interest margin (6)			3.69%			3.66%			3.46%

(1) Average balances are based on amortized cost.

(2) Interest income is presented on a tax equivalent basis using 21% federal tax rate.

(3) Includes loan fee income and accretion of purchase accounting adjustments.

(4) Loans include nonaccrual loans.

(5) 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.

(6) 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.

	2022/2021			2021/2020		
	Increase (Decrease)			Increase (Decrease)		
	Due to Change in:			Due to Change in:		
	Average Volume	Average Rate	Net Change	Average Volume	Average Rate	Net Change
	(dollars in thousands)					
Interest income:						
Investment securities:.....	\$ 5,244	\$ 4,941	\$ 10,185	\$ 325	\$ (2,866)	\$ (2,541)
Loans receivable and loans held-for-sale ..	46,150	13,614	59,764	10,138	(13,208)	(3,070)
Federal funds sold and interest-earnings deposits with banks.....	(1,827)	3,915	2,088	69	(358)	(289)
Restricted investment in bank stocks	718	(34)	684	(298)	(373)	(671)
Total interest income:	<u>\$ 50,285</u>	<u>\$ 22,436</u>	<u>\$ 72,721</u>	<u>\$ 10,234</u>	<u>\$ (16,805)</u>	<u>\$ (6,571)</u>
Interest expense:						
Savings, NOW, money market, interest checking.....	\$ 1,981	\$ 17,294	\$ 19,275	\$ 1,822	\$ (9,440)	\$ (7,618)
Time deposits	2,200	4,317	6,517	(5,608)	(14,392)	(20,000)
Borrowings and subordinated debentures .	6,312	667	6,979	(4,545)	825	(3,720)
Finance obligation	(13)	9	(4)	(12)	1	(11)
Total interest expense:	<u>\$ 10,480</u>	<u>\$ 22,287</u>	<u>\$ 32,767</u>	<u>\$ (8,343)</u>	<u>\$ (23,006)</u>	<u>\$ (31,349)</u>
Net interest income:	<u>\$ 39,805</u>	<u>\$ 149</u>	<u>\$ 39,954</u>	<u>\$ 18,577</u>	<u>\$ 6,201</u>	<u>\$ 24,778</u>

Provision for (Reversal of) Credit Losses

In determining the provision for credit 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.

The Bank adopted CECL beginning on January 1, 2021. Provision expense may therefore 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.

For the year ended December 31, 2022, the provision for (reversal of) credit losses was \$17.8 million, an increase of \$23.3 million, compared to the provision for (reversal of) credit losses of (\$5.5) million for the year ended December 31, 2021. The increase in provision for credit losses for the year ended December 31, 2022 reflected strong organic loan growth and changes in forecasted macroeconomic conditions.

For the year ended December 31, 2021, the provision for (reversal of) credit losses was (\$5.5) million, a decrease of \$46.5 million, compared to the provision for (reversal of) loan losses of \$41.0 million for the year ended December 31, 2020. The elevated provision for loan losses for the year ended December 31, 2020 was due to the economic uncertainties of the COVID-19 pandemic, including consideration of related borrower payment deferrals requested and or/ granted. The release of allowance for credit losses during the year ended December 31, 2021 was the result of the continually improving macro-economic outlook during the course of 2021.

Noninterest Income

Noninterest income for the full-year 2022 decreased by \$2.4 million, or 15.6%, to \$13.2 million from \$15.7 million in 2021. The decrease was primarily due to decreases in net gains on loans held for sale of \$2.1 million, gains on sale of branches of \$0.7 million, net gains on sale/redemption of investment securities of \$0.2 million and an increase in net losses on equity securities of \$1.1 million, partially offset by increases in deposit, loan and other income of \$0.9 million and income on bank owned life insurance of \$0.8 million.

Noninterest income for the full-year 2021 increased by \$1.3 million, or 9.0%, to \$15.7 million from \$14.4 million in 2020. The increase was primarily due to increases in net gains on loans held for sale of \$1.7 million, gain on sale of branches of \$0.7 million and net gains on sale/redemption of investment securities of \$0.2 million, partially offset by decreases in deposit, loan and other income of \$0.5 million, income on bank owned life insurance of \$0.2 million and net gains on equity securities of \$0.6 million. The increase in net gains on loans held-for-sale resulted from mortgage loan sales, SBA loan sales and elevated commercial loan sales. The increase in gain on sale of branches was the result of the Bank selling two branches during the first quarter of 2021 related to the BNJ acquisition.

Noninterest Expense

Noninterest expenses for the full-year 2022 increased by \$17.4 million, or 15.9%, to \$126.4 million from \$109.0 million in 2021. The increase was primarily due to increases in salaries and employee benefits of \$16.9 million, change in value of acquisition price of \$1.5 million, other expenses of \$1.1 million, marketing and advertising \$0.4 million and FDIC insurance of \$0.2 million, partially offset by decreases in occupancy and equipment of \$1.8 million, amortization of core deposit intangible of \$0.3 million, information technology and communication of \$0.2 million, professional and consulting of \$0.2 million and other components of net periodic pension income of \$0.3 million. The increase in salaries and employee benefits was attributable to increased staff in both revenue and back-office areas of the Bank, base salary increases, and incentive compensation accruals.

Noninterest expenses for the full-year 2021 decreased by \$12.0 million, or 9.9%, to \$109.0 million from \$121.0 million in 2020. The decrease was primarily due to decreases in merger expenses of \$14.6 million, change in value of acquisition price of \$2.3 million, occupancy and equipment of \$2.2 million, and FDIC insurance of \$1.3 million, partially offset by increases in salaries and employee benefits of \$5.5 million, other expenses of \$2.6 million and professional and consulting of \$0.9 million. Excluding the impact on expenses related to mergers costs, expense increases were mainly attributable to increased levels of business.

Income Taxes

Income tax expense was \$46.0 million for 2022 compared to \$44.7 million for 2021 and \$19.1 million for 2020. The increase in income tax expense in 2022 when compared to 2021 was primarily the result of higher taxable income. The increase in income tax expense in 2021 when compared to 2020 was also primarily the result of higher taxable income. The effective tax rates were 26.9% in 2022, 25.5% in 2021 and 21.1% for 2020. The higher effective tax rate during 2022 when compared to 2021 and 2020, was the result of a higher percentage of income being derived from taxable sources. The Company expects its effective tax rate to increase in 2023, as a result of the Company's revenue growth in existing and new markets.

For a more detailed description of income taxes see Note 10 of the Notes to Consolidated Financial Statements.

Financial Condition Overview

As of December 31, 2022, the Company's total assets were \$9.6 billion, an increase of \$1.5 billion from December 31, 2021. Total loans (including loans held-for-sale) were \$8.1 billion, an increase of \$1.3 billion from December 31, 2021. Deposits were \$7.4 billion, an increase of \$1.0 billion from December 31, 2021.

As of December 31, 2021, the Company's total assets were \$8.1 billion, an increase of \$0.6 billion from December 31, 2020. Total loans (including loans held-for-sale) were \$6.8 billion, an increase of \$0.6 billion from December 31, 2020. Deposits were \$6.3 billion, an increase of \$0.4 billion from December 31, 2020.

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, Nassau, Rockland, Orange and Westchester counties, in New York and businesses and individuals living and working in the communities served by the Bank's West Palm Beach, Florida office. 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.

Gross loans as of December 31, 2022 totaled \$8.1 billion, an increase of \$1.3 billion, or 18.6%, over gross loans as of December 31, 2021 of \$6.8 billion.

The largest component of the gross loan portfolio as of December 31, 2022 and December 31, 2021 was commercial real estate loans. Commercial real estate loans as of December 31, 2022 totaled \$5.8 billion, an increase of \$1.1 billion, or 22.2%, compared to commercial real estate loans as of December 31, 2021 of \$4.7 billion. The main component contributing to the increase in commercial real estate loans is an increase in the multifamily loans. Commercial loans totaled \$1.5 billion as of December 31, 2022, an increase of \$173.3 million, or 13.3%, compared to commercial loans as of December 31, 2021 of \$1.3 billion. Included in commercial loans were PPP loans of \$11.4 million as of December 31, 2022 and \$93.1 million as of December 31, 2021. Commercial construction loans as of December 31, 2022 totaled \$574.1 million, an increase of \$34.0 million, or 6.3%, compared to commercial construction loans as of December 31, 2021 of \$540.2 million.

Residential real estate loans totaled \$264.7 million as of December 31, 2022, an increase of \$9.5 million, or 3.7%, compared to residential real estate loans as of December 31, 2021 of \$255.3 million. Consumer loans as of December 31, 2022 totaled \$2.3 million compared to \$1.9 million as of December 31, 2021.

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

	December 31, 2022	December 31, 2021	December 31, 2020
Commercial (1).....	\$ 1,472,734	\$ 1,299,428	\$ 1,521,967
Commercial real estate.....	5,795,228	4,741,590	3,783,550
Commercial construction	574,139	540,178	617,747
Residential real estate	264,748	255,269	322,564
Consumer	2,312	1,886	1,853
Gross loans	8,109,161	6,838,351	6,247,681
Net deferred fees	(9,472)	(9,729)	(11,374)
Loans receivable.....	8,099,689	6,828,622	6,236,307
Allowance for credit losses.....	(90,513)	(78,773)	(79,226)
Net loans receivable	<u>\$ 8,009,176</u>	<u>\$ 6,749,849</u>	<u>\$ 6,157,081</u>

(1) Includes PPP loans of \$11.4 million and \$93.1 million as of December 31, 2022 and December 31, 2021, respectively.

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, 2022 by remaining contractual maturity.

As of December 31, 2022 Maturing:					
	In One Year or Less	After One Year through Five Years	After Five Years through Fifteen Years	After Fifteen Years	Total
Commercial.....	\$ 405,707	\$ 476,375	\$ 535,069	\$ 55,583	\$ 1,472,734
Commercial real estate.....	449,887	1,781,846	3,519,717	43,778	5,795,228
Commercial construction.....	391,074	183,065	-	-	574,139
Residential real estate.....	4,316	25,740	65,092	169,600	264,748
Consumer.....	2,090	197	18	7	2,312
Total.....	<u>\$ 1,253,074</u>	<u>\$ 2,467,223</u>	<u>\$ 4,119,896</u>	<u>\$ 268,968</u>	<u>\$ 8,109,161</u>
Loans with:					
Fixed rates.....	\$ 394,882	\$ 1,488,757	\$ 1,399,617	\$ 143,789	\$ 3,427,045
Variable rates.....	858,192	978,466	2,720,279	125,179	4,682,116
Total.....	<u>\$ 1,253,074</u>	<u>\$ 2,467,223</u>	<u>\$ 4,119,896</u>	<u>\$ 268,968</u>	<u>\$ 8,109,161</u>

For additional information regarding loans, see Note 4 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 the borrower’s 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. Typically, a nonaccrual loan may return to accrual status if the borrower makes the loan current, and then makes six consecutive payments as scheduled.

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.

The Company evaluates individual instruments for expected credit losses when those instruments do not share similar risk characteristics with instruments evaluated using a collective (pooled) basis. The Company evaluates the pooling methodology at least annually. Loans transition from defined segments for individual analysis when credit characteristics, or risk traits, change in a material manner. A loan is considered for individual analysis when, based on current information and events, it is probable that the Company 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 the Company in determining individual analysis 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 troubled debt restructurings (“TDR”) and are individually analyzed if carrying value is \$250,000 or higher. Additionally, nonaccrual loans that are \$250,000 or higher are also individually analyzed. All purchased credit-deteriorated (PCD) loans are individually analyzed. For loans designated as TDR or nonaccrual with balances less than \$250,000, these loans are collectively evaluated, and, accordingly, are not separately identified for analysis or disclosures. Instruments will not be included in both collective and individual analysis. Individual analysis will establish a specific reserve for instruments in scope.

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 credit losses must be established 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 credit 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 credit 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 credit 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:

	2022	2021
(dollars in thousands)		
Classified Loans:		
Substandard	\$ 120,330	\$ 157,434
Doubtful	-	-
Loss	-	-
Total classified loans	120,330	157,434
Special Mention Loans	62,105	72,286
Total classified and special mention loans.....	<u>\$ 182,435</u>	<u>\$ 229,720</u>

During the year ended December 31, 2022, “substandard” loans and “doubtful” loans, which include lower credit quality loans which possess higher risk characteristics than “special mention” loans, decreased to \$120.3 million, or 1.5% of loans receivable, as of December 31, 2022 from \$157.4 million, or 2.3% of loans receivable, as of December 31, 2021. During the year ended December 31, 2022, “special mention” loans were \$62.1 million, or 0.8% of loans receivable, while “special mention” loans as of December 31, 2021 were \$72.3 million, or 1.0% of loans receivable.

Nonaccrual Loans, Performing Troubled Debt Restructurings, OREO and Loans 90 Days or Greater Past Due and Still Accruing

Nonperforming assets include nonaccrual loans and OREO. Nonaccrual loans represent loans on which interest accruals have been suspended. OREO represents property acquired through foreclosure in partial or full satisfaction of loans. 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. Loans 90 days or greater past due and still accruing represents purchased credit-deteriorated loans, net of fair value marks, which accrete income per the valuation at date of acquisition. For additional information regarding loans, see Note 4 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:

	December 31, 2022	December 31, 2021	December 31, 2020
Nonaccrual loans.....	\$ 44,454	\$ 61,700	\$ 61,696
OREO	264	-	-
Total nonperforming assets.....	<u>\$ 44,718</u>	<u>\$ 61,700</u>	<u>\$ 61,696</u>
Performing TDRs.....	<u>\$ 51,392</u>	<u>\$ 43,587</u>	<u>\$ 23,655</u>
Loans 90 days or greater past due and still accruing (PCD).....	<u>\$ 5,591</u>	<u>\$ 13,531</u>	<u>\$ 12,821</u>
Nonaccrual loans to loans receivable.....	0.55%	0.90%	0.99%
Nonperforming assets to total assets.....	0.46%	0.76%	0.82%
Nonperforming assets, performing TDRs, and loans 90 days or greater past due and still accruing to total loans	1.26%	1.74%	1.57%

Allowance for Credit Losses and Related Provision

The allowance for credit losses is a reserve established through charges to earnings in the form of a provision for credit losses. We maintain an allowance for credit 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 credit losses.

As of December 31, 2022, the allowance for credit losses for loans was \$90.5 million, an increase of \$11.7 million, or 14.9%, from \$78.8 million as of December 31, 2021. The increase in the allowance for credit losses was primarily driven by an increase in general reserves, resulting primarily from organic loan growth and changes in forecasted macroeconomic conditions, primarily offset by releases in specific reserves. As a result of the adoption, the Bank recorded a "Day 1" CECL adjustment on January 1, 2021 of \$6.5 million that increased the allowance for credit losses for loans. This increase was offset by a release of provision for credit losses of \$5.5 million as well as \$2.0 million in net charge-offs during the year ended December 31, 2021. The \$5.5 million release of provision for credit losses during the year ended December 31, 2021 was the result of a continued improvement in the macroeconomic outlook during 2021. Included in the \$2.0 million net charge-offs for the year ended December 31, 2021 was a \$1.4 million charge-off of a commercial real estate loan that previously had a specific credit reserve.

The allowance for credit losses for loans as a percentage of loans receivable was 1.12% as of December 31, 2022 and 1.15% as of December 31, 2021.

Three-Year Statistical Allowance for Credit Losses for Loans

The following table reflects the relationship of loan volume, the provision and allowance for credit losses for loans and net charge-offs for the periods presented.

	December 31, 2022	December 31, 2021	December 31, 2020
Balance as of January 1,.....	\$ 78,773	\$ 79,226	\$ 38,293
CECL Day 1 Adjustment.....	-	6,557	-
Balance as of January 1, as adjusted for changes in accounting principal.....	78,773	85,783	38,293
Charge-offs:			
Commercial.....	2,612	382	552
Commercial real estate.....	2,819	1,780	-
Residential real estate.....	9	235	341
Consumer.....	3	-	7
Total charge-offs.....	5,443	2,397	900
Recoveries:			
Commercial.....	54	289	4
Commercial real estate.....	-	85	802
Residential real estate.....	63	20	23
Consumer.....	-	11	4
Total recoveries.....	117	405	833
Net charge-offs.....	5,326	1,992	67
Provision for (reversal of) credit losses for loans.....	17,066	(5,018)	41,000
Balance at end of year.....	\$ 90,513	\$ 78,773	\$ 79,226
Ratio of net charge-offs during the year to average loans receivable outstanding during the year.....	0.07%	0.03%	0.00%
Allowance for credit losses for loans as a percentage of loans receivable.....	1.12%	1.15%	1.27%

For additional information regarding loans, see Note 4 of the Notes to the Consolidated Financial Statements.

Implicit in the lending function is the fact that credit 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 credit losses has been allocated in the table below according to the estimated amount deemed to be reasonably and supportably necessary to provide for the possibility of either lifetime expected losses or losses being incurred within the following categories of loans as of December 31, for each of the past three 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 loan type shown below includes commercial, commercial real estate and commercial construction loans.

