

# Section 1: 10-K (ANNUAL REPORT)

[Table of Contents](#)

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, 2017

OR

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

For the Transition Period from to

Commission File Number: 000-11486



**ConnectOne Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

**New Jersey**

(State or Other Jurisdiction of  
Incorporation or Organization)

**52-1273725**

(IRS Employer  
Identification Number)

**301 Sylvan Avenue**

**Englewood Cliffs, New Jersey 07632**

(Address of Principal Executive Offices) (Zip Code)

**201-816-8900**

(Registrant's Telephone Number, Including Area Code)

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

Title of each class	Name of each exchange on which registered
Common Stock, no par value	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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Regulation S-T (232,405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant has required to submit and post such files.) Yes  No

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

K or any amendment to the Form 10-K.

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 is a shell company (as defined in Rule 12b-2 of the Act) Yes  or 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 - \$557.7 million.

**Shares Outstanding on March 6, 2018**

**Common Stock, no par value: 32,119,241 shares**

**DOCUMENTS INCORPORATED BY REFERENCE**

Definitive proxy statement in connection with the 2018 Annual Stockholders Meeting to be filed with the Commission pursuant to Regulation 14A will be incorporated by reference in Part III

---

## CONNECTONE BANCORP, INC.

## TABLE OF CONTENTS

	<b>Page</b>
<b><u>PART I</u></b>	
<a href="#">Item 1. Business</a>	<a href="#">3</a>
<a href="#">Item 1A. Risk Factors</a>	<a href="#">12</a>
<a href="#">Item 1B. Unresolved Staff Comments</a>	<a href="#">19</a>
<a href="#">Item 2. Properties</a>	<a href="#">20</a>
<a href="#">Item 3. Legal Proceedings</a>	<a href="#">20</a>
<a href="#">Item 4. Mine Safety Disclosures</a>	<a href="#">20</a>
<b><u>PART II</u></b>	
<a href="#">Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</a>	<a href="#">21</a>
<a href="#">Item 6. Selected Financial Data</a>	<a href="#">23</a>
<a href="#">Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	<a href="#">27</a>
<a href="#">Item 7A. Quantitative and Qualitative Disclosures About Market Risk</a>	<a href="#">44</a>
<a href="#">Item 8. Financial Statements and Supplementary Data:</a>	<a href="#">44</a>
<a href="#">Report of Independent Registered Public Accounting Firm</a>	<a href="#">45</a>
<a href="#">Consolidated Statements of Condition</a>	<a href="#">46</a>
<a href="#">Consolidated Statements of Income</a>	<a href="#">47</a>
<a href="#">Consolidated Statements of Comprehensive Income</a>	<a href="#">48</a>
<a href="#">Consolidated Statements of Changes in Stockholders’ Equity</a>	<a href="#">49</a>
<a href="#">Consolidated Statements of Cash Flows</a>	<a href="#">50</a>
<a href="#">Notes to Consolidated Financial Statements</a>	<a href="#">51</a>
<a href="#">Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</a>	<a href="#">107</a>
<a href="#">Item 9A. Controls and Procedures</a>	<a href="#">107</a>
<a href="#">Item 9B. Other Information</a>	<a href="#">107</a>
<b><u>PART III</u></b>	
<a href="#">Item 10. Directors, Executive Officers and Corporate Governance</a>	<a href="#">108</a>
<a href="#">Item 11. Executive Compensation</a>	<a href="#">108</a>
<a href="#">Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</a>	<a href="#">108</a>
<a href="#">Item 13. Certain Relationships and Related Transactions, and Director Independence</a>	<a href="#">108</a>
<a href="#">Item 14. Principal Accounting Fees and Services</a>	<a href="#">108</a>
<b><u>PART IV</u></b>	
<a href="#">Item 15. Exhibits, Financial Statements Schedules</a>	<a href="#">109</a>
<a href="#">Signatures</a>	<a href="#">112</a>

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

---

CONNECTONE BANCORP, INC.  
FORM 10-K

PART I

Item 1. Business

Forward Looking Statements

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

Historical Development of Business

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

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

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

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

## [Table of Contents](#)

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

### **SEC Reports and Corporate Governance**

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

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

### **Narrative Description of the Business**

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

Our talented, diverse team of financial experts and relationship specialists know that the demands of a successful business extend far beyond '9-5.' A big part of the trust we've earned from entrepreneurs and business owners stems from our firsthand knowledge of the businesses and communities we serve. That trust extends to the families we help thrive, from helping them refinance their homes to being able to easily access accounts wherever and whenever they're needed.