	Commercial		Residential Real Estate		Consumer		Unallocated	
	Amount of Allowance	% of Total Allowance	Amount of Allowance	% of Total Allowance	Amount of Allowance	% of Total Allowance	Amount of Allowance	Total Allowance
(dollars in thousands)								
2022.....	\$ 86,363	95.4%	\$ 4,143	4.6%	\$ 7	0.1%	\$ -	\$ 90,513
2021.....	75,138	95.4%	3,628	4.6%	7	0.1%	-	78,773
2020.....	75,967	94.8%	2,687	5.2%	4	0.0%	568	79,226

Investments

For the year ended December 31, 2022, the average volume of investment securities, including equity securities, increased by \$196.4 million to approximately \$660.8 million or 8.0% of average earning assets, from \$464.3 million, or 6.4% of average earning assets, for the year ended December 31, 2021. As of December 31, 2022, 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 Subdivisions, Corporate Bonds and other debt and equity securities.

During the year ended December 31, 2022, rate related factors increased investment revenue by \$4.9 million and volume related factors increased investment revenue by \$5.2 million. The tax-equivalent yield on investments increased by 106 basis points to 2.67% from a yield of 1.61% during the year ended December 31, 2021.

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.

As of December 31, 2022, net unrealized losses on securities available-for-sale, which are carried as a component of accumulated other comprehensive loss and included in stockholders' equity, net of tax, amounted to \$61.8 million as compared with net unrealized losses of \$0.5 million as of December 31, 2021. The increase in unrealized losses is predominately attributable to changes in market conditions and interest rates. Unrealized losses have not been recognized into income because the issuers are of high credit quality, we do not intend to sell, and it is likely that we will not be required to sell the securities prior to their anticipated recovery. The decline in fair value is largely due to changes in interest rates and other market conditions. This also resulted in a \$25.1 million increase in deferred tax assets, attributable to the decline in fair value on securities available-for-sale since December 31, 2021. The issuers continue to make timely principal and interest payments on the securities. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income, net of applicable taxes. For additional information regarding the Company's investment portfolio, see Note 3, Note 15 and Note 20 of the Notes to the Consolidated Financial Statements.

During 2022 and 2021, there were no sales from the Company's available-for-sale portfolio. During 2020, there were \$19.6 million in sales from the Company's available-for-sale portfolio. The Company had a \$195 thousand gain on the redemption of available-for-sale securities during 2021. The gross realized gains on securities sold, called or matured amounted to \$29 thousand in 2020. The Company had no impairment charges in 2022, 2021 and 2020. 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, 2022, 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		Total		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Market Value
(dollars in thousands)											
Investment Securities Available-for-Sale											
Federal Agency Obligations ...	\$ -	-%	\$ -	-%	\$ 153	2.67%	\$ 54,736	2.18%	\$ 54,889	2.18%	\$ 44,450
Residential Mortgage Pass-through Securities	3	3.71	418	2.57	3,062	3.44	471,780	3.12	475,263	3.12	417,578
Commercial Mortgage Pass-through Securities	-	-	-	-	4,033	1.52	21,452	2.86	25,485	2.65	21,104
Obligations of U.S. States and Political Subdivisions .	453	4.21	2,106	4.99	2,073	4.04	152,615	3.64	157,247	3.66	142,896
Corporate Bonds and Notes	5,000	3.29	2,000	3.58	-	-	-	-	7,000	3.37	6,974
Asset-backed Securities	-	-	-	-	21	3.89	1,652	5.36	1,673	5.34	1,640
Other Securities	242	0.25	-	-	-	-	-	-	242	0.25	242
Total											
Investment Securities .	<u>\$ 5,698</u>	<u>3.23%</u>	<u>\$ 4,524</u>	<u>4.14%</u>	<u>\$ 9,342</u>	<u>2.73%</u>	<u>\$ 702,235</u>	<u>3.16%</u>	<u>\$ 721,799</u>	<u>3.16%</u>	<u>\$ 634,884</u>

For information regarding the carrying value of the investment portfolio, see Note 3, Note 15 and Note 20 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 as of December 31, 2022. 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.

	2022	2021	2020
	(dollars in thousands)		
Investment Securities Available-for-Sale:			
Federal agency obligations	\$ 44,450	\$ 50,360	\$ 38,458
Residential mortgage pass-through securities	417,578	316,095	270,884
Commercial mortgage pass-through securities	21,104	10,469	6,922
Obligations of U.S. States and political subdivisions	142,896	145,625	142,808
Corporate bonds and notes	6,974	9,049	25,095
Asset-backed securities	1,640	2,564	3,480
Certificates of deposit	-	150	151
Other securities	242	195	157
Total	<u>\$ 634,884</u>	<u>\$ 534,507</u>	<u>\$ 487,955</u>

For other information regarding the Company's investment securities portfolio, see Note 3, Note 15 and Note 20 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, 2022, and December 31, 2021, 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, 2022, we estimated that over the next one-year period a 200 basis-point instantaneous increase in the general level of interest rates would decrease our net interest income by 2.22%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 2.01%. As of December 31, 2021, 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 3.35%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 5.64%.

Based on our model, which was run as of December 31, 2022, 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 decrease our net interest income by 2.66%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 3.99%. As of December 31, 2021, 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 9.77%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 10.41%.

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, 2022, would decrease by 10.51% with an instantaneous rate shock of up 200 basis points, and decrease by 1.13% with an instantaneous rate shock of down 100 basis points. Our EVE as of December 31, 2021, would increase by 0.24% with an instantaneous rate shock of up 200 basis points, and decline by 5.20% 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, 2022.

Interest Rates (basis points)	Estimated EVE	Estimated Change in EVE		Interest Rates (basis points)	Estimated NII	Estimated Change in NII	
		Amount	%			Amount	%
+300	\$ 1,192,148	\$ (205,018)	(14.67)	+300	\$ 284,695	\$ (8,243)	(2.81)
+200	1,250,366	(146,800)	(10.51)	+200	286,436	(6,502)	(2.22)
+100	1,312,519	(84,647)	(6.06)	+100	288,295	(4,643)	(1.58)
0	1,397,166	-	—	0	292,938	-	-
-100	1,381,343	(15,823)	(1.13)	-100	287,036	(5,902)	(2.01)
-200	1,350,498	(46,668)	(3.34)	-200	280,706	(12,232)	(4.18)
-300	1,304,602	(92,564)	(6.63)	-300	276,359	(16,579)	(5.66)

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 20 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.

As of December 31, 2022, 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, 2022, liquid assets (cash and due from banks, interest-bearing deposits with banks and unencumbered investment securities) were \$760.0 million, which represented 7.9% of total assets and 9.3% of total deposits and borrowings, compared to \$742.1 million as of December 31, 2021, which represented 9.1% of total assets and 10.9% 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, 2022, had the ability to borrow \$2.0 billion. In addition, as of December 31, 2022, the Bank had borrowing capacity of \$450 million through correspondent banks. As of December 31, 2022, the Bank had aggregate available and unused credit of approximately \$949 million, which represents the aforementioned facilities totaling \$2.4 billion net of \$1.5 billion in outstanding borrowings and letters of credit. As of December 31, 2022, outstanding commitments for the Bank to extend credit were \$1.2 billion.

Cash and cash equivalents totaled \$268.3 million as of December 31, 2022, increasing by \$2.8 million from \$265.5 million as of December 31, 2021. Operating activities provided \$176.8 million in net cash. Investing activities used \$1.5 billion in net cash, primarily reflecting an increase in loans. Financing activities provided \$1.4 billion in net cash, primarily reflecting a net increase in deposits of \$1.0 billion and an increase in net borrowings of \$389.4 million.

Deposits

Deposits are our primary source of funds. Average total deposits increased by \$0.6 million, or 9.0%, to \$6.8 billion in 2022 from \$6.2 billion in 2021 and increased \$0.4 million, or 6.9%, to \$6.2 billion in 2021 from \$5.8 billion in 2020. The increase in total average deposits in 2022 and 2021 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 2022, 2021 and 2020.

	2022		2021		2020	
	Balance	Rate	Balance	Rate	Balance	Rate
(dollars in thousands)						
Demand, noninterest-bearing	\$ 1,612,040	-	\$ 1,454,148	-	\$ 1,195,547	-
Demand, interest-bearing & NOW	3,284,866	0.80%	3,081,899	0.29%	2,583,590	0.66%
Savings.....	417,907	0.70%	369,866	0.31%	236,318	0.27%
Time.....	1,449,826	1.47%	1,300,270	1.14%	1,792,568	1.94%
Average Total Deposits.....	<u>\$ 6,764,639</u>	<u>0.75%</u>	<u>\$ 6,206,183</u>	<u>0.52%</u>	<u>\$ 5,808,023</u>	<u>0.90%</u>

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

	December 31, 2022		December 31, 2021	
	Amount	% of total	Amount	% of total
(dollars in thousands)				
Demand, noninterest-bearing	\$ 1,501,614	20.4%	\$ 1,617,049	25.5%
Demand, interest-bearing & NOW	3,085,613	41.9%	3,127,350	49.4%
Savings.....	375,205	5.1%	438,445	6.9%
Time.....	2,394,190	32.5%	1,150,109	18.2%
Total Deposits.....	<u>\$ 7,356,622</u>	<u>100.0%</u>	<u>\$ 6,332,953</u>	<u>100.0%</u>

As of December 31, 2022, we held \$591.8 million of time deposits that exceed the Federal Deposit Insurance Corporation ("FDIC") insurance limit, which was an increase of \$341.3 million from \$250.5 million as of December 31, 2021. The following table provides information on the maturity distribution of the time deposits exceeding the FDIC insurance limit as of December 31, 2022 and 2021:

	December 31, 2022	December 31, 2021
	(dollars in thousands)	
3 months or less	\$ 147,761	\$ 71,293
Over 3 to 6 months.....	103,074	69,394
Over 6 to 12 months.....	213,961	63,549
Over 12 months.....	126,984	46,288
Total.....	<u>\$ 591,780</u>	<u>\$ 250,524</u>

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, 2022, the Company had a gross carrying value of \$857.6 million, excluding a net fair value discount of \$80 thousand, in notes outstanding at a weighted average interest rate of 4.32%. As of December 31, 2021, the Company had a gross carrying value of \$468.3 million, excluding a net fair value discount of \$120 thousand, in notes outstanding at a weighted average interest rate of 0.73%.

Contractual Obligations and Other Commitments

The following table summarizes contractual obligations as of December 31, 2022 and the effect such obligations are expected to have on liquidity and cash flows in future periods.

	<u>Total</u>	<u>Less than 1 year</u>	<u>1 – 3 years</u>	<u>4 – 5 years</u>	<u>Over 5 years</u>
		(dollars in thousands)			
<u>December 31, 2022</u>					
<u>Contractual obligations:</u>					
Operating lease obligations.....	\$ 12,313	\$ 2,958	\$ 4,561	\$ 3,434	\$ 1,360
Other contractual obligations:					
Time Deposits	2,395,643	1,571,746	614,278	209,619	-
Federal Home Loan Bank advances and repurchase agreements.....	857,702	830,000	25,000	2,050	652
Finance lease	1,733	323	706	704	-
Subordinated debentures, net of debt issuance costs	153,255	-	-	-	153,255
Total other contractual obligations	<u>3,408,333</u>	<u>2,402,069</u>	<u>639,984</u>	<u>212,373</u>	<u>153,907</u>
Other commercial commitments – off- balance sheet:					
Commitments under commercial loans and lines of credit	662,515	394,442	231,345	1,000	35,728
Home equity and other revolving lines of credit	54,302	8,935	11,886	20,047	13,434
Outstanding commercial mortgage loan commitments.....	433,034	209,925	195,631	2,984	24,494
Standby letters of credit.....	20,770	18,739	2,031	-	-
Overdraft protection lines.....	905	461	-	186	258
Total other commercial commitments-off balance sheet	<u>1,171,526</u>	<u>632,502</u>	<u>440,893</u>	<u>24,217</u>	<u>73,914</u>
Total contractual obligations and other commitments	<u>\$ 4,592,172</u>	<u>\$ 3,037,529</u>	<u>\$ 1,085,438</u>	<u>\$ 240,024</u>	<u>\$ 229,181</u>

Capital

The maintenance of a solid capital foundation continues to be a primary goal for the Company. Accordingly, capital plans, stock repurchases, 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) as of December 31, 2022 amounted to \$1.0 billion or 10.7% of average total assets. As of December 31, 2021, the Company's Tier 1 leverage capital amounted to \$909.6 million or 11.7% of average total assets. The increase in Tier 1 capital reflects the Company's retained earnings during 2022.

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 risk-weightings and require banking institutions to maintain a minimum ratio of capital to risk-weighted assets. As of December 31, 2022, the Company's CET 1, Tier 1 and total risk-based capital ratios were 10.30%, 11.66% and 14.45%, respectively. For information on risk-based capital and regulatory guidelines for the Parent Corporation and its bank subsidiary, see Note 15 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 as of December 31, 2022 was 7.26%.

During June 2020, the Parent Corporation issued \$75 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "2020 Notes"). The 2020 Notes bear interest at 5.75% annually from, and including, the date of initial issuance to, but excluding, September 15, 2025 or the date of earlier redemption, payable semi-annually in arrears on September 15 and December 15 of each year, commencing December 15, 2020. From and including September 15, 2025 through maturity or earlier redemption, the interest rate shall reset quarterly to an interest rate per annum equal to a benchmark rate, which is expected to be Three-Month Term SOFR (as defined in the Second Supplemental Indenture), plus 560.5 basis points, payable quarterly in arrears on March 15, June 15, September 15 and December 15 of each year, commencing on September 15, 2025. Notwithstanding the foregoing, if the benchmark rate is less than zero, then the benchmark rate shall be deemed to be zero.

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 were non-callable for five years, have a stated maturity of February 1, 2028 and bear interest at a rate that resets quarterly to then current three-month LIBOR rate plus 284 basis points. The 2018 Notes were redeemed in full on February 1, 2023.

During June 2015, the Parent Corporation issued \$50 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "2015 Notes"). As of December 31, 2020, the 2015 Notes had a stated maturity of July 1, 2025, and bore interest until the maturity date or early redemption date at a variable rate equal to the then current three-month LIBOR rate plus 393 basis points. As of December 31, 2020, the variable interest rate was 4.16%, all costs related to 2015 issuance had been amortized and the 2015 Notes were redeemed in full on January 1, 2021.

Preferred Stock

On August 19, 2021, the Company completed an underwritten public offering of 115,000 shares, or \$115 million in aggregate liquidation preference, of its depositary shares, each representing a 1/40th interest in a share of the Company's 5.25% Fixed-Rate Non-Cumulative Perpetual Preferred Stock, Series A, no par value, with a liquidation preference of \$1,000 per share. The net proceeds received from the issuance of preferred stock at the time of closing were \$110.9 million.

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.

PART II

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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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM (PCAOB ID 173)

Shareholders and the Board of Directors 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, 2022 and 2021, 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, 2022, 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, 2022, 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, 2022 and 2021, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2022 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, 2022, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Explanatory Paragraph – Change in Accounting Principle

As discussed in Note 1a to the consolidated financial statements, the Company has changed its method of accounting for credit losses effective January 1, 2021 due to the adoption of ASC 326, Financial Instruments – Credit Losses.

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 Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Credit Losses – Qualitative Loss Factors on Commercial and Commercial Real Estate Loans

As described in Note 1a to the consolidated financial statements, the Company accounts for credit losses under ASC 326, Financial Instruments – Credit Losses. ASC 326 requires the measurement of expected lifetime credit losses for financial assets measured at amortized cost at the reporting date. As of December 31, 2022, the allowance for credit losses ("ACL") on loans was \$90,513,000.

Management employs a process and methodology to estimate the ACL on pooled loans that evaluates both quantitative and qualitative factors. The methodology for evaluating quantitative factors includes pooling loans into portfolio segments for loan that share similar characteristics. Pooled loan portfolio segments include commercial, commercial real estate, commercial construction, residential real estate, and consumer loans.

For pooled loans, the Company utilizes a discounted cash flow ("DCF") methodology to estimate credit losses over the expected life of the loan. The DCF methodology combines probability of default, the loss given default, and prepayment speed assumptions to estimate a reserve for each loan. The quantitative loss rates are adjusted by macroeconomic scenarios and reverts, on a straight-line basis, to average historical losses after the forecasted periods. The sum of all the loan level reserves is aggregated for each portfolio segment and a quantitative loss factor is derived. The quantitative factors are also supplemented by certain qualitative loss factors reflecting management's view of how losses may vary from those represented by quantitative loss rates. Qualitative loss factors, for each loan segment within the portfolio, incorporate consideration for a minimum to maximum range for qualitative loss factor derived from either the Company's historical loss experience or peer group historical loss experience. Changes in these assumptions could have a material effect on the Company's financial results.

We identified auditing the qualitative component of the ACL on pooled loans in the commercial and commercial real estate loan segments as a critical audit matter because the methodology to determine the estimate of credit losses uses subjective judgments by management and is subject to material variability.

Performing audit procedures to evaluate the qualitative loss factors on the commercial and commercial real estate loan segments involved a high degree of auditor judgment and required significant effort, including the need to involve more experienced audit personnel including the use of internal specialists.

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

- Testing the effectiveness of controls over the evaluation of the ACL on pooled loans, including controls addressing:
 - Methodology and accounting policies.
 - Data inputs, judgments and calculations used to determine the qualitative loss factors.
 - Information technology general controls and application controls.
 - Management's evaluation of qualitative loss factors.
- Substantively testing management's process, including evaluating their judgments and assumptions, for developing the ACL on pooled loans, which included:
 - Evaluating the appropriateness of the Company's accounting policies, judgments and elections.
 - Testing the mathematical accuracy of the calculation.
 - Testing the completeness and accuracy of data used in the calculation including utilizing internal specialists to assist in testing the mathematical accuracy of the underlying peer data used to develop the maximum loss factors.
 - Evaluating the reasonableness of management's judgments related to qualitative loss factors to determine if they are calculated to conform with management's policies and were consistently applied period over period.

/s/ Crowe LLP

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

Livingston, New Jersey
February 24, 2023

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

	December 31,	
	2022	2021
(in thousands, except share data)		
ASSETS		
Cash and due from banks	\$ 61,629	\$ 54,352
Interest-bearing deposits with banks	206,686	211,184
Cash and cash equivalents	268,315	265,536
Investment securities	634,884	534,507
Equity securities	15,811	13,794
Loans held-for-sale	13,772	250
Loans receivable	8,099,689	6,828,622
Less: Allowance for credit losses - loans	90,513	78,773
Net loans receivable	8,009,176	6,749,849
Investment in restricted stock, at cost	46,604	27,826
Bank premises and equipment, net	27,800	29,032
Accrued interest receivable	46,062	34,152
Bank owned life insurance	231,328	195,731
Right of use operating lease assets	10,179	11,017
Other real estate owned	264	-
Goodwill	208,372	208,372
Core deposit intangibles	7,312	8,997
Other assets	125,069	50,417
Total assets	\$ 9,644,948	\$ 8,129,480
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 1,501,614	\$ 1,617,049
Interest-bearing	5,855,008	4,715,904
Total deposits	7,356,622	6,332,953
Borrowings	857,622	468,193
Subordinated debentures, net of debt issuance costs	153,255	152,951
Operating lease liabilities	11,397	12,417
Other liabilities	87,301	38,754
Total liabilities	8,466,197	7,005,268
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred Stock, no par value;		
\$1,000 per share liquidation preference; Authorized 5,000,000 shares; issued 115,000 shares as of December 31, 2022 and as of December 31, 2021; outstanding 115,000 shares as of December 31, 2022 and as of December 31, 2021	110,927	110,927
Common stock, no par value:		
Authorized 100,000,000 shares; issued 41,942,149 shares as of December 31, 2022 and 41,820,008 shares as of December 31, 2021; outstanding 39,243,123 shares as of December 31, 2022 and 39,568,090 as of December 31, 2021	586,946	586,946
Additional paid-in capital	30,126	27,246
Retained earnings	535,915	440,169
Treasury stock, at cost 2,699,026 shares as of December 31, 2022 and 2,251,918 shares as of December 31, 2021	(52,799)	(39,672)
Accumulated other comprehensive loss	(32,364)	(1,404)
Total stockholders' equity	1,178,751	1,124,212
Total liabilities and stockholders' equity	\$ 9,644,948	\$ 8,129,480

See the accompanying notes to the consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2022	2021	2020
(dollars in thousands, except for per share data)			
Interest income:			
Interest and fees on loans	\$ 352,993	\$ 293,546	\$ 296,611
Interest and dividends on investment securities:			
Taxable	12,712	4,413	6,456
Tax-exempt.....	3,893	2,403	2,797
Dividends.....	1,655	971	1,642
Interest on federal funds sold and other short-term investments	2,493	405	694
Total interest income	<u>373,746</u>	<u>301,738</u>	<u>308,200</u>
Interest expense:			
Deposits.....	50,561	24,768	52,386
Borrowings.....	21,066	14,092	17,823
Total interest expense	<u>71,627</u>	<u>38,860</u>	<u>70,209</u>
Net interest income	<u>302,119</u>	<u>262,878</u>	<u>237,991</u>
Provision for (reversal of) credit losses	17,750	(5,500)	41,000
Net interest income after provision for credit losses	<u>284,369</u>	<u>268,378</u>	<u>196,991</u>
Noninterest income:			
Deposit, loan and other income	7,472	6,617	7,077
Income on bank owned life insurance	5,597	4,771	5,007
Net gains on sale of loans held-for-sale	1,695	3,807	2,085
Gain on sale of branches	-	674	-
Net (losses) gains on equity securities.....	(1,521)	(373)	202
Net gains on sale/redemption of investment securities.....	-	195	29
Total noninterest income.....	<u>13,243</u>	<u>15,691</u>	<u>14,400</u>
Noninterest expense:			
Salaries and employee benefits	81,289	64,341	58,877
Occupancy and equipment	9,865	11,638	13,882
FDIC insurance	2,881	2,665	4,002
Professional and consulting.....	8,053	8,286	7,383
Marketing and advertising.....	1,692	1,318	1,200
Information technology and communications	11,108	11,267	6,008
Merger expenses.....	-	-	14,640
Amortization of core deposit intangible	1,685	1,981	2,559
Net periodic pension income	(572)	(269)	(119)
Increase in value of acquisition price	1,516	-	2,333
Other expenses	8,871	7,784	10,236
Total noninterest expenses	<u>126,388</u>	<u>109,011</u>	<u>121,001</u>
Income before income tax expense	<u>171,224</u>	<u>175,058</u>	<u>90,390</u>
Income tax expense.....	46,013	44,705	19,101
Net income	<u>125,211</u>	<u>130,353</u>	<u>71,289</u>
Preferred dividends	6,037	1,717	-
Net income available to common stockholders	<u>\$ 119,174</u>	<u>\$ 128,636</u>	<u>\$ 71,289</u>
Earnings per common share:			
Basic.....	\$ 3.03	\$ 3.24	\$ 1.80
Diluted.....	3.01	3.22	1.79

See the accompanying notes to the consolidated financial statements.

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

	Years Ended December 31,		
	2022	2021	2020
(dollars in thousands)			
Net income	\$ 125,211	\$ 130,353	\$ 71,289
Other comprehensive income:			
Unrealized gains and losses:			
Unrealized holding (losses) gains on available-for-sale securities arising during the period	(86,240)	(11,109)	7,005
Tax effect	24,949	2,914	(1,847)
Net of tax	(61,291)	(8,195)	5,158
Reclassification adjustment for realized gains included in net income	-	(195)	(29)
Tax effect	-	48	6
Net of tax	-	(147)	(23)
Unrealized gains (losses) on cash flow hedges	46,181	3,593	(3,423)
Tax effect	(13,960)	(1,012)	962
Net of tax	32,221	2,581	(2,461)
Reclassification adjustment for (gains) losses arising during this period	(3,243)	1,873	1,577
Tax effect	976	(528)	(443)
Net of tax	(2,267)	1,345	1,134
Unrealized pension plan gains (losses):			
Unrealized pension plan gains (losses) before reclassifications	343	-	(112)
Tax effect	(12)	-	31
Net of tax	331	-	(81)
Reclassification adjustment for realized losses included in net income	66	299	301
Tax effect	(20)	(84)	(84)
Net of tax	46	215	217
Total other comprehensive (loss) income	(30,960)	(4,201)	3,944
Total comprehensive income	\$ 94,251	\$ 126,152	\$ 75,233

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 January 1, 2020	\$ -	\$ 468,571	\$ 21,344	\$ 271,782	\$ (29,360)	\$ (1,147)	\$ 731,190
Net income	-	-	-	71,289	-	-	71,289
Other comprehensive income, net of tax	-	-	-	-	-	3,944	3,944
Cash dividends declared on common stock (\$0.27 per share)	-	-	-	(11,120)	-	-	(11,120)
Repurchase of stock (54,693 shares)	-	-	-	-	(911)	-	(911)
Net shares issued in satisfaction of deferred stock units earned (16,541 shares)	-	-	-	-	-	-	-
Exercise of stock options (35,413 shares)	-	-	233	-	-	-	233
Restricted stock grants, net of forfeitures (89,879 shares)	-	-	-	-	-	-	-
Stock grants issued (1,340 shares)	-	-	-	-	-	-	-
Net shares issued in satisfaction of performance units earned (22,402 shares)	-	-	-	-	-	-	-
Share redemption for tax withholdings on performance units and deferred stock units earned	-	-	(639)	-	-	-	(639)
Stock issued (4,602,450 shares) in acquisition of Bancorp of New Jersey	-	118,375	-	-	-	-	118,375
Stock-based compensation expense	-	-	2,949	-	-	-	2,949
Balance as of December 31, 2020	<u>\$ -</u>	<u>\$ 586,946</u>	<u>\$ 23,887</u>	<u>\$ 331,951</u>	<u>\$ (30,271)</u>	<u>\$ 2,797</u>	<u>\$ 915,310</u>
Cumulative effect of change in accounting principle (see note 1b. "Authoritative Accounting Guidance Presentation"), net of tax	-	-	-	(2,925)	-	-	(2,925)
Balance as of January 1, 2021, as adjusted for changes in accounting principle	-	586,946	23,887	329,026	(30,271)	2,797	912,385
Net income	-	-	-	130,353	-	-	130,353
Other comprehensive loss, net of tax	-	-	-	-	-	(4,201)	(4,201)
Cash dividends declared on preferred stock (\$0.371875 per share)	-	-	-	(1,717)	-	-	(1,717)
Cash dividends declared on common stock (\$0.48 per share)	-	-	-	(17,493)	-	-	(17,493)
Exercise of stock options (14,247 shares)	-	-	106	-	-	-	106
Restricted stock grants, net of forfeitures (44,836 shares)	-	-	-	-	-	-	-
Stock grants (4,981 shares)	-	-	-	-	-	-	-
Net shares issued in satisfaction of deferred stock units earned (14,711 shares)	-	-	-	-	-	-	-
Net shares issued in satisfaction of performance units earned (34,458 shares)	-	-	-	-	-	-	-
Share redemption for tax withholdings on performance units and deferred stock units earned	-	-	(1,283)	-	-	-	(1,283)
Repurchase of stock (330,541 shares)	-	-	-	-	(9,401)	-	(9,401)
Proceeds from preferred stock issuance, net of costs (115,000 shares)	110,927	-	-	-	-	-	110,927
Stock-based compensation expense	-	-	4,536	-	-	-	4,536
Balance as of December 31, 2021	<u>\$ 110,927</u>	<u>\$ 586,946</u>	<u>\$ 27,246</u>	<u>\$ 440,169</u>	<u>\$ (39,672)</u>	<u>\$ (1,404)</u>	<u>\$ 1,124,212</u>
Net income	-	-	-	125,211	-	-	125,211
Other comprehensive loss, net of tax	-	-	-	-	-	(30,960)	(30,960)
Cash dividends declared on preferred stock (\$1.3125 per share)	-	-	-	(6,037)	-	-	(6,037)
Cash dividends declared on common stock (\$0.595 per share)	-	-	-	(23,428)	-	-	(23,428)
Exercise of stock options (15,086 shares)	-	-	124	-	-	-	124
Restricted stock grants, net of forfeitures (53,169 shares)	-	-	-	-	-	-	-
Stock grants (153 shares)	-	-	-	-	-	-	-
Net shares issued in satisfaction of deferred stock units earned (31,383 shares)	-	-	-	-	-	-	-
Net shares issued in satisfaction of performance units earned (22,350) shares	-	-	-	-	-	-	-
Share redemption for tax withholdings on performance units and deferred stock units earned	-	-	(2,133)	-	-	-	(2,133)
Repurchase of stock (447,108 shares)	-	-	-	-	(13,127)	-	(13,127)
Stock-based compensation expense	-	-	4,889	-	-	-	4,889
Balance as of December 31, 2022	<u>\$ 110,927</u>	<u>\$ 586,946</u>	<u>\$ 30,126</u>	<u>\$ 535,915</u>	<u>\$ (52,799)</u>	<u>\$ (32,364)</u>	<u>\$ 1,178,751</u>

See the accompanying notes to the consolidated financial statements.

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

	Years Ended December 31,		
	2022	2021	2020
Cash flows from operating activities			
Net income.....	\$ 125,211	\$ 130,353	\$ 71,289
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of premises and equipment.....	3,863	3,757	4,244
Provision for (reversal of) credit losses.....	17,750	(5,500)	41,000
Amortization of intangibles.....	1,685	1,980	2,559
Net accretion of loans.....	(3,178)	(5,350)	(6,687)
Accretion on bank premises.....	(49)	(73)	(90)
Accretion on deposits.....	(777)	(2,224)	(4,301)
Amortization (accretion) on borrowings.....	40	(36)	(183)
Net deferred income tax (benefit) expense.....	(403)	16	(7,495)
Stock-based compensation.....	4,889	4,536	2,949
Gains on sales/redemptions of investment securities, net.....	-	(195)	(29)
Change in fair value of equity securities, net.....	1,521	373	(202)
Gain on sale of loans held-for-sale, net.....	(1,695)	(3,807)	(2,085)
Gain on sale of branches.....	-	(674)	-
Net losses on disposition of other fixed assets.....	22	65	-
Gain (loss) on sale of other real estate owned.....	6	(18)	-
Loans originated for resale.....	(21,128)	(51,669)	(63,114)
Proceeds from sale of loans held-for-sale.....	28,341	72,233	80,323
Increase in cash surrender value of bank owned life insurance.....	(5,597)	(4,771)	(4,793)
Amortization of premiums and accretion of discounts on investments securities, net.....	2,155	5,966	5,506
Amortization of subordinated debt issuance costs.....	304	303	323
(Increase) decrease in accrued interest receivable.....	(11,910)	1,165	(11,458)
Net change in operating leases.....	(182)	(769)	41
(Increase) decrease in other assets.....	(12,413)	46,086	(22,498)
Increase (decrease) in other liabilities.....	48,322	10,526	(4,174)
Net cash provided by operating activities.....	<u>176,777</u>	<u>202,273</u>	<u>81,125</u>
Cash flows from investing activities			
Investment securities available-for-sale:			
Purchases.....	(339,059)	(349,500)	(338,087)
Sales.....	-	-	19,624
Maturities, calls and principal repayments.....	150,287	285,873	256,782
Net (purchases)/redemptions of restricted investment in bank stocks.....	(18,778)	(2,727)	5,362
Purchases of equity securities.....	(3,538)	(780)	(2,000)
Loans held-for-sale payments.....	54	38	1,186
Net increase in loans.....	(1,292,938)	(596,389)	(329,210)
Cash flow hedge premium payment.....	(6,965)	-	-
Purchases of premises and equipment.....	(3,301)	(2,783)	(2,199)
Purchases of bank owned life insurance.....	(30,000)	(25,000)	(25,000)
Proceeds from life insurance death benefits.....	-	-	1,794
Proceeds from disposition of fixed assets.....	697	113	-
Proceeds from sale of branches.....	-	974	-
Cash and cash equivalents acquired in acquisitions, net.....	-	-	87,391
Proceeds from sale of other real estate owned.....	309	321	992
Net cash used in investing activities.....	<u>(1,543,232)</u>	<u>(689,860)</u>	<u>(323,365)</u>
Cash flows from financing activities			
Net increase in deposits.....	1,024,446	375,953	410,605
(Repayment of) increase in subordinated debt.....	-	(50,000)	73,440
Advances of FHLB borrowings.....	4,203,181	340,000	1,526,489
Repayments of FHLB borrowings.....	(3,813,792)	(297,725)	(1,650,387)
Cash dividends paid on preferred stock.....	(6,037)	(1,717)	-
Cash dividends paid on common stock.....	(23,428)	(17,493)	(14,317)
Proceeds from preferred stock offering.....	-	110,927	-
Purchase of treasury stock.....	(13,127)	(9,401)	(911)
Proceeds from exercise of stock options.....	124	106	233
Share redemption for tax withholdings on performance units and deferred stock units earned.....	(2,133)	(1,283)	(639)
Net cash provided by financing activities.....	<u>1,369,234</u>	<u>449,367</u>	<u>344,513</u>
Net change in cash and cash equivalents.....	2,779	(38,220)	102,273
Cash and cash equivalents at beginning of period.....	265,536	303,756	201,483
Cash and cash equivalents at end of period.....	<u>\$ 268,315</u>	<u>\$ 265,536</u>	<u>\$ 303,756</u>
Supplemental disclosures of cash flow information:			
Cash payments for:			
Interest paid.....	\$ 67,850	\$ 41,787	\$ 74,701
Income taxes paid.....	49,234	45,431	26,548
Supplemental disclosures of noncash investing activities:			
Transfer of loans to other real estate owned.....	\$ 579	\$ 304	\$ -
Transfer of loans held-for-sale to loans held-for-investment.....	8,043	4,293	10,995
Transfer of loans held-for-investment to loans held-for-sale.....	27,137	16,628	26,548

See the accompanying notes to the consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies

Nature of Operations

ConnectOne Bancorp, Inc. (the “Parent Corporation”) is incorporated under the laws of the State of New Jersey and is a registered bank holding company under the Bank Holding Company Act of 1956, as amended (the “BHCA”). 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), Port Jervis Holdings, LLC (a New Jersey limited liability company), BONJ Special Properties, LLC (a New Jersey limited liability company) and BoeFly, Inc. (a New Jersey financial technology company).