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

### **Our Market Area**

Our banking offices are located in Bergen, Union, Morris, Essex, Hudson, Mercer and Monmouth Counties in New Jersey and in the borough of Manhattan, in New York City, and we expect to open our newest banking office in Melville, Suffolk County New York in the first quarter of 2018. Our market area includes some of the most affluent markets in the United States. We also attract business and clients from broader regions, including the other boroughs of New York City as well as Westchester County and Long Island in New York State.

### **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 other borrowings). We offer a broad range of deposit and loan products. In addition, to attract the business of consumer and business clients, we also provide a broad array of other banking services. Products and services provided include personal and business checking accounts, retirement accounts, money market accounts, time and savings accounts, credit cards, wire transfers, access to automated teller services, internet banking, Treasury Direct, ACH origination, lockbox services and mobile banking by phone. In addition, we offer safe deposit boxes. The Bank also offers remote deposit capture banking for both retail and business clients, providing the ability to electronically scan and transmit checks for deposit, reducing time and cost.

## Table of Contents

Noninterest demand deposit products include “Totally Free Checking” and “Simply Better Checking” for retail clients and “Small Business Checking” and “Analysis Checking” for commercial clients. Interest-bearing checking accounts require minimum balances for both retail and commercial clients and include “Consumer Interest Checking” and “Business Interest Checking”. Money market accounts consist of products that provide a market rate of interest to depositors but offer a limited number of preauthorized withdrawals. Our savings accounts consist of statement type accounts. Time deposits consist of certificates of deposit, including those held in IRA accounts, generally with initial maturities ranging from 7 days to 60 months and brokered certificates of deposit, which we use for asset liability management purposes and to supplement other sources of funding. CDARS/ICS Reciprocal deposits are offered based on the Bank’s participation in the Promontory Interfinancial Network, LLC network. Clients who are FDIC insurance sensitive are able to place large dollar deposits with the Company and the Company uses CDARS to place those funds into certificates of deposit issued by other banks in the Network. This occurs in increments of less than the FDIC insurance limits so that both the principal and interest are eligible for FDIC insurance coverage in amounts larger than the standard dollar amount. The FDIC currently considers these funds as brokered deposits.

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

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

Commercial loans are loans made for business purposes and are primarily secured by collateral such as cash balances with the Bank, marketable securities held by or under the control of the Bank, business assets including accounts receivable, inventory and equipment, and liens on commercial and residential real estate. Included in commercial loans are loans secured by New York City taxi medallions. As of December 31, 2017, the carrying value of our taxi medallion portfolio totaled \$46.8 million, all of which was re-designated as held-for-investment. All of our taxi medallion loans are secured by New York City taxi medallions.

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

The Board of Directors has approved a loan policy granting designated lending authorities to specific officers of the Bank. Those officers are comprised of the Chief Executive Officer, Chief Lending Officer, Chief Credit Officer, Team Leaders and the Consumer Loan Officers. All loan approvals require the signatures of a minimum of two officers. The Senior Lending Group (Chief Executive Officer, Chief Lending Officer and Chief Credit Officer) can approve loans up to \$25 million in aggregate loan exposure and which do not exceed 65% of the Legal Lending Limit of the Bank (currently \$75.1 million as of December 31, 2017 for most loans), provided that (i) the credit does not involve an exception to policy and a principal balance greater than \$7.5 million or \$20 million in all credit outstanding to the borrower in the aggregate, (ii) the credit does not exceed certain dollar amount thresholds set forth in our policy, which varies by loan type, and (iii) the credit is not extended to an insider of the Bank. The Board Loan Committee (which includes the Chief Executive Officer and four other Board members) approves credits that are both exceptions to policy and are above prescribed amounts related to loan type and collateral. Loans to insiders must be approved by the entire Board.

The Bank’s lending policies generally provide for lending within our primary trade area. However, the Bank will make loans to persons outside of our primary trade area when we deem it prudent to do so. In an effort to promote a high degree of asset quality, the Bank focuses primarily upon offering secured loans. However, the Bank does make short-term unsecured loans to borrowers with high net worth and income profiles. The Bank generally requires loan clients to maintain deposit accounts with the Bank. In addition, the Bank generally provides for a minimum required rate of interest in its variable rate loans. The Bank’s legal lending limit to any one borrower is 15% of the Bank’s capital base (defined as tangible equity plus the allowance for loan losses) for most loans (\$75.1 million) and 25% of the capital base for loans secured by readily marketable collateral (\$125.2 million). At December 31, 2017, the Bank’s largest committed relationship (to several affiliated borrowers) totaled \$69.6 million. The Bank’s largest single loan outstanding at December 31, 2017 was \$35.0 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.