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 twenty-four 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 Presentation and Principals of Consolidation

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

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.

Risks and Uncertainties

As previously disclosed, on March 11, 2020 the World Health Organization declared the outbreak of COVID-19 as a global pandemic, which continues to impact the United States and the world. On March 27, 2020, the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) was enacted to, among other things, provide emergency assistance for individuals, families and businesses affected by the COVID-19 pandemic. The COVID-19 pandemic has adversely affected, and continues to adversely affect economic activity globally, nationally and locally. Although economic activity accelerated during 2022 the COVID pandemic and changes to peoples’ patterns of work and spending may have an adverse impact on the economies and financial markets of many countries and parts of the United States, including the New Jersey/New York metropolitan area in which the Company primarily operates. COVID-19 could impact the Company’s operations in the future. Although state and local governments have lifted restrictions on conducting business, it is possible that restrictions could be reimposed.

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

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

On July 27, 2017, the U.K. Financial Conduct Authority, which regulates London Interbank Offered Rate ("LIBOR"), announced that it will no longer persuade or compel banks to submit rates for the calculation of LIBOR to the LIBOR administrator after 2021. The announcement also indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, although banks have continued to submit certain rates for the calculation of LIBOR in 2022, at this time, it is not possible to predict whether and to what extent banks will continue to provide LIBOR submissions to the LIBOR administrator. Similarly, banking regulators in the United States have required insured depository institutions in the United States to cease originating loans using LIBOR as a rate index as of December 31, 2021, and in March 2022 Congress adopted legislation providing for the replacement of LIBOR indexes in contracts without fall back language with the Secured Overnight Financing Rate ("SOFR"), and for the Federal Reserve to adopt regulation by September of 2022 implementing this change. Although the Bank ceased using LIBOR as an index for loans it originates, it is unclear at this time what effect these changes may have on the values of loans and liabilities held or owed by the Bank whose interest rates are or were tied to LIBOR. Uncertainty surrounding the phase out of LIBOR may adversely affect the value of, and the return on our loans, and our investment securities.

The United States economy is currently experiencing a level of price inflation not experienced since the late 1970's and early 1980's. It is therefore difficult to predict the response of consumers and businesses to this level of inflation, and its impact on the economy. In addition, in order to attempt to control and reduce the level of inflation, the Federal Reserve has embarked on a series of interest rate increases along with quantitative tightening to further constrict economic conditions. It is unclear whether the Federal Reserve's efforts will be successful, and what impact they may have on the United States' economy. It is possible that the combined effects of inflation and increases in market interest rates could cause the economy of the United States to enter a recession, which could negatively affect the businesses of our borrowers and their ability to repay their loans or need credit, which could negatively affect our results of operations.

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 client loan and deposit transactions, interest-bearing deposits in other financial institutions, and federal funds purchased and repurchase agreements.

Investment Securities

Effective January 1, 2021, 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.

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 available-for-sale are carried at fair value, with unrealized holding gains and losses reported in comprehensive income, net of tax. Interest income includes amortization of purchase premiums or discounts. Premiums and discounts on securities are generally amortized using the level-yield method without estimating prepayments, except for mortgage-backed securities, where prepayment rates are estimated. Premiums on callable investment securities are amortized to their earliest call date. Gains and losses on sales of securities are recorded on the trade date and determined using the specific identification method.

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

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies – (continued)

For available-for-sale investment securities which are in an unrealized loss position, the Company will first assess whether we intend to sell, or it is more likely than not, that we will be required to sell the security before recovery of the amortized cost basis. If either of the criteria is met, the amortized cost basis of the security is written down to fair value through income. For available-for-sale investment securities that do not meet the aforementioned criteria, we evaluate whether the decline in fair value has resulted from an actual or estimated credit loss event or other factors. In making this assessment, we consider the extent to which fair value is less than amortized cost, changes to the rating of the security, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss is likely, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of the cash flows expected to be collected is less than the amortized cost basis, an allowance for credit losses is recorded for the estimated credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit loss is recognized in other comprehensive income, net of tax. The Company elected the practical expedient of zero loss estimates for securities issued by U.S. government entities and agencies. These securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major agencies and have a long history of no credit losses.

Prior to January 1, 2021, securities were 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 were considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management assessed 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 were 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 was 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 was recognized through earnings. The amount of the total other-than-temporary impairment related to all other factors was recognized through other comprehensive income.

Equity Securities

The Company's investments in equity securities are recorded at fair value, with unrealized gains and losses included in earnings.

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, and 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 credit 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.

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

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies – (continued)

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 certain cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans include both smaller balance homogeneous loans that are collectively evaluated for credit losses and loans individually evaluated for credit losses.

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.

The policy of the Company is to generally grant commercial, residential and consumer loans to residents and businesses within the market-areas served by its offices in New Jersey, New York and Florida. 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 credit 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 Credit Losses

The allowance for credit losses is an estimate of current expected credit losses considering available information relevant to assessing collectability of cash flows over the contractual term of the financial assets necessary to cover lifetime expected credit losses inherent in financial assets at the balance sheet date. The measurement of expected credit losses is applicable to loans receivable and investment securities measured at amortized cost. It also applies to off-balance sheet credit exposures such as loan commitments and unused lines of credit. Loan losses are charged against the allowance for credit losses when the Company believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for credit losses. The allowance is established through a provision for credit losses that is charged against income. The methodology for determining the allowance for credit losses is considered a critical accounting policy by management because of the high degree of judgment involved, the subjectivity of the assumptions used, and the potential for changes in the forecasted economic environment that could result in changes to the amount of the recorded allowance for credit losses. The expected credit loss for unfunded loan commitments is reported on the consolidated statement of financial condition in other liabilities.

For financial assets, the allowance for credit losses is a valuation account that is deducted from, or added to, the amortized cost basis of the financial assets to present the net amount expected to be collected on the financial assets. The Company's methodology to estimate the allowance for credit losses has two components: (i) a collective reserve component for estimated lifetime expected credit losses for pools of loans that share common risk characteristics and (ii) an individual reserve component for loans that do not share common risk characteristics. The Company maintains an allowance for unfunded credit commitments mainly consisting of undisbursed non-cancellable lines of credit, new loan commitments and commercial letters of credit.

Information relevant to establishing an estimate of current expected credit losses includes historical credit loss experience on financial assets with similar risk characteristics, current conditions, and reasonable and supportable forecasts that affect the collectability of the remaining cash flows over the contractual term of the financial assets. The Company reports in net income (as a credit loss expense) the amount necessary to adjust the allowance for credit losses and liabilities for credit losses on off-balance-sheet credit exposures for the current estimate of expected credit losses.

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

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies – (continued)

Expected credit losses of financial assets are measured on a collective (pool) basis when similar risk characteristic(s) exist. If the Company determines that a financial asset does not share risk characteristics with other financial assets, the Company will evaluate the financial asset for expected credit losses on an individual basis. Financial assets are assessed once, either through collective assessments or individual assessments. Standard expected losses are evaluated on a collective, or pool, basis when financial assets share similar risk characteristics. For pooled loan segments, utilizing a quantitative analysis, the Company calculates estimated credit losses using a probability of default and loss given default methodology, the results of which are applied to the aggregated discounted cash flow of each individual loan within the segment. In the absence of relevant and reliable internal data, probability of default and loss given default rates are determined using peer data. The point in time probability of default and loss given default are then conditioned by macroeconomic scenarios to incorporate reasonable and supportable forecasts that affect the collectability of the reported amount. Financial assets may be segmented based on one characteristic, or a combination of characteristics. Examples of risk characteristics relevant to the Company's evaluation included, but were not limited to: (1) Internal or external credit scores or credit ratings, (2) Risk ratings or classifications, (3) Financial asset type, (4) Collateral type, (5) Size, (6) Effective interest rate, (7) Term, (8) Geographical location, (9) Industry of the borrower and (10) Vintage.

The Company's quantitative analysis also considers relevant available information from internal and external sources related to past events and current conditions, as well as the incorporation of reasonable and supportable forecasts. The Company evaluates a variety of factors including third party economic forecasts, industry trends and other available published economic information in arriving at its forecasts. After the reasonable and supportable forecast period, the Company reverts, on a straight-line basis, to average historical losses. Expected credit losses are estimated over the contractual term of the loans, adjusted for expected prepayments when appropriate.

Included in the allowance for credit losses are qualitative reserves to cover losses that are expected but, in the Company's assessment, may not be adequately represented in the quantitative analysis or the forecasts described above. Each qualitative loss factor, for each loan segment within the portfolio, incorporates consideration for a minimum to maximum range for loss factors derived from either the Company's historical loss experience, or peer group historical charge-off experience. These qualitative factor adjustments may increase or decrease the Company's estimate of expected credit losses and are applied to each loan segment.

The Bank evaluates individual instruments for expected credit losses when those instruments do not share similar risk characteristics with instruments evaluated using a collective (pooled) basis. The Company evaluates the pooling methodology at least annually. Loans transition from defined segments for individual analysis when credit characteristics, or risk traits, change in a material manner. A loan is considered for individual analysis when, based on current information and events, it is probable that the Company 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 the Company in determining individual analysis 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 troubled debt restructurings ("TDR") and are individually analyzed if carrying value is \$250,000 or higher. Additionally, nonaccrual loans that are \$250,000 or higher are also individually analyzed. All PCD loans are individually analyzed. For loans designated as TDR or nonaccrual with balances less than \$250,000, these loans are collectively evaluated, and, accordingly, are not separately identified for analysis or disclosures. Instruments will not be included in both collective and individual analysis. Individual analysis will establish a specific reserve for instruments in scope.

For collateral dependent loans, when it is determined that a foreclosure is probable, the allowance for credit losses is determined on a loan level basis using the fair value of the collateral as of the reporting date, less estimated disposition costs ("net fair value"), which will ensure that the credit loss is not delayed until the time at which the actual foreclosure takes place. In the event that this fair value is less than then amortized cost basis of these specific loans, the Company will recognize the difference between the net fair value at the reporting date and the amortized cost basis in the allowance for credit losses. If the fair value of the collateral has increased as of the evaluation date, the increase in the fair value of the collateral is reflected through a reduction in the allowance for credit losses. Adjustments for estimated disposition costs are not appropriate when the repayment of a collateral-dependent loan is expected from the operation of the collateral. If repayment is based upon future expected cash flows, the present value of the expected future cash flows discounted at the loan's original effective interest rate is compared to the carrying value of the loan, and any shortfall is recorded as the allowance for credit losses. The effective interest rate used to discount expected cash flows is adjusted to incorporate expected prepayments, if applicable.

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

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies – (continued)

Purchased Credit-Deteriorated Loans

Loans acquired in a business combination that have experienced a more-than-significant deterioration in credit quality since origination are considered PCD loans. The Company evaluates acquired loans for deterioration in credit quality based on any of, but not limited to, the following: (1) non-accrual status; (2) troubled debt restructured designation; (3) risk ratings of special mention, substandard or doubtful; (4) watchlist credits; and (5) delinquency status, including loans that were current on acquisition date, but had been previously delinquent. At the acquisition date, an estimate of expected credit losses is made for groups of PCD loans with similar risk characteristics and individual PCD loans without similar risk characteristics. This initial allowance for credit losses is allocated to individual PCD loans and added to the purchase price or acquisition date fair values to establish the initial amortized cost basis of the PCD loans. As the initial allowance for credit losses is added to the purchase price, there is no credit loss expense recognized upon acquisition of a PCD loan. Any difference between the unpaid principal balance of PCD loans and the amortized cost basis is considered to relate to noncredit factors and results in a discount or premium, which is recognized through interest income on a level-yield basis over the lives of the related loans. All loans considered to be purchased credit-impaired (PCI) prior to the adoption of ASU 2016-13 were converted to PCD upon adoption.

PCD loans that met the criteria for nonaccrual may be considered performing, regardless of whether the client 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's quantitative analysis also considers relevant available information from internal and external sources related to past events and current conditions, as well as the incorporation of reasonable and supportable forecasts. The Company evaluates a variety of factors including third party economic forecasts, industry trends and other available published economic information in arriving at its forecasts. After the reasonable and supportable forecast period, the Company reverts, on a straight-line basis, to average historical economic driver conditions. Expected credit losses are estimated over the contractual term of the loans, adjusted for expected prepayments when appropriate.

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 Operations, Basis of 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

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.

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

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies – (continued)

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.

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 18 of the Notes to Consolidated Financial Statements for a further discussion.

Treasury Stock

Subject to certain regulatory 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, 2022 and December 31, 2021, the Parent Corporation repurchased 447,108 and 330,541 shares, respectively, under a board-approved share repurchase program.

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 as of the years ended December 31, 2022, 2021 and 2020.

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

Note 1a – Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies – (continued)

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.

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 2021 and 2020 to conform to the classifications presented in 2022. Such reclassifications had no impact on net income or stockholders' equity.

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

Note 1b – Authoritative Accounting Guidance

Adoption of New Accounting Standards in 2023

In March 2022, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2022-02, “Financial Instruments – Credit Losses (Topic 326), Troubled Debt Restructurings and Vintage Disclosures” (“ASU 2022-02”). ASU 2022-02 eliminates the accounting guidance for troubled debt restructurings (“TDRs”) in ASC 310-40, “Receivables - Troubled Debt Restructurings by Creditors” for entities that have adopted the current expected credit loss (“CECL”) model introduced by ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (ASU 2016-13). ASU 2022-02 also requires that public business entities disclose current-period gross charge-offs by year of origination for financing receivables and net investments in leases within the scope of Subtopic 326-20, “Financial Instruments—Credit Losses—Measured at Amortized Cost”. ASU 2022-02 is effective for the Company for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years, with early adoption permitted. The adoption of ASU 2022-02 did not have a material effect on the Company’s consolidated financial statements.

Newly Issued, But Not Yet Effective Accounting Standards

In June 2022, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2022-03, “Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions” (“ASU 2022-03”). ASU 2022-03 clarifies that a contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, is not considered in measuring fair value. ASU 2022-03 is effective for the Company for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years, with early adoption permitted. The Company is evaluating the effect that ASU 2022-03 will have on its consolidated financial statements.

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

Note 2 – 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,		
	2022	2021	2020
	(in thousands, except per share amounts)		
Net income available to common stockholders	\$ 119,174	\$ 128,636	\$ 71,289
Earnings allocated to participating securities.....	(287)	(313)	(356)
Income attributable to common stock	<u>\$ 118,887</u>	<u>\$ 128,323</u>	<u>\$ 70,933</u>
Weighted average common shares outstanding, including participating securities.....	39,355	39,723	39,643
Weighted average participating securities.....	(95)	(97)	(131)
Weighted average common shares outstanding	<u>39,260</u>	<u>39,626</u>	<u>39,512</u>
Incremental shares from assumed conversions of options, deferred stock units, performance units and restricted stock	216	260	132
Weighted average common and equivalent shares outstanding.....	<u>39,476</u>	<u>39,886</u>	<u>39,644</u>
Earnings per common share:			
Basic.....	\$ 3.03	\$ 3.24	\$ 1.80
Diluted.....	3.01	3.22	1.79

There were no antidilutive common share equivalents as of December 31, 2022, 2021 and 2020.

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

Note 3 – Investment Securities

The Company's investment securities are classified as available-for-sale as of December 31, 2022 and December 31, 2021. 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, 2022 and December 31, 2021. 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 20 of the Notes to Consolidated Financial Statements for a further discussion.