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

## **SUPERVISION AND REGULATION**

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

### **Bank Holding Company Regulation**

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

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

## Table of Contents

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 requires new capital rules and the application of the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies. In addition to making bank holding companies subject to the same capital requirements as their bank subsidiaries, these provisions (often referred to as the Collins Amendment to the Dodd-Frank Act) were also intended to eliminate or significantly reduce the use of hybrid capital instruments, especially trust preferred securities, as regulatory capital. The Dodd-Frank Act also requires banking regulators to seek to make capital standards countercyclical, so that the required levels of capital increase in times of economic expansion and decrease in times of economic contraction. See “Capital Adequacy Guidelines” for a description of capital requirements adopted by U.S. federal banking regulators in 2013 and the treatment of trust preferred securities under such rules.
- *The Consumer Financial Protection Bureau (“Bureau”).* The Dodd-Frank Act created the Bureau. The Bureau is tasked with establishing and implementing rules and regulations under certain federal consumer protection laws with respect to the conduct of providers of certain consumer financial products and services. The Bureau has rulemaking authority over many of the statutes governing products and services offered to bank consumers. In addition, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are more stringent than those regulations promulgated by the Bureau and state attorneys general are permitted to enforce consumer protection rules adopted by the Bureau against state-chartered institutions. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Institutions with \$10 billion or less in assets, such as the Bank, will continue to be examined for compliance with the consumer laws by their primary bank regulators.
- *Deposit Insurance.* The Dodd-Frank Act makes permanent the \$250,000 deposit insurance limit for insured deposits. Amendments to the Federal Deposit Insurance Act also revise the assessment base against which an insured depository institution’s deposit insurance premiums paid to the Deposit Insurance Fund (“DIF”) will be calculated. Under the amendments, the assessment base will no longer be 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. In December 2010, the FDIC increased the designated reserve ratio to 2.0%.
- *Shareholder Votes.* The Dodd-Frank Act requires publicly traded companies like the Company to give shareholders a non-binding vote on executive compensation and so-called “golden parachute” payments in certain circumstances. The Dodd-Frank Act also authorizes the SEC to promulgate rules that would allow shareholders to nominate their own candidates using a company’s proxy materials. The SEC has not yet adopted such rules.

Although a significant number of the rules and regulations mandated by the Dodd-Frank Act have been finalized, many of the new requirements called for have yet to be implemented and will likely be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which 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.

## **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



## Table of Contents

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

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

Further, under Regulation W:

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

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

## **FDICIA**

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

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

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

## **Capital Adequacy Guidelines**

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

## Table of Contents

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.” When fully phased in on January 1 2019, the Company and the Bank will be required to maintain a 2.5% capital conservation buffer, which is composed entirely of CET1, on top of the minimum risk-weighted asset ratios described above, resulting in the following minimum capital ratios:

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

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

The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level, and it increases by 0.625% on each subsequent January 1 until it reaches 2.5% on January 1, 2019.

The New Rules provide for several deductions from and adjustments to CET1, which are being phased in between January 1, 2015 and January 1, 2018. 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.

### **Federal Deposit Insurance and Premiums**

Substantially all of 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 \$3.1 million in total FDIC assessments in 2017, as compared to \$2.4 million in 2016.

## [Table of Contents](#)

Pursuant to the Dodd-Frank Act, the FDIC has established 2.0% as the designated reserve ratio (DRR), that is, the ratio of the DIF to insured deposits. The FDIC has adopted a plan under which it will meet the statutory minimum DRR of 1.35% by September 30, 2020, the deadline imposed by the Dodd-Frank Act. 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 FDIC has not yet announced how it will implement this offset.

In addition to deposit insurance assessments, the FDIC is required to continue to collect from institutions payments for the servicing of obligations of the Financing Corporation (“FICO”) that were issued in connection with the resolution of savings and loan associations, so long as such obligations remain outstanding. The Bank paid a FICO premium of \$210 thousand in 2017, as compared to \$209 thousand in 2016.

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

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

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

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

### **Community Reinvestment Act**

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

### **USA PATRIOT Act**

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

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

- All financial institutions must establish anti-money laundering programs that include, at a minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.
- The Secretary of the Department of Treasury, in conjunction with other bank regulators, is authorized to issue regulations that provide for minimum standards with respect to customer identification at the time new accounts are opened.
- Financial institutions that establish, maintain, administer, or manage private banking accounts or correspondent accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) are required to establish appropriate, specific and,

where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.

- Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.
- Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

The United States Treasury Department has issued a number of implementing regulations which address various requirements of the USA PATRIOT Act and are applicable to financial institutions such as the Bank. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers.

### **Loans to Related Parties**

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

### **Dividend Restrictions**

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

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

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

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

## Item 1A. Risk Factors

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

### Risks Applicable to Our Business:

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

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

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

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

#### **We have a significant concentration in commercial real estate loans.**

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

At December 31, 2017, we had \$3.1 billion of commercial real estate loans, including commercial construction loans, which represented 73.7% of loans receivable. Concentrations in commercial real estate are also monitored by regulatory agencies and subject to scrutiny. Guidance from these regulatory agencies includes all commercial real estate loans, including commercial construction loans, in calculating our commercial real estate concentration, but excludes owner-occupied commercial real estate loans. Based on this regulatory definition, our commercial real estate loans represented 568% of total risk-based capital.

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

Although the economy in our market area generally, and the real estate market in particular, is growing, we can give you no assurance that it will continue to grow or that the rate of growth will accelerate. Many factors, including the exchange rate for the U.S. dollar, potential international trade tariffs, and changes in federal tax laws effecting the deductibility of state and local taxes and mortgage interest could reduce or halt growth in our local economy and real estate market. Accordingly, it may be more difficult for commercial real estate borrowers to repay their loans in a timely manner, as commercial real estate borrowers' ability to repay their loans frequently depends on the successful development of their properties. The deterioration of one or a few of our commercial real estate loans could cause a material increase in our level of nonperforming loans, which would result in a loss of revenue from these loans and could result in an increase in the provision for loan 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 may seek to 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, 2017, we had \$2.6 billion in commercial real estate loans outstanding. Approximately 67% of the loans, or \$1.7 billion, had been originated in the past three years. Our limited experience with these loans does not provide us with a significant payment history pattern with which to judge future collectability. As a result, it may be difficult to predict the future performance of our loan portfolio. These loans may have delinquency or charge-off levels above our expectations, which could negatively affect our performance.

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

We maintain a significant credit exposure (\$46.8 million carrying value as of December 31, 2017) of loans secured by New York City taxi medallions. The taxi industry in New York City is facing significant competition and pressure from technology based ride share companies such as Uber and Lyft. This has resulted in volatility in the pricing of medallions, and has impacted the earnings of many medallion holders, including our borrowers. The entire taxi medallion portfolio was designated as nonaccrual, and the entire portfolio has been re-designated as loans held-for-investment, reflecting reduced interest by purchasers in smaller portfolios of loans secured by taxi medallions, such as ours. Any further deterioration in the value of New York City taxi medallions, or in the medallion taxi industry in New York City, could expose us to additional losses through additional write downs on these loans.

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

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

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

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

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

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

**Competition from other financial institutions in originating loans and attracting deposits may adversely affect our profitability.**

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

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

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

We have also been active in competing for New Jersey governmental and municipal deposits. At December 31, 2017, governmental and municipal deposits accounted for approximately \$358.8 million in deposits. The newly elected 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.

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

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

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

Liquidity is derived primarily from deposit growth and retention; principal and interest payments on loans; 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 originations 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. The liquidity issues have been particularly acute for regional and community banks, as many of the larger financial institutions have significantly curtailed their lending to regional and community banks to reduce their exposure to the risks of other banks. In addition, many of the larger correspondent lenders have reduced or even eliminated federal funds lines for their correspondent customers. 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

## [Table of Contents](#)

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, 2017, we had approximately \$435.3 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 that is considered other-than-temporary. 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," beginning in 2016, banks and bank holding companies are required to maintain a capital conservation buffer on top of minimum risk-weighted asset ratios. When fully phased in on January 1, 2019, the capital conservation buffer will be 2.5%. Banking institutions which do not maintain capital in excess of the capital conservation buffer will face constraints on the payment of dividends, equity repurchases and compensation based on the amount of the shortfall. Accordingly, if the Bank fails to maintain the applicable minimum capital ratios and the capital conservation buffer, distributions to the Company may be prohibited or limited.

### **We may incur impairment to goodwill.**

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

### **If we pursue acquisitions, we may heighten the risks to our operations and financial condition.**

To the extent that we undertake acquisitions, we may experience the effects of higher operating expenses relative to operating income from the new operations, which may have a material adverse effect on our levels of reported net income, return on average equity and return on average assets. Other effects of engaging in such growth strategies may include potential diversion of our management's time and attention and general disruption to our business. To the extent that we grow through acquisitions, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses involve similar risks to those commonly associated with branching, but may also involve additional risks, including:

- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- exposure to potential asset quality issues of the acquired bank or related business;
- difficulty and expense of integrating the operations and personnel of banks and businesses we acquire; and
- the possible loss of key employees and customers of the banks and businesses we acquire.