The following tables present information related to the Company's portfolio of investment securities available-for-sale as of December 31, 2022 and 2021.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(dollars in thousands)		
December 31, 2022				
Investment securities available-for-sale				
Federal agency obligations	\$ 54,889	\$ -	\$ (10,439)	\$ 44,450
Residential mortgage pass-through securities	475,263	178	(57,863)	417,578
Commercial mortgage pass-through securities	25,485	-	(4,381)	21,104
Obligations of U.S. states and political subdivisions	157,247	111	(14,462)	142,896
Corporate bonds and notes	7,000	-	(26)	6,974
Asset-backed securities	1,673	-	(33)	1,640
Other securities	242	-	-	242
Total securities available-for-sale	\$ 721,799	\$ 289	\$ (87,204)	\$ 634,884

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(dollars in thousands)		
December 31, 2021				
Investment securities available-for-sale				
Federal agency obligations	\$ 50,336	\$ 649	\$ (625)	\$ 50,360
Residential mortgage pass-through securities	317,111	1,868	(2,884)	316,095
Commercial mortgage pass-through securities	10,814	118	(463)	10,469
Obligations of U.S. states and political subdivisions	145,045	1,562	(982)	145,625
Corporate bonds and notes	8,968	81	-	9,049
Asset-backed securities	2,563	3	(2)	2,564
Certificates of deposit	150	-	-	150
Other securities	195	-	-	195
Total securities available-for-sale	\$ 535,182	\$ 4,281	\$ (4,956)	\$ 534,507

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

Note 3 – Investment Securities – (continued)

Investment securities having a carrying value of approximately \$157 million and \$71 million as of December 31, 2022 and December 31, 2021, respectively, were pledged to secure public deposits, borrowings, Federal Reserve Discount Window borrowings and Federal Home Loan Bank advances and for other purposes required or permitted by law. As of December 31, 2022, and December 31, 2021, 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 investment securities available-for-sale as of December 31, 2022, 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, 2022	
	Amortized Cost	Fair Value
	(dollars in thousands)	
Investment securities available-for-sale:		
Due in one year or less.....	\$ 5,453	\$ 5,451
Due after one year through five years.....	4,106	4,082
Due after five years through ten years	2,247	2,244
Due after ten years	209,003	184,183
Residential mortgage pass-through securities	475,263	417,578
Commercial mortgage pass-through securities	25,485	21,104
Other securities	242	242
Total securities available-for-sale	<u>\$ 721,799</u>	<u>\$ 634,884</u>

Gross gains and losses from the sales and redemptions of investment securities for the years ended December 31, 2022, 2021 and 2020 were as follows:

	Years Ended December 31,		
	2022	2021	2020
	(dollars in thousands)		
Proceeds.....	\$ -	\$ 5,185	\$ 19,624
Gross gains on sale/redemption of investment securities.....	\$ -	\$ 195	\$ 29
Gross losses on sale/redemption of investment securities	-	-	-
Net gains on sales/redemptions of investment securities	-	195	29
Tax provision on net gains	-	(48)	(6)
Net gains on sale/redemption of investment securities, after tax	<u>\$ -</u>	<u>\$ 147</u>	<u>\$ 23</u>

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

Note 3 – Investment Securities – (continued)

Impairment Analysis of Available-for-Sale Debt Securities

The following tables indicate gross unrealized losses for which an ACL has not been recorded, aggregated by investment category and by the length of continuous time individual securities have been in an unrealized loss position as of December 31, 2022 and December 31, 2021.

	December 31, 2022					
	Total		Less than 12 Months		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	\$ 44,451	\$ (10,439)	\$ 20,517	\$ (1,831)	\$ 23,934	\$ (8,608)
Residential mortgage pass-through securities.....	403,039	(57,863)	218,918	(13,869)	184,121	(43,994)
Commercial mortgage pass-through securities.....	21,105	(4,381)	14,523	(2,304)	6,582	(2,077)
Obligations of U.S. states and political subdivisions.....	133,265	(14,462)	47,446	(3,404)	85,819	(11,058)
Corporate bonds and notes.....	4,973	(26)	4,973	(26)	-	-
Asset-backed securities.....	1,640	(33)	1,048	(16)	592	(17)
Total temporarily impaired securities.....	<u>\$ 608,473</u>	<u>\$ (87,204)</u>	<u>\$ 307,425</u>	<u>\$ (21,450)</u>	<u>\$ 301,048</u>	<u>\$ (65,754)</u>
	December 31, 2021					
	Total		Less than 12 Months		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	\$ 28,974	\$ (625)	\$ 28,974	\$ (625)	\$ -	\$ -
Residential mortgage pass-through securities.....	246,396	(2,884)	214,701	(2,111)	31,695	(773)
Commercial mortgage pass-through securities.....	8,370	(463)	4,682	(75)	3,688	(388)
Obligations of U.S. states and political subdivisions.....	89,473	(982)	89,473	(982)	-	-
Asset-backed securities.....	802	(2)	802	(2)	-	-
Total temporarily impaired securities.....	<u>\$ 374,015</u>	<u>\$ (4,956)</u>	<u>\$ 338,632</u>	<u>\$ (3,795)</u>	<u>\$ 35,383</u>	<u>\$ (1,161)</u>

On January 1, 2021, the Company adopted ASU 2016-13 and implemented the CECL methodology for allowance for credit losses on its investment securities available-for-sale. The new CECL methodology replaces the other-than-temporary impairment model that previously existed. The Company did not have a CECL day 1 impact attributable to its investment securities portfolio and did not have an allowance for credit losses as of December 31, 2022. The Company has elected to exclude accrued interest from the amortized cost of its investment securities available-for-sale. Accrued interest receivable for investment securities available for sale as of December 31, 2022 and December 31, 2021, totaled \$2.4 million and \$1.6 million, respectively.

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

Note 3 – Investment Securities – (continued)

The Company evaluates securities in an unrealized loss position for impairment related to credit losses on at least a quarterly basis. Securities in unrealized loss positions are first assessed as to whether we intend to sell, or if it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If one of the criteria is met, the security's amortized cost basis is written down to fair value through current earnings. For securities that do not meet these criteria, the Company evaluates whether the decline in fair value resulted from credit losses or other factors. If this assessment indicates that a credit loss exists, we compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis for the security, a credit loss exists and an allowance for credit losses is recorded, limited to the amount that the fair value of the security is less than its amortized cost basis. Unrealized losses on asset backed securities and state and municipal securities have not been recognized into income because the issuers are of high credit quality, we do not intend to sell and it is likely that we will not be required to sell the securities prior to their anticipated recovery. The decline in fair value is largely due to changes in interest rates and other market conditions. The issuers continue to make timely principal and interest payments on the securities. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income, net of applicable taxes. No allowance for credit losses for available-for-sale securities was recorded as of December 31, 2022.

Federal agency obligations, residential mortgage-backed pass-through securities and commercial mortgage-backed pass-through securities are issued by U.S. Government agencies and U.S. Government sponsored enterprises. Although a government guarantee exists on these investments, these entities are not legally backed by the full faith and credit of the federal government, and the current support they receive is subject to a cap as part of the agreement entered into in 2008. Nonetheless, at this time we do not foresee any set of circumstances in which the government would not fund its commitments on these investments as the issuers are an integral part of the U.S. housing market in providing liquidity and stability. Therefore, we concluded that a zero-allowance approach for these investment securities is appropriate.

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

Note 4 – Loans and the Allowance for Credit Losses

Loans Receivable: The following table sets forth the composition of the Company’s loan portfolio segments, net of deferred fees, as of December 31, 2022 and December 31, 2021:

	2022	2021
	(dollars in thousands)	
Commercial (1).....	\$ 1,472,734	\$ 1,299,428
Commercial real estate.....	5,795,228	4,741,590
Commercial construction.....	574,139	540,178
Residential real estate	264,748	255,269
Consumer.....	2,312	1,886
Gross loans.....	8,109,161	6,838,351
Net deferred fees.....	(9,472)	(9,729)
Loans receivable	<u>\$ 8,099,689</u>	<u>\$ 6,828,622</u>

- (1) Included in commercial loans as of December 31, 2022 and December 31, 2021 were Paycheck Protection Program (“PPP”) loans of \$11.4 million and \$93.1 million, respectively. These loans are 100% federally guaranteed and currently not subject to any allocation of allowance for credit losses.

As of December 31, 2022, and 2021, loan balances of approximately \$2.7 billion and \$2.5 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 real estate 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.

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

Loans Held-For-Sale: The following table presents loans held-for-sale by loan segment as of December 31, 2022 and December 31, 2021:

	2022	2021
	(dollars in thousands)	
Commercial.....	\$ 13,473	\$ -
Residential real estate	299	250
Total carrying amount.....	<u>\$ 13,772</u>	<u>\$ 250</u>

Loans Receivable on Nonaccrual Status - The following tables present nonaccrual loans with an allowance for credit loss (“ACL”) as of December 31, 2022 and December 31, 2021 and nonaccrual loans without an ACL as of December 31, 2022 and December 31, 2021:

	December 31, 2022		
	Nonaccrual loans with ACL	Nonaccrual loans without ACL	Total Nonaccrual loans
	(dollars in thousands)		
Commercial.....	\$ 23,512	\$ 1,745	\$ 25,257
Commercial real estate.....	10,220	6,597	16,817
Residential real estate	604	1,776	2,380
Total	<u>\$ 34,336</u>	<u>\$ 10,118</u>	<u>\$ 44,454</u>

	December 31, 2021		
	Nonaccrual loans with ACL	Nonaccrual loans without ACL	Total Nonaccrual loans
	(dollars in thousands)		
Commercial.....	\$ 28,746	\$ 1,316	\$ 30,062
Commercial real estate.....	15,362	10,031	25,393
Commercial construction	-	3,150	3,150
Residential real estate	1,239	1,856	3,095
Total	<u>\$ 45,347</u>	<u>\$ 16,353</u>	<u>\$ 61,700</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 4 – Loans and the Allowance for Credit 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 as “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 as “Substandard” if the asset has a well-defined weakness that requires management’s attention to a greater degree than for loans classified as 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.

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

We evaluate whether a modification, extension or renewal of a loan is a current period origination in accordance with GAAP. Generally, loans up for renewal are subject to a full credit evaluation before the renewal is granted and such loans are considered current period originations for purpose of the table below. As of December 31, 2022, our loans based on year of origination and risk designation are as follows (dollars in thousands):

	Term loans amortized cost basis by origination year						Revolving	Total
	2022	2021	2020	2019	2018	Prior	Loans	Gross Loans
<u>Commercial</u>								
Pass	\$ 301,636	\$ 305,721	\$ 47,952	\$ 28,177	\$ 52,950	\$ 127,739	\$ 550,483	\$1,414,658
Special mention.....	-	-	-	583	26	8,551	3,292	12,452
Substandard.....	7,615	146	15	1,769	11,214	22,596	2,269	45,624
Doubtful.....	-	-	-	-	-	-	-	-
Total Commercial	\$ 309,251	\$ 305,867	\$ 47,967	\$ 30,529	\$ 64,190	\$ 158,886	\$ 556,044	\$1,472,734
<u>Commercial Real Estate</u>								
Pass	\$1,571,751	\$1,608,023	\$382,987	\$358,578	\$375,886	\$ 987,982	\$ 401,365	\$5,686,572
Special mention.....	3,040	-	-	-	-	37,774	8,839	49,653
Substandard.....	-	1,929	-	6,526	19,138	23,287	8,123	59,003
Doubtful.....	-	-	-	-	-	-	-	-
Total Commercial Real Estate	\$1,574,791	\$1,609,952	\$382,987	\$365,104	\$395,024	\$1,049,043	\$ 418,327	\$5,795,228
<u>Commercial Construction</u>								
Pass	\$ 8,615	\$ 7,605	\$ 6,720	\$ 508	\$ -	\$ -	\$ 542,460	\$ 565,908
Special mention.....	-	-	-	-	-	-	-	-
Substandard.....	-	-	-	-	-	-	8,231	8,231
Doubtful.....	-	-	-	-	-	-	-	-
Total Commercial Construction	\$ 8,615	\$ 7,605	\$ 6,720	\$ 508	\$ -	\$ -	\$ 550,691	\$ 574,139
<u>Residential Real Estate</u>								
Pass	\$ 45,926	\$ 25,318	\$ 24,409	\$ 21,557	\$ 20,284	\$ 78,314	\$ 41,468	\$ 257,276
Special mention.....	-	-	-	-	-	-	-	-
Substandard.....	-	-	-	-	-	3,379	4,093	7,472
Doubtful.....	-	-	-	-	-	-	-	-
Total Residential Real Estate ..	\$ 45,926	\$ 25,318	\$ 24,409	\$ 21,557	\$ 20,284	\$ 81,693	\$ 45,561	\$ 264,748
<u>Consumer</u>								
Pass	\$ 2,219	\$ -	\$ 9	\$ -	\$ -	\$ 2	\$ 82	\$ 2,312
Special mention.....	-	-	-	-	-	-	-	-
Substandard.....	-	-	-	-	-	-	-	-
Doubtful.....	-	-	-	-	-	-	-	-
Total Consumer	\$ 2,219	\$ -	\$ 9	\$ -	\$ -	\$ 2	\$ 82	\$ 2,312
<u>Total</u>								
Pass	\$1,930,147	\$1,946,667	\$462,077	\$408,820	\$449,120	\$1,194,037	\$1,535,858	\$7,926,726
Special mention.....	3,040	-	-	583	26	46,325	12,131	62,105
Substandard.....	7,615	2,075	15	8,295	30,352	49,262	22,716	120,330
Doubtful.....	-	-	-	-	-	-	-	-
Grand Total	\$1,940,802	\$1,948,742	\$462,092	\$417,698	\$479,498	\$1,289,624	\$1,570,705	\$8,109,161

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

As of December 31, 2021, our loans based on year of origination and risk designation are as follows (dollars in thousands):

	2021	2020	2019	2018	2017	Prior	Revolving Loans	Total Gross Loans
Commercial								
Pass	\$ 403,203	\$ 58,534	\$ 54,485	\$ 60,409	\$ 95,727	\$ 86,556	\$ 471,588	\$1,230,502
Special mention.....	-	-	-	-	1	4,045	4,266	8,312
Substandard.....	170	-	1,842	13,298	9,740	21,024	14,540	60,614
Doubtful.....	-	-	-	-	-	-	-	-
Total Commercial	\$ 403,373	\$ 58,534	\$ 56,327	\$ 73,707	\$ 105,468	\$ 111,625	\$ 490,394	\$1,299,428
Commercial Real Estate								
Pass	\$1,692,098	\$ 533,315	\$ 420,995	\$ 452,262	\$ 497,065	\$ 842,244	\$ 170,721	\$4,608,700
Special mention.....	-	-	-	-	5,142	50,438	6,601	62,181
Substandard.....	1,968	9,039	4,006	20,624	-	26,108	8,964	70,709
Doubtful.....	-	-	-	-	-	-	-	-
Total Commercial Real Estate	\$1,694,066	\$ 542,354	\$ 425,001	\$ 472,886	\$ 502,207	\$ 918,790	\$ 186,286	\$4,741,590
Commercial Construction								
Pass	\$ 8,018	\$ 7,370	\$ 12,625	\$ 2,600	\$ 2,339	\$ -	\$ 490,119	\$ 523,071
Special mention.....	-	-	-	-	350	-	1,443	1,793
Substandard.....	-	-	-	-	-	-	15,314	15,314
Doubtful.....	-	-	-	-	-	-	-	-
Total Commercial Construction.....	\$ 8,018	\$ 7,370	\$ 12,625	\$ 2,600	\$ 2,689	\$ -	\$ 506,876	\$ 540,178
Residential Real Estate								
Pass	\$ 27,081	\$ 29,539	\$ 23,611	\$ 25,070	\$ 28,701	\$ 66,249	\$ 44,221	\$ 244,472
Special mention.....	-	-	-	-	-	-	-	-
Substandard.....	-	-	-	-	-	7,262	3,535	10,797
Doubtful.....	-	-	-	-	-	-	-	-
Total Residential Real Estate	\$ 27,081	\$ 29,539	\$ 23,611	\$ 25,070	\$ 28,701	\$ 73,511	\$ 47,756	\$ 255,269
Consumer								
Pass	\$ 1,590	\$ 85	\$ 39	\$ 21	\$ 28	\$ -	\$ 123	\$ 1,886
Special mention.....	-	-	-	-	-	-	-	-
Substandard.....	-	-	-	-	-	-	-	-
Doubtful.....	-	-	-	-	-	-	-	-
Total Consumer.....	\$ 1,590	\$ 85	\$ 39	\$ 21	\$ 28	\$ -	\$ 123	\$ 1,886
Total								
Pass	\$2,131,990	\$ 628,843	\$ 511,755	\$ 540,362	\$ 623,860	\$ 995,049	\$1,176,772	\$6,608,631
Special mention.....	-	-	-	-	5,493	54,483	12,310	72,286
Substandard.....	2,138	9,039	5,848	33,922	9,740	54,394	42,353	157,434
Doubtful.....	-	-	-	-	-	-	-	-
Grand Total.....	\$2,134,128	\$ 637,882	\$ 517,603	\$ 574,284	\$ 639,093	\$1,103,926	\$1,231,435	\$6,838,351

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

Collateral Dependent Loans: Loans which meet certain criteria are individually evaluated as part of the process of calculating the allowance for credit losses. The evaluation is determined on an individual basis using the fair value of the collateral as of the reporting date. The following table presents collateral dependent loans that were individually evaluated for impairment as of December 31, 2022 and 2021:

	December 31, 2022		
	Real Estate	Other	Total
	(dollars in thousands)		
Commercial.....	\$ 5,352	\$ 22,517	\$ 27,869
Commercial real estate.....	52,477	-	52,477
Commercial construction	8,232	-	8,232
Residential real estate	5,864	-	5,864
Total	<u>\$ 71,925</u>	<u>\$ 22,517</u>	<u>\$ 94,442</u>

	December 31, 2021		
	Real Estate	Other	Total
	(dollars in thousands)		
Commercial.....	\$ 6,385	\$ 26,182	\$ 32,567
Commercial real estate.....	55,244	-	55,244
Commercial construction	13,196	-	13,196
Residential real estate	8,856	-	8,856
Total	<u>\$ 83,681</u>	<u>\$ 26,182</u>	<u>\$ 109,863</u>

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

Aging Analysis - The following table provides an analysis of the aging of the loans by class, excluding the effect of net deferred fees, which are past due as of December 31, 2022 and December 31, 2021 (dollars in thousands):

December 31, 2022							
	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	Gross Loans
Commercial.....	\$ 306	\$ -	\$ -	\$ 25,257	\$ 25,563	\$1,447,171	\$1,472,734
Commercial real Estate.....	90	-	5,591	16,817	22,498	5,772,730	5,795,228
Commercial construction.....	-	-	-	-	-	574,139	574,139
Residential real Estate.....	1,569	-	-	2,380	3,949	260,799	264,748
Consumer.....	-	-	-	-	-	2,312	2,312
Total	<u>\$ 1,965</u>	<u>\$ -</u>	<u>\$ 5,591</u>	<u>\$ 44,454</u>	<u>\$ 52,010</u>	<u>\$8,057,151</u>	<u>\$8,109,161</u>

The 90 days or greater past due and still accruing category reflects purchased credit-deteriorated loans, net of fair value marks, which accrete income per the valuation at date of acquisition.

December 31, 2021							
	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.....	\$ 4,305	\$ 729	\$ 4,457	\$ 30,062	\$ 39,553	\$1,259,875	\$1,299,428
Commercial real estate.....	1,622	1,009	5,935	25,393	33,959	4,707,631	4,741,590
Commercial construction.....	-	-	-	3,150	3,150	537,028	540,178
Residential real estate	1,437	292	3,139	3,095	7,963	247,306	255,269
Consumer.....	-	-	-	-	-	1,886	1,886
Total	<u>\$ 7,364</u>	<u>\$ 2,030</u>	<u>\$ 13,531</u>	<u>\$ 61,700</u>	<u>\$ 84,625</u>	<u>\$6,753,726</u>	<u>\$6,838,351</u>

The 90 days or greater past due and still accruing category reflects purchased credit-deteriorated loans, net of fair value marks, which accrete income per the valuation at date of acquisition.

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

The following tables detail the amount of gross loans that are individually evaluated for impairment, collectively evaluated for impairment, and loans acquired with deteriorated quality, and the related portion of the allowance for credit losses for loans that are allocated to each loan portfolio segment.

	December 31, 2022					
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Total
	(dollars in thousands)					
Allowance for credit losses - loans						
Individually evaluated.....	\$ 7,426	\$ 1,003	\$ -	\$ 50	\$ -	\$ 8,479
Collectively evaluated.....	19,319	50,818	3,718	4,093	7	77,955
Acquired with deteriorated credit quality individually analyzed.....	2,158	1,921	-	-	-	4,079
Total.....	<u>\$ 28,903</u>	<u>\$ 53,742</u>	<u>\$ 3,718</u>	<u>\$ 4,143</u>	<u>\$ 7</u>	<u>\$ 90,513</u>
<u>Gross loans</u>						
Individually evaluated.....	\$ 30,994	\$ 46,886	\$ 8,232	\$ 5,864	\$ -	\$ 91,976
Collectively evaluated.....	1,436,866	5,742,751	565,907	258,884	2,312	8,006,720
Acquired with deteriorated credit quality individually analyzed.....	4,874	5,591	-	-	-	10,465
Total.....	<u>\$ 1,472,734</u>	<u>\$ 5,795,228</u>	<u>\$ 574,139</u>	<u>\$ 264,748</u>	<u>\$ 2,312</u>	<u>\$ 8,109,161</u>

	December 31, 2021					
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Total
	(dollars in thousands)					
Allowance for credit losses - loans						
Individually evaluated.....	\$ 15,131	\$ 955	\$ -	\$ 131	\$ -	\$ 16,217
Collectively evaluated.....	8,561	42,713	3,580	3,497	7	58,358
Acquired with deteriorated credit quality individually analyzed.....	2,277	1,921	-	-	-	4,198
Total.....	<u>\$ 25,969</u>	<u>\$ 45,589</u>	<u>\$ 3,580</u>	<u>\$ 3,628</u>	<u>\$ 7</u>	<u>\$ 78,773</u>
<u>Gross loans</u>						
Individually evaluated.....	\$ 33,726	\$ 49,310	\$ 13,196	\$ 5,717	\$ -	\$ 101,949
Collectively evaluated.....	1,260,537	4,686,346	526,982	246,413	1,886	6,722,164
Acquired with deteriorated credit quality individually analyzed.....	5,165	5,934	-	3,139	-	14,238
Total.....	<u>\$ 1,299,428</u>	<u>\$ 4,741,590</u>	<u>\$ 540,178</u>	<u>\$ 255,269</u>	<u>\$ 1,886</u>	<u>\$ 6,838,351</u>

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

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

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance as of January 1, 2022.....	\$ 25,969	\$ 45,589	\$ 3,580	\$ 3,628	\$ 7	\$ -	\$ 78,773
Charge-offs	(2,612)	(2,819)	-	(9)	(3)	-	(5,443)
Recoveries.....	54	-	-	63	-	-	117
Provision for credit losses.....	5,492	10,972	138	461	3	-	17,066
Balance as of December 31, 2022.....	<u>\$ 28,903</u>	<u>\$ 53,742</u>	<u>\$ 3,718</u>	<u>\$ 4,143</u>	<u>\$ 7</u>	<u>\$ -</u>	<u>\$ 90,513</u>

On January 1, 2021, the Company adopted CECL, which replaced the incurred loss method we used in prior periods for determining the provision for credit losses and the allowance for credit losses. Under CECL, we record an expected loss of all cash flows we do not expect to collect at the inception of the loan. The adoption of CECL resulted in an increase in our allowance for credit losses for loans of \$6.6 million, which did not impact our consolidated income statement.

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance as of January 1, 2021.....	\$ 28,443	\$ 39,330	\$ 8,194	\$ 2,687	\$ 4	\$ 568	\$ 79,226
Day 1 Adjustment CECL	(4,225)	9,605	(961)	2,697	9	(568)	6,557
Balance as of January 1, 2021.....	24,218	48,935	7,233	5,384	13	-	85,783
Charge-offs	(382)	(1,780)	-	(235)	-	-	(2,397)
Recoveries.....	289	85	-	20	11	-	405
Provision for (reversal of) credit losses	1,844	(1,651)	(3,653)	(1,541)	(17)	-	(5,018)
Balance as of December 31, 2021.....	<u>\$ 25,969</u>	<u>\$ 45,589</u>	<u>\$ 3,580</u>	<u>\$ 3,628</u>	<u>\$ 7</u>	<u>\$ -</u>	<u>\$ 78,773</u>

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance as of January 1, 2020.....	\$ 8,349	\$ 20,853	\$ 7,304	\$ 1,685	\$ 3	\$ 99	\$ 38,293
Charge-offs	(552)	-	-	(341)	(7)	-	(900)
Recoveries.....	4	802	-	23	4	-	833
Provision for loan losses	20,642	17,675	890	1,320	4	469	41,000
Balance as of December 31, 2020.....	<u>\$ 28,443</u>	<u>\$ 39,330</u>	<u>\$ 8,194</u>	<u>\$ 2,687</u>	<u>\$ 4</u>	<u>\$ 568</u>	<u>\$ 79,226</u>

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

Troubled Debt Restructurings

Loans are considered to have been modified in a troubled debt restructuring (“TDR”) when, except as discussed below, 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, maturity extensions, 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 TDR remains on nonaccrual status for a period of nine 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.

As of December 31, 2022, 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 a TDR.

As of December 31, 2022, TDRs totaled \$75.1 million, of which \$23.7 million were on nonaccrual status and \$51.4 million were classified as accruing and were performing under their restructured terms. As of December 31, 2021, TDRs totaled \$79.5 million, of which \$35.9 million were on nonaccrual status and \$43.6 million were classified as accruing and were performing under their restructured terms. The Company has allocated \$4.2 million and \$10.4 million of specific allowance related to TDRs as of December 31, 2022 and December 31, 2021, respectively. There were no TDRs for which there was a payment default within twelve months following the modification during the year ended December 31, 2022, 2021 and 2020.

The following table presents loans by class modified as TDRs during the year ended December 31, 2022:

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
		(dollars in thousands)	
Troubled debt restructurings:			
Commercial.....	2	\$ 633	\$ 633
Commercial real estate.....	3	12,083	11,583
Residential real estate	3	949	949
Total	8	\$ 13,665	\$ 13,165

The loans modified as TDRs during the year ended December 31, 2022 included maturity extensions and interest rate reductions. One of the commercial real estate loans included a one-time principal payoff of \$500,000 at the time of modification. The eight loans modified during the year ended December 31, 2022 resulted in a \$0.3 million increase to the allowance for credit losses at the time of their modification.

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

The following table presents loans by class modified as TDRs during the year ended December 31, 2021

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
		(dollars in thousands)	
Troubled debt restructurings:			
Commercial.....	4	\$ 1,276	\$ 1,276
Commercial real estate.....	11	35,635	35,635
Commercial construction	1	1,641	1,641
Residential real estate	3	1,758	1,758
Total	19	\$ 40,310	\$ 40,310

The loans modified as TDRs during the year ended December 31, 2021 included maturity extensions and interest rate reductions.

The following table presents loans by class modified as TDRs during the year ended December 31, 2020:

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
		(dollars in thousands)	
Troubled debt restructurings:			
Commercial.....	1	\$ 188	\$ 188
Commercial real estate.....	1	93	93
Commercial construction	1	4,021	4,021
Residential real estate	2	2,184	2,184
Total	5	\$ 6,486	\$ 6,486

The five loan modifications during the year ended December 31, 2020 were maturity extensions.

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

Note 4 – Loans and the Allowance for Credit Losses – (continued)

Allowance for Credit Losses for Unfunded Commitments

The Company has recorded an ACL for unfunded credit commitments, which is recorded in other liabilities. The provision is recorded within the (reversal of) provision for credit losses on the Company's income statement. The following table presents the allowance for credit losses for unfunded commitments for the year ended December 31, 2022 and 2021 (dollars in thousands):

	2022	2021
Balance as of beginning of period.....	\$ 2,351	\$ -
Day 1 Effect of CECL	-	2,833
Provision for (reversal of) credit losses - unfunded commitments	684	(482)
Balance as of end of period.....	<u>\$ 3,035</u>	<u>\$ 2,351</u>

Components of (Reversal of) Provision for Credit Losses

The following table summarizes the provision for (reversal of) provision for credit losses for the year ended December 31, 2022 and 2021 (dollars in thousands):

	2022	2021
Provision for (reversal of) credit losses - loans.....	\$ 17,066	\$ (5,018)
Provision for (reversal of) credit losses - unfunded commitments	684	(482)
Provision for (reversal of) credit losses	<u>\$ 17,750</u>	<u>\$ (5,500)</u>

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

Note 5 – Premises and Equipment

Premises and equipment are summarized as follows December 31, 2022 and 2021 :

	Estimated Useful Life (Years)	2022	2021
		(dollars in thousands)	
Land	-	\$ 6,732	\$ 7,232
Buildings	10-25	9,797	10,509
Furniture, fixtures and equipment	3-7	24,830	24,137
Leasehold improvements	10-20	25,164	27,343
Subtotal		66,523	69,221
Less: accumulated depreciation, amortization and fair value adjustments		38,723	40,189
Total premises and equipment, net		<u>\$ 27,800</u>	<u>\$ 29,032</u>

Depreciation and amortization expense of premises and equipment was \$3.9 million, \$3.8 million and \$4.2 million for 2022, 2021 and 2020, respectively.

Finance Leases: The Company has a lease agreement for a building accounted for as a finance lease. The lease arrangement requires monthly payments through 2028. As of December 31, 2022, the weighted average remaining term for the finance lease was 5.9 years and the weighted average discount rate used in the measurement of finance lease liabilities was 6.0%. Total finance lease costs for the year ended December 31, 2022, was \$280 thousand.

The Company has included this lease in premises and equipment as follows December 31, 2022 and 2021 :

	2022	2021
	(dollars in thousands)	
Finance lease	\$ 3,423	\$ 3,423
Less: accumulated amortization	2,395	2,224
	<u>\$ 1,028</u>	<u>\$ 1,199</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 as of December 31, 2022 (dollars in thousands):

2023	\$ 323
2024	353
2025	353
2026	353
2027	353
Thereafter	323
Total minimum lease payments	2,058
Less amount representing interest	325
Present value of net minimum lease payments	<u>\$ 1,733</u>

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

Note 5 – Premises and Equipment – (continued)

The Company leases certain premises and equipment under operating leases. As of December 31, 2022, the Company had lease liabilities totaling \$11.4 million and right-of-use assets totaling \$10.2 million. As of December 31, 2022, the weighted average remaining lease term for operating leases was 5 years and the weighted average discount rate used in the measurement of operating lease liabilities was 2.8%. Total lease costs for the year ended December 31, 2022 was \$3.2 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, 2022
	(dollars in thousands)
Lease payments due:	
Less than 1 year	\$ 2,958
1 year through less than 2 years	2,422
2 years through less than 3 years	2,139
3 years through less than 4 years	2,043
4 years through 5 years	1,391
After 5 years	1,360
Total undiscounted cash flows	12,313
Impact of discounting	(916)
Total lease liability	<u>\$ 11,397</u>

Note 6 – 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.

Based upon management’s review through December 31, 2022, the Company’s goodwill was not impaired. 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:

	2022	2021
	(dollars in thousands)	
Balance, January 1	\$ 208,372	\$ 208,372
Acquired goodwill	-	-
Impairment	-	-
Balance, December 31	<u>\$ 208,372</u>	<u>\$ 208,372</u>

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

Note 6 – 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	Net Carrying Amount
	(dollars in thousands)		
Core deposit intangibles			
December 31, 2022	\$ 18,515	\$ (11,203)	\$ 7,312
Core deposit intangibles			
December 31, 2021	\$ 18,515	\$ (9,518)	\$ 8,997

Aggregate amortization expense was approximately \$1.7 million, \$2.0 million and \$2.6 million for 2022, 2021 and 2020, respectively. Estimated amortization expense for each of the next five years (dollars in thousands):

2023	\$ 1,438
2024	1,235
2025	1,116
2026	1,050
2027	989

Note 7 – Deposits

Time Deposits

As of December 31, 2022, and 2021, the Company's total time deposits were \$2.4 billion and \$1.2 billion, respectively. Included in time deposits were gross nonreciprocal brokered time deposits of \$934.9 million and \$215.2 million as of December 31, 2022 and 2021, respectively. As of December 31, 2022, the contractual maturities of these time deposits were as follows (dollars in thousands):

2023	\$ 1,571,746
2024	502,172
2025	112,106
2026	169,440
2027	40,179
Time Deposits (before net discount).....	\$ 2,395,643
Fair value net discount.....	(1,453)
Total Time Deposits (after net discount)	\$ 2,394,190

The amount of time deposits with balances in excess of \$250,000 were \$591.8 million and \$250.5 million as of December 31, 2022 and 2021, respectively.

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

Note 8 – FHLB Borrowings

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

	December 31, 2022		December 31, 2021	
	Amount	Rate	Amount	Rate
	(dollars in thousands)			
By remaining period to maturity:				
Less than 1 year.....	\$ 830,000	4.42%	\$ 390,549	0.56%
1 year through less than 2 years	-	-	50,000	1.84
2 years through less than 3 years.....	25,000	1.00	-	n/a
3 years through less than 4 years	2,050	2.23	25,000	1.00
4 years through 5 years	326	2.85	2,050	2.23
After 5 Years	326	2.96	714	2.91
FHLB borrowings - (before discount)	857,702	4.32%	468,313	0.73%
Fair value discount	(80)		(120)	
FHLB borrowings (after discount)	<u>\$ 857,622</u>		<u>\$ 468,193</u>	

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 have fixed rates. The advances as of December 31, 2022 were primarily collateralized by approximately \$2.7 billion of commercial mortgage and residential loans, net of required over collateralization amounts, under a blanket lien arrangement. As of December 31, 2022, the Company had remaining borrowing capacity of approximately \$498.9 million at the FHLB.

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

Note 9 – 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 I 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 as of December 31, 2022 was 7.26%. 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 as of December 31, 2022 and December 31, 2021.

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

On June 10, 2020, the Parent Corporation issued \$75 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "2020 Notes"). The 2020 Notes bear interest at 5.75% annually from, and including, the date of initial issuance to, but excluding, June 15, 2025 or the date of earlier redemption, payable semi-annually in arrears on June 15 and December 15 of each year, commencing December 15, 2020. From and including June 15, 2025 through maturity or earlier redemption, the interest rate shall reset quarterly to an interest rate per annum equal to a benchmark rate, which is expected to be Three-Month Term SOFR (as defined in the Second Supplemental Indenture), plus 560.5 basis points, payable quarterly in arrears on March 15, June 15, September 15 and December 15 of each year, commencing on September 15, 2025. Notwithstanding the foregoing, if the benchmark rate is less than zero, then the benchmark rate shall be deemed to be zero.