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

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

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

Hurricanes and other weather events can disrupt our operations, result in damage to our properties and negatively affect the local economies in which we operate. In addition, these weather events may result in a decline in value or destruction of properties securing our loans and an increase in delinquencies, foreclosures and loan losses.

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

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

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

**Risks Applicable to the Banking Industry Generally:**

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

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

Although we believe that our allowance for loan losses is adequate to cover known and probable incurred losses included in the portfolio, we cannot assure you that we will not further increase the allowance for loan losses or that our regulators will not require us to increase this allowance. Either of these occurrences could adversely affect our earnings.

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

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

A sustained increase in market interest rates could adversely affect our earnings if our cost of funds increases more rapidly than our yield on our earning assets, and compresses our net interest margin. In addition, the economic value of portfolio equity would decline if interest rates increase. For example, we estimate that as of December 31, 2017, a 200 basis point increase in interest rates would have resulted in our economic value of portfolio equity declining by approximately \$72.4 million or 12.83%. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate Sensitivity Analysis."

## Table of Contents

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

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

### **The banking business is subject to significant government regulations.**

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

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

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

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

## Table of Contents

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

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

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

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

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

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

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

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

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

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

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

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

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

[Table of Contents](#)

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, consisting of one office each in Englewood Cliffs, Englewood, Cresskill, Fort Lee, Hackensack, Ridgewood and Saddle River; nine banking offices in Union County, NJ, consisting of four offices in Union Township, and one office each in Springfield Township, Berkeley Heights, and Summit; three banking offices in Morris County, NJ, consisting of one office each in Boonton, Madison and Morristown; one office in Newark in Essex County, NJ; one office in West New York in Hudson County, NJ; one office in Princeton in Mercer County, NJ; one office in Holmdel in Monmouth County, and one banking office in the borough of Manhattan in New York City. The Bank is also opening a banking office in Melville, New York on Long Island. The Bank's principal office is located at 301 Sylvan Avenue, Englewood Cliffs, NJ. The principal office is a three-story leased building constructed in 2008.

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

<b>Banking Office Location</b>	<b>Term</b>
301 Sylvan Avenue, Englewood Cliffs, NJ	Term expires November 2028; renewable at the Bank's option
12 East Palisade Avenue, Englewood, NJ	Term expires July 2022; renewable at the Bank's option
1 Union Avenue, Cresskill, NJ	Term expires June 2026; renewable at the Bank's option
899 Palisade Avenue, Fort Lee, NJ	Term expires August 2022; renewable at the Bank's option
142 John Street, Hackensack, NJ	Term expires December 2021; renewable at the Bank's option
171 East Ridgewood Avenue, Ridgewood, NJ	Term expires April 2019; renewable at the Bank's option
71 East Allendale Road, Saddle River, NJ	Term expires June 2029; unless canceled or extended by the Bank
356 Chestnut Street, Union, NJ	Term expires May 2027
104 Ely Place, Boonton, NJ	Term expires August 2021
300 Main Street, Madison, NJ	Term expires July 2020
545 Morris Avenue, Summit, NJ	Term expires January 2024; renewable at the Bank's option
217 Chestnut Street, Newark, NJ	Term expires February 2019; renewable at the Bank's option
5914 Park Avenue, West New York, NJ	Term expires September 2018; renewable at the Bank's option
344 Nassau Street, Princeton, NJ	Term expires June 2019
963 Holmdel Road, Holmdel, NJ	Term expires March 2021; renewable at the Bank's option
551 Madison Avenue, Suite 202, NY, NY	Term expires September 2024

The Bank operates a Drive In/Walk Up located at 2022 Stowe Street, Union, NJ.

**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 Equity Stock, 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, 2017, the Company had 475 stockholders of record, excluding beneficial owners for whom CEDE & Company or others act as nominees. On December 31, 2017, the closing sale price was \$25.75.

The following table sets forth the high and low closing sales price, and the dividends declared, on a share of the Company's common stock for the years ended December 31, 2017 and 2016.

	Common Stock Price				Common Dividends Declared	
	2017		2016		2017	2016
	High	Low	High	Low		
Fourth Quarter	\$ 27.80	\$ 24.70	\$ 26.50	\$ 17.78	\$ 0.075	\$ 0.075
Third Quarter	24.60	21.25	18.86	15.22	0.075	0.075
Second Quarter	24.40	21.50	17.30	15.12	0.075	0.075
First Quarter	26.00	22.45	18.63	15.17	0.075	0.075
Total					<u>\$ 0.300</u>	<u>\$ 0.300</u>

**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. Shares repurchased were used for stock dividends and other issuances. No repurchases were made of the Company's common stock during 2017 or 2016.

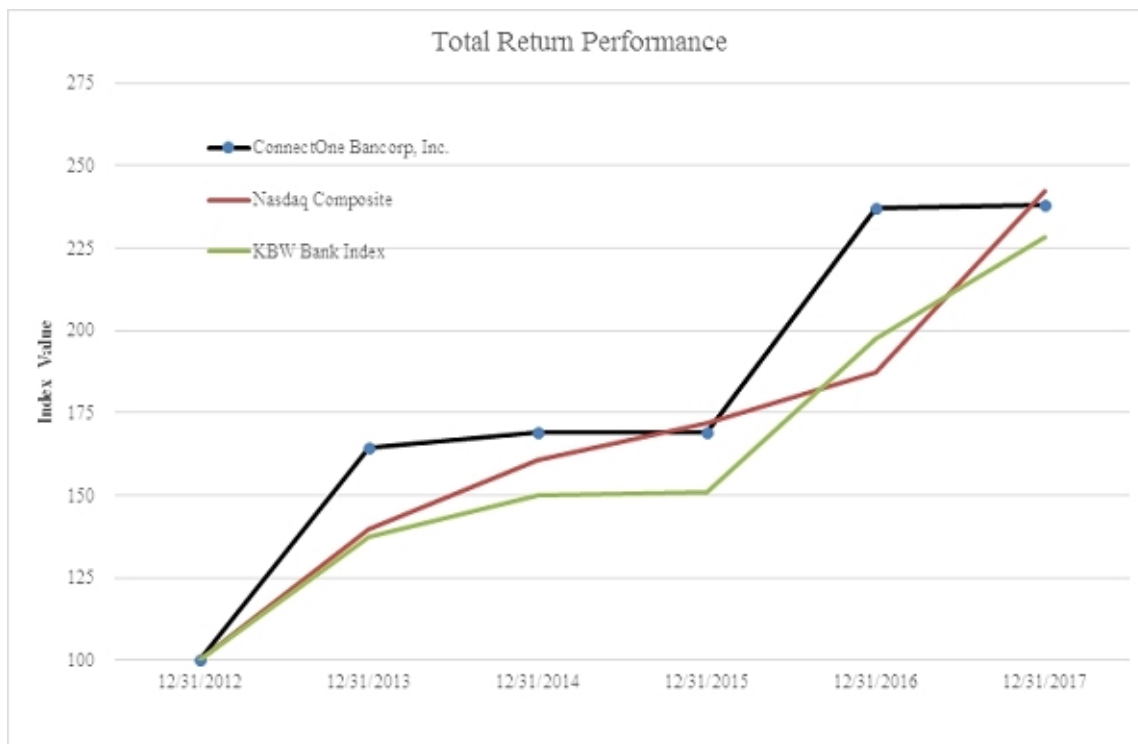
**Dividends**

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

**Stockholders Return Comparison**

Set forth on the following page is a line graph presentation comparing the cumulative stockholder return on the Parent Corporation's common stock, on a dividend reinvested basis, against the cumulative total returns of the NASDAQ Composite and the KBW Bank Index for the period from December 31, 2012 through December 31, 2017.

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



**Assumes \$100 Invested on December 31, 2012, with Dividends Reinvested  
Year Ended December 31, 2017**

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

Company/Index/Market	Fiscal Year Ending					
	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17
ConnectOne Bancorp, Inc.	100.00	164.25	168.98	168.89	237.20	238.12
NASDAQ	100.00	139.89	160.47	171.83	187.03	242.34
KBW Bank Index	100.00	137.40	150.09	150.82	197.72	228.08

**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, 2017 and 2016 and the selected consolidated summary of income data for the years ended December 31, 2017, 2016 and 2015 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, 2015, 2014, 2013 and the selected consolidated summary of income data for the years ended December 31, 2014 and 2013 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**