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 bore interest at a rate that resets 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. Interest on the 2018 Notes was to be paid 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. The 2018 Notes were redeemed in full on February 1, 2023.

During June 2015, the Parent Corporation issued \$50 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "2015 Notes"). As of December 31, 2020, the 2015 Notes had a stated maturity of July 1, 2025, and bore interest until the maturity date or early redemption date at a variable rate equal to the then current three-month LIBOR rate plus 393 basis points. As of December 31, 2020, the variable interest rate was 4.16%, all costs related to 2015 issuance had been amortized and the 2015 Notes were redeemed in full on January 1, 2021.

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

Note 10 – Income Taxes

The current and deferred amounts of income tax expense for December 2022, 2021 and 2020 are as follows (dollars in thousands):

	2022	2021	2020
Current:			
Federal	\$ 33,169	\$ 32,364	\$ 19,590
State	13,247	12,325	7,006
Subtotal	46,416	44,689	26,596
Deferred:			
Federal	(3,353)	(110)	(3,881)
State	2,950	126	(3,614)
Subtotal	(403)	16	(7,495)
Income tax expense.....	<u>\$ 46,013</u>	<u>\$ 44,705</u>	<u>\$ 19,101</u>

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. However, in 2020, this surtax was extended through December 31, 2023, at the 2.5% level. 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.

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) December 31,

	2022	2021	2020
Income before income tax expense.....	\$ 171,224	\$ 175,058	\$ 90,390
Federal statutory rate	21%	21%	21%
Computed “expected” Federal income tax expense	35,957	36,762	18,982
State tax, net of federal tax benefit	13,314	9,127	1,913
162M adjustment	777	-	-
Bank owned life insurance.....	(1,175)	(1,001)	(1,052)
Tax-exempt interest and dividends	(1,969)	(1,405)	(1,491)
Tax benefits from stock-based compensation	(417)	(261)	157
Other, net	(474)	1,483	592
Income tax expense.....	<u>\$ 46,013</u>	<u>\$ 44,705</u>	<u>\$ 19,101</u>

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

Note 10 – Income Taxes – (continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax asset and deferred tax liability as of December 31, 2022 and 2021 are presented in the following table:

	2022	2021
	(dollars in thousands)	
<u>Deferred tax assets</u>		
Allowance for credit losses.....	\$ 26,901	\$ 23,955
Depreciation.....	-	205
Pension actuarial losses	1,269	1,301
New Jersey net operating loss.....	156	3,609
Deferred compensation	3,784	2,786
Unrealized losses on available-for-sale securities.....	25,141	191
Deferred loan costs, net of fees.....	2,664	2,163
Finance lease.....	212	222
Nonaccrual interest	168	62
Operating lease liability	3,424	3,747
Other	4,172	3,703
Total deferred tax assets.....	<u>\$ 67,891</u>	<u>\$ 41,944</u>
<u>Deferred tax liabilities</u>		
Employee benefit plans.....	\$ (2,452)	\$ (2,289)
Purchase accounting	(1,458)	(925)
Depreciation.....	(381)	-
Prepaid expenses.....	(1,011)	(288)
Market discount accretion.....	-	(437)
Unrealized gains on swaps.....	(13,704)	(941)
Right of use asset	(3,059)	(3,325)
Other	(1,681)	(1,984)
Total deferred tax liabilities	<u>(23,746)</u>	<u>(10,189)</u>
Net deferred tax assets	<u>\$ 44,145</u>	<u>\$ 31,755</u>

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 is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, the projected future taxable income, and tax planning strategies in making this assessment. During 2022 and 2021, 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 2019 tax return year and forward. The Company's state income tax returns are generally open from the 2018 and later tax return years based on individual state statutes of limitations.

As of December 31, 2022, the Company has \$1.7 million in New Jersey net operating loss (NOL). The NOL is set to expire on December 31, 2040.

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

Note 11 – Preferred Stock

On August 19, 2021, the Company completed an underwritten public offering of 115,000 shares, or \$115 million in aggregate liquidation preference, of its depositary shares, each representing a 1/40th interest in a share of the Company's 5.25% Fixed-Rate Non-Cumulative Perpetual Preferred Stock, Series A, no par value, with a liquidation preference of \$1,000 per share. The net proceeds received from the issuance of preferred stock at the time of closing were \$110.9 million.

Note 12 – 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 client. 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 as of December 31, 2022 and 2021:

	2022	2021
	(dollars in thousands)	
Commitments under commercial loans and lines of credit	\$ 662,515	\$ 647,971
Home equity and other revolving lines of credit	54,302	53,180
Outstanding commercial mortgage loan commitments	433,034	514,473
Standby letters of credit	20,770	25,271
Overdraft protection lines	905	973
Total	<u>\$ 1,171,526</u>	<u>\$ 1,241,868</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.

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

Note 13 – Transactions with Executive Officers, Directors and Principal Stockholders

Loans to principal officers, directors, and their affiliates during the years ended December 31, 2022 and 2021 were as follows:

	2022	2021
	(dollars in thousands)	
Balance, January 1	\$ 17,616	\$ 21,534
New loans	1,200	5,250
Repayments.....	(2,550)	(9,168)
Balance, December 31	<u>\$ 16,266</u>	<u>\$ 17,616</u>

Deposits from principal officers, directors, and their affiliates as of December 31, 2022 and 2021 were \$49.7 million and \$59.5 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.

Note 14 – 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 accumulated other comprehensive gain or loss, on securities and derivatives is not included in computing regulatory capital. Management believes as of December 31, 2022, 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, 2022, and 2021, 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.

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

Note 14 – Stockholders’ Equity and Regulatory Requirements – (continued)

The following is a summary of the Bank’s and the Parent Corporation’s actual capital amounts and ratios as of December 31, 2022 and 2021, compared to the FRB and FDIC minimum capital adequacy requirements and the FDIC requirements for classification as a well-capitalized institution.

			Minimum Capital Adequacy		For Classification Under Corrective Action Plan as Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
The Bank			(dollars in thousands)			
<u>December 31, 2022</u>						
Leverage (Tier 1) capital.....	\$ 996,013	10.64%	\$ 374,553	4.00%	\$ 468,191	5.00%
Risk-Based Capital:						
CET 1.....	\$ 996,013	11.60	\$ 386,289	4.50	\$ 557,972	6.50
Tier 1.....	996,013	11.60	515,051	6.00	686,735	8.00
Total.....	1,117,733	13.02	686,735	8.00	858,419	10.00
<u>December 31, 2021</u>						
Leverage (Tier 1) capital.....	\$ 891,730	11.43%	\$ 312,166	4.00%	\$ 390,207	5.00%
Risk-Based Capital:						
CET 1.....	\$ 891,730	11.96	\$ 335,641	4.50	\$ 484,815	6.50
Tier 1.....	891,730	11.96	447,522	6.00	596,696	8.00
Total.....	1,002,753	13.44	596,696	8.00	745,869	10.00

			Minimum Capital Adequacy		For Classification as Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
The Company			(dollars in thousands)			
<u>December 31, 2022</u>						
Leverage (Tier 1) capital.....	\$ 1,000,577	10.68%	\$ 374,729	4.00%	N/A	N/A
Risk-Based Capital:						
CET 1.....	\$ 884,495	10.30	\$ 386,295	4.50	N/A	N/A
Tier 1.....	1,000,577	11.66	515,061	6.00	N/A	N/A
Total.....	1,240,047	14.45	686,748	8.00	N/A	N/A
<u>December 31, 2021</u>						
Leverage (Tier 1) capital.....	\$ 909,577	11.65%	\$ 312,194	4.00%	N/A	N/A
Risk-Based Capital:						
CET 1.....	\$ 793,495	10.64	\$ 335,648	4.50	N/A	N/A
Tier 1.....	909,577	12.19	447,531	6.00	N/A	N/A
Total.....	1,138,350	15.26	596,708	8.00	N/A	N/A

As of December 31, 2022, both the Company and Bank satisfy the capital conservation buffer requirements applicable to them. The lowest ratio at the Company is the Tier 1 Risk Based Ratio which was 3.16% above the minimum buffer ratio and, at the Bank, the lowest ratio was the Total Risk Based Capital Ratio which was 2.52% above the minimum buffer ratio.

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

Note 15 – Comprehensive Income

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

The following table represents the reclassification out of accumulated other comprehensive (loss) income for the periods presented:

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
	For the Year Ended			
	December 31,			
(dollars in thousands)	2022	2021	2020	
Sale of investment securities available-for-sale	\$ -	\$ 195	\$ 29	Net gains on sale of investment securities
	-	(48)	(6)	Income tax expense
	-	147	23	
Net interest income (expense) on swaps	3,243	(1,873)	(1,577)	Interest income (expense)
	(976)	528	443	Income tax (benefit) expense
	2,267	(1,345)	(1,134)	
Amortization of pension plan net actuarial losses	(66)	(299)	(301)	Salaries and employee benefits
	20	84	84	Income tax benefit
	(46)	(215)	(217)	
Total reclassification	\$ 2,221	\$ (1,413)	\$ (1,328)	

Accumulated other comprehensive (loss) income as of December 31, 2022 and 2021 consisted of the following:

	2022	2021
	(dollars in thousands)	
Investment securities available-for-sale, net of tax	\$ (61,775)	\$ (484)
Cash flow hedge, net of tax	32,360	2,406
Defined benefit pension, net of tax	(2,949)	(3,326)
Total	\$ (32,364)	\$ (1,404)

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

Note 16 – 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 as of December 31, 2022 and 2021.

	2022	2021
	(dollars in thousands)	
Change in Benefit Obligation:		
Projected benefit obligation as of January 1,	\$ 14,644	\$ 13,476
Interest cost.....	311	284
Actuarial (gain) loss.....	(4,657)	1,584
Benefits paid	(981)	(700)
Projected benefit obligation as of December 31,	<u>\$ 9,317</u>	<u>\$ 14,644</u>
Change in Plan Assets:		
Fair value of plan assets as of January 1,	\$ 17,604	\$ 15,868
Actual return on plan assets	(3,366)	2,436
Benefits paid	(981)	(700)
Fair value of plan assets as of December 31,	<u>\$ 13,257</u>	<u>\$ 17,604</u>
Funded status	<u>\$ 3,940</u>	<u>\$ 2,960</u>

The accumulated benefit obligation was \$9.3 million and \$14.6 million as of the year ended December 31, 2022 and 2021, respectively.

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

Note 16 – Pension and Other Benefits – (continued)

Amounts recognized as a component of accumulated other comprehensive loss as of the periods presented that have not been recognized as a component of the net periodic pension expense for the plan are presented in the following table. As of December 31, 2022, the Company expects to recognize approximately \$0.3 million of the net actuarial loss as a component of net periodic pension expense during 2023.

	As of December 31,	
	2022	2021
	(dollars in thousands)	
Net actuarial loss recognized in accumulated other comprehensive income (pre-tax)	\$ 4,219	\$ 4,627

The pre-tax, net periodic pension expense (income) and other comprehensive income for the years ended December 31, 2022, 2021 and 2020 includes the following:

	2022	2021	2020
	(dollars in thousands)		
Interest cost.....	\$ 311	\$ 284	\$ 364
Expected return on plan assets.....	(949)	(852)	(784)
Net amortization	66	299	301
Total net periodic pension income	\$ (572)	\$ (269)	\$ (119)
Total unrealized (gain) loss recognized in other comprehensive income	(343)	-	112
Realized losses included in net income.....	(66)	(299)	(301)
Total recognized in net periodic pension income and other comprehensive income	\$ (981)	\$ (568)	\$ (308)

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

Note 16 – Pension and Other Benefits – (continued)

The following table presents the weighted average assumptions used to determine the pension benefit obligations as of December 31, for the following periods.

	2022	2021
Discount rate	4.92%	2.57%
Rate of compensation increase.....	N/A	N/A

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

	2023	2022	2021
Discount rate	4.92%	2.57%	2.17%
Expected long-term return on plan assets	6.50%	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 returns 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.

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, 2022 and 2021, target allocation, and expected long-term rate of return by asset are as follows:

	Target Allocation	% of Plan Assets – Year Ended 2022	% of Plan Assets – Year Ended 2021	Weighted Average Expected Long-Term Rate of Return
Equity Securities				
Domestic	45%	58%	59%	4.5%
International	15	4	5	0.4
Debt and/or fixed income securities.....	38	35	34	1.5
Cash and other alternative investments, including real estate funds, commodity funds, hedge funds and equity structured notes	2	3	2	0.1
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>6.5%</u>

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

Note 16 – Pension and Other Benefits – (continued)

The fair values of the Company’s pension plan assets as of December 31, 2022 and 2021, by asset class, are as follows:

Asset Class	December 31, 2022	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	\$ 262	\$ 262	\$ -	\$ -
Equity securities:				
U.S. companies	7,611	7,611	-	-
International companies	569	569	-	-
Debt and/or fixed income securities	4,684	4,684	-	-
Commodity funds	95	95	-	-
Real estate funds	36	36	-	-
Total	<u>\$ 13,257</u>	<u>\$ 13,257</u>	<u>\$ -</u>	<u>\$ -</u>

Asset Class	December 31, 2021	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	\$ 178	\$ 178	\$ -	\$ -
Equity securities:				
U.S. companies	10,551	10,551	-	-
International companies	897	897	-	-
Debt and/or fixed income securities	5,804	5,804	-	-
Commodity funds	111	111	-	-
Real estate funds	63	63	-	-
Total	<u>\$ 17,604</u>	<u>\$ 17,604</u>	<u>\$ -</u>	<u>\$ -</u>

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 20):

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).

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

Note 16 – Pension and Other Benefits – (continued)

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 2023.

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):

2023	\$	738
2024		726
2025		724
2026		728
2027		770
2028 - 2032		3,744

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 2022, 2021 and 2020, employer contributions amounted to \$2.2 million, \$1.6 million and \$1.6 million, respectively.

Supplemental Executive Retirement Plan ("SERP")

During 2019 and in 2021, 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 \$1.4 million, \$1.0 million and \$0.4 million for the years ended December 31, 2022, December 31, 2021 and December 31, 2020, respectively.

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

Note 17 – 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, 2022. 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, 2022 are approximately 201,715. The Company intends to issue all shares under the Plan in the form of newly issued shares.

Restricted stock, options and deferred 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 deferred 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 \$4.9 million, \$4.5 million and \$2.9 million for the years ended December 31, 2022, 2021 and 2020 respectively.

Activity under the Company's options for the year ended December 31, 2022 was as follows:

	Number of Stock Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2021	23,766	\$ 9.94		
Granted	-	-		
Exercised.....	(15,086)	8.21		
Forfeited/cancelled/expired.....	-	-		
Outstanding as of December 31, 2022	<u>8,680</u>	<u>12.95</u>	<u>0.29</u>	<u>\$ 97,673</u>
Exercisable as of December 31, 2022	<u>8,680</u>	<u>\$ 12.95</u>	<u>-</u>	<u>\$ -</u>

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

Note 17 – Stock Based Compensation - (continued)

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, 2022 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, 2022. 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, 2022 was as follows:

	Nonvested Shares	Weighted- Average Grant Date Fair Value
Nonvested as of December 31, 2021	82,693	\$ 21.78
Granted	53,543	30.76
Vested	(49,931)	23.74
Forfeited/cancelled/expired.....	(374)	30.99
Nonvested December 31, 2022	<u>85,931</u>	<u>\$ 26.20</u>

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

Note 17 – Stock Based Compensation – (continued)

As of December 31, 2022, there was approximately \$0.8 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 1.1 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 as of December 31, 2021	209,995		\$ 16.18
Awarded.....	34,874		32.80
Vested shares	(49,604)		20.79
Unearned as of December 31, 2022	<u>195,265</u>	<u>221,541</u>	\$ 17.98

As of December 31, 2022, the specific number of shares related to performance units that were expected to vest was 195,265, 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. As of December 31, 2022, the maximum amount of performance units that ultimately could vest if performance targets were exceeded is 221,541. During the year ended December 31, 2022, 49,604 shares vested. A total of 27,254 shares were netted from the vested shares to satisfy employee tax obligations. The net shares issued from vesting of performance units during the year ended December 31, 2022 were 22,350 shares. As of December 31, 2022, compensation cost of approximately \$1.2 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 deferred stock units and the changes in deferred stock units during the period is presented in the table below:

	Units (expected)	Weighted Average Grant Date Fair Value
Unearned as of December 31, 2021	136,948	\$ 16.52
Awarded.....	52,312	32.80
Vested shares	(69,225)	16.13
Unearned as of December 31, 2022	<u>120,035</u>	\$ 23.84

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, 2022, 69,225 shares vested. A total of 37,842 shares were netted from the vested shares to satisfy employee tax obligations. The net shares issued from vesting of deferred stock units during the year ended December 31, 2022 were 31,383 shares. As of December 31, 2022, compensation cost of approximately \$1.5 million related to non-vested deferred stock units, not yet recognized, is expected to be recognized over a weighted-average period of 1.5 years.