	As of or For the Years Ended December 31,				
	2017	2016	2015	2014	2013
	(dollars in thousands, except share data)				
<b>Selected Statement of Financial Condition Data</b>					
Total assets	\$ 5,108,442	\$ 4,426,348	\$ 4,015,909	\$ 3,448,572	\$ 1,673,082
Loans receivable	4,171,456	3,475,832	3,099,007	2,538,641	960,943
Allowance for loan losses	31,748	25,744	26,572	14,160	10,333
Securities – available-for-sale	435,284	353,290	195,770	289,532	323,070
Securities – held-to-maturity	-	-	224,056	224,682	215,286
Goodwill and other intangible assets	148,273	148,997	149,817	150,734	16,828
Borrowings	670,077	476,280	671,587	495,553	146,000
Subordinated debt (net of issuance costs)	54,699	54,534	54,343	5,155	5,155
Deposits	3,795,128	3,344,271	2,790,966	2,475,607	1,342,005
Tangible common stockholders' equity <sup>(1)</sup>	417,164	325,127	316,277	284,235	168,584
Total stockholders' equity	565,437	531,032	477,344	446,219	168,584
Average total assets	4,629,380	4,236,758	3,661,306	2,520,524	1,633,270
Average common stockholders' equity	553,390	491,110	456,036	301,004	153,775
<b>Dividends</b>					
Cash dividends paid on common stock	\$ 9,612	\$ 9,067	\$ 8,996	\$ 6,940	\$ 4,254
Dividend payout ratio	22.24%	29.19%	21.84%	37.60%	21.50%
<b>Cash dividends per share</b>					
Cash dividends	\$ 0.300	\$ 0.300	\$ 0.300	\$ 0.300	\$ 0.280
<b>Selected Statement of Income Data</b>					
Interest income	\$ 181,324	\$ 161,241	\$ 140,967	\$ 94,207	\$ 57,268
Interest expense	(36,255)	(31,096)	(23,814)	(14,808)	(11,082)
Net interest income	145,069	130,145	117,153	79,399	46,186
Provision for loan losses	(6,000)	(38,700)	(12,605)	(4,683)	(350)
Net interest income after provision for loan losses	139,069	91,445	104,548	74,716	45,836
Noninterest income	8,204	9,920	11,173	7,498	6,851
Noninterest expense	(78,759)	(58,507)	(54,484)	(54,804)	(25,278)
Income before income tax expense	68,514	42,858	61,237	27,410	27,409
Income tax expense	(25,294)	(11,776)	(19,926)	(8,845)	(7,484)
Net income	43,220	31,082	41,311	18,565	19,925
Preferred stock dividends	-	(22)	(112)	(112)	(141)
Net income available to common stockholders	<u>\$ 43,220</u>	<u>\$ 31,060</u>	<u>\$ 41,199</u>	<u>\$ 18,453</u>	<u>\$ 19,784</u>

(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.

	As of or For the Years Ended December 31,				
	2017	2016	2015	2014	2013
<b>Per Common Share Data</b>					
	(dollars in thousands, except share data)				
Basic	\$ 1.35	\$ 1.02	\$ 1.37	\$ 0.80	\$ 1.21
Diluted	1.34	1.01	1.36	0.79	1.21
Book value per common share	17.63	16.62	15.49	14.65	9.61
Tangible book value per common share <sup>(1)</sup>	13.01	11.96	10.51	9.57	8.58
<b>Selected Performance Ratios</b>					
Return on average assets	0.93%	0.73%	1.13%	0.74%	1.22%
Return on average common stockholders' equity	7.81	6.30	9.03	6.13	12.87
Net interest margin	3.45	3.38	3.55	3.57	3.30
<b>Selected Asset Quality Ratios as a % of loans receivable:</b>					
Nonaccrual loans (excluding loans held-for-sale)	1.57%	0.16%	0.67%	0.46%	0.33%
Loans 90 days or greater past due and still accruing (non-PCI)	-	-	-	0.05	-
Loans 90 days or greater past due and still accruing (PCI)	0.04	0.15	-	-	-
Performing TDRs	0.36	0.38	2.77	0.07	0.60
Allowance for loan losses	0.76	0.74	0.86	0.56	1.08
Nonperforming assets <sup>(2)</sup> to total assets	1.29%	1.57%	0.58%	0.37%	0.20%
Allowance for loan losses to nonaccrual loans (excluding loans held-for-sale)	168.4	449.0	128.1	122.0	329.4
Net loan charge-offs (recoveries) to average loans <sup>(3)</sup>	0.01	1.18	0.01	0.05	0.03
<b>Capital Ratios</b>					
Leverage ratio	8.92%	9.29%	9.07%	9.37%	9.69%
Common equity Tier 1 risk-based ratio	9.15	9.74	9.14	n/a	n/a
Risk-based Tier 1 capital ratio	9.26	9.87	9.61	10.44	12.10
Risk-based capital ratio	11.04	11.78	11.77	10.94	12.90
Tangible common equity to tangible assets <sup>(1)</sup>	8.41	8.93	8.18	8.62	8.48

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

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

(3) Charge-offs in 2016 included \$36.5 million related to the transfer of our taxi medallion portfolio to loans held-for-sale.