Note 18 – 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. As of December 31, 2022, approximately \$259.3 million was available for payment of dividends based on regulatory guidelines.

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

Note 19 – Derivatives

As part of our overall asset liability management and strategy the Company uses derivative instruments, which can include interest rate swaps, collars, caps, and floors. The notional amount 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 agreements. Derivative instruments are recognized on the balance sheet at their fair value and are not reported on a net basis.

Derivatives Designated as Hedges

Subsequent changes in fair value for a hedging instrument that has been designated and qualifies as part of a hedging relationship are accounted for in the following manner:

- 1) Cash flow hedges: changes in fair value are recognized as a component in other comprehensive income
- 2) Fair value hedges: changes in fair value are recognized concurrently in earnings

As long as a hedging instrument is designated and the results of the effectiveness testing support that the instrument qualifies for hedge accounting treatment, 100% of the periodic changes in fair value of the hedging instrument are accounted for as outlined above. This is the case whether or not economic mismatches exist in the hedging relationship. As a result, there is no periodic measurement or recognition of ineffectiveness. Rather, the full impact of hedge gains and losses is recognized in the period in which the hedged transactions impact earnings. The change in fair value of the hedging instrument that is included in the assessment of hedge effectiveness is presented in the same income statement line item that is used to present the earnings effect of the hedged item.

The Company entered into eleven pay fixed-rate interest rate swaps, with a total notional amount of \$500 million, all of which were entered into in 2021 and 2022. These are designated as cash flow hedges of current, Federal Home Loan Bank advances. We are required to pay fixed rates of interest ranging from 0.63% to 3.41% and receive variable rates of interest that reset quarterly based on the daily compounding secured overnight financing rate (“SOFR”). All swaps carry expiration dates on the eleven positions ranging from December 2025 to March 2028. The swaps are 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 swap 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.

The Company previously entered into one forward starting interest rate cap spread transaction, with a total notional amount of \$150 million, which became effective on October 1, 2022 and matures in October of 2027 and one additional interest rate cap spread transaction, with a total notional amount of \$75 million, which became effective in November 2022 and matures in November of 2027. These are designated as cash flow hedges of brokered certificates of deposits, and the interest rate cap spread is indexed to a benchmark of fed funds with payment required on a monthly basis. The structure of these instruments is such that the Company entered into a total of \$225 million in notional amount of sold interest rate cap agreements, in which we are required to pay the counterparty an incremental amount if the index rate exceeds a set cap rate. Simultaneously, the Company purchased a total of \$225 million notional amount of interest rate cap agreements in which we receive an incremental amount if the index rate is above a set cap rate. No payments are required if the index rate is at, or below, the cap rate on the sold or purchased interest rate cap agreements.

Interest expense recorded on these swap and cap transactions totaled approximately \$(3.3) million, \$1.9 million, and \$(1.6) million during 2022, 2021, and 2020 is reported as a component of either interest expense on FHLB Advances and brokered certificates of deposits.

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

Note 19 – Derivatives (continued)

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, 2022 and 2021:

	2022		
	Amount of gain (loss) recognized in OCI (Effective Portion)	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	\$ 46,282	\$ (3,343)	\$ -

	2021		
	Amount of gain (loss) recognized in OCI (Effective Portion)	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	\$ 3,593	\$ 1,873	\$ -

The following table reflects the cash flow hedges included in the Consolidated Statements of Condition as of December 31, 2022 and December 31, 2021:

	2022		2021	
	Notional Amount	Fair Value	Notional Amount	Fair Value
(dollars in thousands)				
Included in other assets/(liabilities):				
Interest rate contracts	\$ 950,000	\$ 56,797	\$ 475,000	\$ 3,347

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, 2022 and December 31, 2021.

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

Note 20 – 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 the 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 as of December 31, 2022 and December 31, 2021:

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.

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.

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

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 as of December 31, 2022 and December 31, 2021 are as follows:

		December 31, 2022		
		Fair Value Measurements at Reporting Date Using		
	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(dollars in thousands)				
Recurring fair value measurements:				
Assets				
Investment securities:				
Available-for-sale:				
Federal agency obligations	\$ 44,450	\$ -	\$ 44,450	\$ -
Residential mortgage pass-through securities	417,578	-	417,578	-
Commercial mortgage pass-through securities	21,104	-	21,104	-
Obligations of U.S. states and political subdivision	142,896	-	135,547	7,349
Corporate bonds and notes	6,974	-	6,974	-
Asset-backed securities	1,640	-	1,640	-
Certificates of deposit	-	-	-	-
Other securities	242	242	-	-
Total available-for-sale	\$ 634,884	\$ 242	\$ 627,293	\$ 7,349
Equity securities	15,811	9,733	6,078	-
Derivatives - interest rate contracts	56,797	-	56,797	-
Total assets	\$ 707,492	\$ 9,975	\$ 690,168	\$ 7,349

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2022 and 2021.

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

		December 31, 2021		
		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	\$ 50,360	\$ -	\$ 50,360	\$ -
Residential mortgage pass-through securities	316,095	-	316,095	-
Commercial mortgage pass-through securities	10,469	-	10,469	-
Obligations of U.S. states and political subdivision ..	145,625	-	137,060	8,565
Corporate bonds and notes	9,049	-	9,049	-
Asset-backed securities	2,564	-	2,564	-
Certificates of deposit	150	-	150	-
Other securities	195	195	-	-
Total available-for-sale	\$ 534,507	\$ 195	\$ 525,747	\$ 8,565
Equity securities	13,794	11,081	2,713	-
Derivatives - interest rate contracts	3,347	-	3,347	-
Total assets	\$ 551,648	\$ 11,276	\$ 531,807	\$ 8,565

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 as of December 31, 2022 and December 31, 2021:

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

Note 20 – Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Collateral Dependent Loans: The Company may record adjustments to the carrying value of loans based on fair value measurements, either as specific reserves or 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 marketplace and are also based on Level 3 inputs.

For assets measured at fair value on a nonrecurring basis, the fair value measurements as of December 31, 2022 and December 31, 2021 are as follows:

		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)
	December 31, 2022			
Assets measured at fair value on a nonrecurring basis:		(dollars in thousands)		
Collateral dependent loans:				
Commercial.....	\$ 14,550	\$ -	\$ -	\$ 14,550
Commercial real estate.....	17,264	-	-	17,264
Residential real estate	1,392	-	-	1,392

		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)
	December 31, 2021			
Assets measured at fair value on a nonrecurring basis:		(dollars in thousands)		
Collateral dependent loans:				
Commercial.....	\$ 13,399	\$ -	\$ -	\$ 13,399
Commercial real estate.....	20,185	-	-	20,185
Residential real estate	2,794	-	-	2,794

Collateral dependent loans - Collateral dependent loans as of December 31, 2022 that required a valuation allowance were \$43.8 million with a related valuation allowance of \$10.5 million.

Collateral dependent loans - Collateral dependent loans as of December 31, 2021 that required a valuation allowance were \$54.1 million with a valuation allowance of \$17.8 million.

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

Note 20 – 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 years ended December 31, 2022 and year ended December 31, 2021:

	Municipal Securities (dollars in thousands)
Beginning balance, January 1, 2022	\$ 8,565
Principal paydowns.....	(287)
Changes in unrealized gain (loss)	(929)
Ending balance, December 31, 2022	<u>\$ 7,349</u>

	Municipal Securities (dollars in thousands)
Beginning balance, January 1, 2021	\$ 8,844
Principal paydowns.....	(279)
Ending balance, December 31, 2021	<u>\$ 8,565</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 as of December 31, 2022 and December 31, 2021. The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 hierarchy.

<u>December 31, 2022</u>				
	Fair Value	Valuation Techniques	Unobservable Input	Range
Securities available-for-sale:		(dollars in thousands)		
Municipal securities	\$ 7,349	Discounted cash flows	Discount rate	4.3%
 December 31, 2021				
	Fair Value	Valuation Techniques	Unobservable Input	Range
Securities available-for-sale:		(dollars in thousands)		
Municipal securities	\$ 8,565	Discounted cash flows	Discount rate	2.9%

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

Note 20 – 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, 2022

<u>(dollars in thousands)</u>	<u>Fair Value</u>	<u>Valuation Techniques</u>	<u>Unobservable Input</u>	<u>Range (weighed average)</u>
Commercial loans.....	\$ 14,028	Market approach (100%)	Average transfer price as a price to unpaid principal balance	65% to 96% (67%)
Commercial loans.....	522	Appraisals of collateral	Adjustment for comparable sales	-10% to +13% (+3%)
Commercial real estate loans	17,264	Appraisals of collateral	Adjustment for comparable sales	-20% to +0% (-15%)
Residential real estate loans	1,392	Appraisals of collateral	Adjustment for comparable sales	+21% to +39% (22%)

December 31, 2021

<u>(dollars in thousands)</u>	<u>Fair Value</u>	<u>Valuation Techniques</u>	<u>Unobservable Input</u>	<u>Range (weighed average)</u>
Commercial loans.....	\$ 12,193	Market approach (100%)	Average transfer price as a price to unpaid principal balance	48% to 73% (49%)
Commercial loans.....	1,206	Appraisals of collateral	Adjustment for comparable sales	-10% to +35% (+6%)
Commercial real estate loans	20,185	Appraisals of collateral	Adjustment for comparable sales	-20% to +15% (-6%)
Residential real estate loans	2,794	Appraisals of collateral	Adjustment for comparable sales	-15% to +39% (5%)

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

Note 20 – Fair Value Measurements and Fair Value of Financial Instruments – (continued)

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.

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.*, non-interest-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 20 – 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, 2022 and December 31, 2021:

			Fair Value Measurements		
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(dollars in thousands)		
<u>December 31, 2022</u>					
<u>Financial assets:</u>					
Cash and due from banks.....	\$ 268,315	\$ 268,315	\$ 268,315	\$ -	\$ -
Investment securities available-for-sale.....	634,884	634,884	242	627,293	7,349
Restricted investment in bank stocks.....	46,604	n/a	n/a	n/a	n/a
Equity securities.....	15,811	15,811	9,733	6,078	-
Net loans.....	8,009,176	7,723,378	-	-	7,723,378
Derivatives - interest rate contracts.....	56,797	56,797	-	56,797	-
Accrued interest receivable.....	46,062	46,062	-	4,685	41,377
<u>Financial liabilities:</u>					
Noninterest-bearing deposits	1,501,614	1,501,614	1,501,614	-	-
Interest-bearing deposits	5,855,008	5,811,291	3,460,818	2,350,473	-
Borrowings	857,622	854,698	-	854,698	-
Subordinated debentures.....	153,255	153,581	-	153,581	-
Accrued interest payable.....	6,925	6,925	-	6,925	-
<u>December 31, 2021</u>					
<u>Financial assets:</u>					
Cash and due from banks.....	\$ 265,536	\$ 265,536	\$ 265,536	\$ -	\$ -
Investment securities available-for-sale.....	534,507	534,507	195	525,747	8,565
Restricted investment in bank stocks.....	27,826	n/a	n/a	n/a	n/a
Equity securities.....	13,794	13,794	11,081	2,713	-
Net loans.....	6,749,849	6,800,287	-	-	6,800,287
Derivatives - interest rate contracts.....	3,347	3,347	-	3,347	-
Accrued interest receivable.....	34,152	34,152	-	1,554	32,598
<u>Financial liabilities:</u>					
Noninterest-bearing deposits	1,617,049	1,617,049	1,617,049	-	-
Interest-bearing deposits	4,715,904	4,716,358	3,565,795	1,150,563	-
Borrowings	468,193	469,671	-	469,671	-
Subordinated debentures.....	152,951	163,995	-	163,995	-
Accrued interest payable.....	2,716	2,716	-	2,716	-

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

Note 20 – 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, considering 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.

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

Note 21 – 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 18 of the Notes to Consolidated Financial Statements).

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

Condensed Statements of Condition

	As of December 31,	
	2022	2021
	(dollars in thousands)	
ASSETS		
Cash and cash equivalents	\$ 117,162	\$ 133,648
Investment in subsidiaries	1,179,342	1,111,520
Investment securities	32,405	32,405
Equity securities	4,218	725
Other assets	699	699
Total assets	<u>\$ 1,333,826</u>	<u>\$ 1,278,997</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Other liabilities	1,820	1,834
Subordinated debentures, net	153,255	152,951
Stockholders' equity	1,178,751	1,124,212
Total liabilities and stockholders' equity	<u>\$ 1,333,826</u>	<u>\$ 1,278,997</u>

Condensed Statements of Income

	For Years Ended December 31,		
	2022	2021	2020
	(dollars in thousands)		
Income:			
Dividend income from subsidiaries	\$ 36,475	\$ 24,071	\$ 15,200
Other income	1,638	1,627	1,683
Total Income	38,113	25,698	16,883
Expenses	(8,928)	(8,741)	(9,263)
Income before equity in undistributed earnings of subsidiaries	29,185	16,957	7,620
Equity in undistributed earnings of subsidiaries	96,026	113,396	63,669
Net Income	125,211	130,353	71,289
Preferred dividends	6,037	1,717	-
Net income available to common stockholders	<u>\$ 119,174</u>	<u>\$ 128,636</u>	<u>\$ 71,289</u>

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

Note 21 – Parent Corporation Only Financial Statements – (continued)

Condensed Statements of Cash Flows

	For Years Ended December 31		
	2022	2021	2020
	(dollars in thousands)		
Cash flows from operating activities:			
Net income	\$ 125,211	\$ 130,353	\$ 71,289
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiary	(96,026)	(113,396)	(63,669)
Loss on equity securities, net	45	55	-
Amortization of subordinated debt issuance costs	304	303	323
Decrease (increase) in other assets	-	50,590	(50,001)
Decrease in other liabilities	(14)	(287)	(391)
Net cash provided by (used in) operating activities	<u>29,520</u>	<u>67,618</u>	<u>(42,449)</u>
Cash flows from investing activities:			
Sale of equity securities	(3,538)	(780)	-
Repayment of short-term borrowing	-	-	(3,000)
Net cash used in investing activities	<u>(3,538)</u>	<u>(780)</u>	<u>(3,000)</u>
Cash flows from financing activities:			
Proceeds from (repayment of) proceeds from subordinated debt	-	(50,000)	73,440
Cash dividends paid on preferred stock	(6,037)	(1,717)	-
Cash dividends paid on common stock	(23,428)	(17,493)	(14,317)
Purchase of treasury stock	(13,127)	(9,401)	(911)
Proceeds from preferred stock offering	-	110,927	-
Proceeds from exercise of stock options	124	106	233
Net cash (used in) provided by financing activities	<u>(42,468)</u>	<u>32,422</u>	<u>58,445</u>
Decrease (increase) in cash and cash equivalents	(16,486)	99,260	12,996
Cash and cash equivalents as of January 1,	133,648	34,388	21,392
Cash and cash equivalents as of December 31,	<u>\$ 117,162</u>	<u>\$ 133,648</u>	<u>\$ 34,388</u>

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

Note 22 – Quarterly Financial Information of ConnectOne Bancorp, Inc. (unaudited)

	2022			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	(dollars in thousands, except per share data)			
Total interest income	\$ 112,469	\$ 96,980	\$ 85,356	\$ 78,941
Total interest expense	34,460	18,819	9,765	8,583
Net interest income	78,009	78,161	75,591	70,358
Provision for credit losses	3,300	10,000	3,000	1,450
Total other income	3,508	3,322	3,359	3,054
Other expenses	33,312	32,143	31,703	29,230
Income before income taxes	44,905	39,340	44,247	42,732
Income tax expense	12,348	10,425	11,889	11,351
Net income	32,557	28,915	32,358	31,381
Preferred dividends	1,510	1,509	1,509	1,509
Net income available to common stockholders	<u>\$ 31,047</u>	<u>\$ 27,406</u>	<u>\$ 30,849</u>	<u>\$ 29,872</u>
Earnings per share:				
Basic	\$ 0.79	\$ 0.70	\$ 0.78	\$ 0.76
Diluted	0.79	0.70	0.78	0.75

Note: Due to rounding, quarterly earnings per share for 2022 do not sum to reported annual earnings per share.

	2021			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	(dollars in thousands, except per share data)			
Total interest income	\$ 79,040	\$ 77,026	\$ 73,051	\$ 72,621
Total interest expense	8,579	8,781	10,042	11,458
Net interest income	70,461	68,245	63,009	61,163
Provision for (reversal of) credit losses	815	1,100	(1,649)	(5,766)
Total other income, net of securities gains	3,777	4,016	4,472	3,426
Other expenses	28,084	28,183	26,259	26,485
Income before income taxes	45,339	42,978	42,871	43,870
Income tax expense	12,301	10,881	10,652	10,871
Net income	33,038	32,097	32,219	32,999
Preferred dividends	1,717	-	-	-
Net income available to common stockholders	<u>\$ 31,321</u>	<u>\$ 32,097</u>	<u>\$ 32,219</u>	<u>\$ 32,999</u>
Earnings per share:				
Basic	\$ 0.79	\$ 0.81	\$ 0.81	\$ 0.83
Diluted	0.79	0.80	0.81	0.82

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