**Non-GAAP Reconciliation Table**

	As of December 31				
	2017	2016	2015	2014	2013
	(dollars in thousands, except per share data)				
<b>Tangible common equity and tangible common equity/tangible assets</b>					
Common stockholders' equity	\$ 565,437	\$ 531,032	\$ 466,094	\$ 434,969	\$ 157,334
Less: goodwill and other intangible assets	148,273	148,997	149,817	150,734	16,828
Tangible common stockholders' equity	<u>\$ 417,164</u>	<u>\$ 382,035</u>	<u>\$ 316,277</u>	<u>\$ 284,235</u>	<u>\$ 140,506</u>
<b>Total assets</b>					
Total assets	\$ 5,108,442	\$ 4,426,348	\$ 4,015,909	\$ 3,448,572	\$ 1,673,082
Less: goodwill and other intangible assets	148,273	148,997	149,817	150,734	16,828
Tangible assets	<u>\$ 4,960,169</u>	<u>\$ 4,277,351</u>	<u>\$ 3,866,092</u>	<u>\$ 3,297,838</u>	<u>\$ 1,656,254</u>
Tangible common equity ratio	8.41%	8.93%	8.18%	8.62%	8.48%
<b>Tangible book value per common share</b>					
Book value per common share	\$ 17.63	\$ 16.62	\$ 15.49	\$ 14.65	\$ 9.61
Less: goodwill and other intangible assets	4.62	4.66	4.98	5.08	1.03
Tangible book value per common share	<u>\$ 13.01</u>	<u>\$ 11.96</u>	<u>\$ 10.51</u>	<u>\$ 9.57</u>	<u>\$ 8.58</u>

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

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

### ***Cautionary Statement Concerning Forward-Looking Statements***

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

### **Critical Accounting Policies and Estimates**

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

### ***Allowance for Loan Losses and Related Provision***

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

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

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

### ***Income Taxes***

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

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

### ***Goodwill***

The Company has adopted the provisions of FASB ASC 350-10-05, which requires that goodwill be reported separate from other intangible assets in the Consolidated Statements of Condition and not be amortized but tested for impairment annually or more frequently if indicators arise for impairment. No impairment charge was deemed necessary for the years ended December 31, 2017, 2016 and 2015.

### **Overview and Strategy**

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

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

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

### **General**

The following discussion and analysis presents the more significant factors affecting the Company's financial condition as of December 31, 2017 and 2016 and results of operations for each of the years in the three-year period ended December 31, 2017. The MD&A should be read in conjunction with the consolidated financial statements, notes to consolidated financial statements and other information contained in this report.

## Operating Results Overview

Net income for the year ended December 31, 2017 was \$43.2 million, an increase of \$12.1 million, or 39.1%, compared to net income of \$31.1 million for 2016. Net income available to common shareholders for the year ended December 31, 2017 was \$43.2 million, an increase of \$12.2 million, or 39.2%, compared to net income available to common shareholders of \$31.1 million for 2016. Diluted earnings per share were \$1.34 for 2017, a 32.7% increase from \$1.01 for 2016.

The change in net income from 2016 to 2017 was attributable to the following:

- Increased net interest income of \$14.9 million primarily due to organic growth,
- Decreased provision for loan losses of \$32.7 million primarily due to \$36.5 million in charge-offs of taxi medallion loans in 2016. In 2017, charges related to the taxi medallion portfolio were recorded as a valuation allowance in noninterest expenses (see below),
- Decrease in noninterest income of \$1.7 million primarily resulting from lower net gains on the sale of investment securities (\$2.6 million), offset by current year increase in BOLI income (\$0.6 million) and a net gain on the sale of loans held-for-sale in 2017 (\$0.5 million),
- Noninterest expense increased approximately \$20.3 million primarily due to a \$15.6 million increase in valuation allowance for loans held-for-sale related to the Company's taxi medallion loans, an increase in salaries and employee benefits (\$4.1 million), FDIC insurance (\$0.5 million), data processing (\$0.4 million) and other expenses (\$0.3 million), offset by a decrease in occupancy and equipment expense (\$0.4 million).
- Increased income tax expense of \$13.5 million resulting from an increase in income before taxes and a charge against the Company's deferred tax assets of \$5.6 million due to the impact of Tax Cuts and Jobs Act of 2017.

Net income for the year ended December 31, 2016 was \$31.1 million, a decrease of \$10.2 million, or 24.8%, compared to net income of \$41.3 million for 2015. Net income available to common shareholders for the year ended December 31, 2016 was \$31.1 million, a decrease of \$10.1 million, or 24.6%, compared to net income available to common shareholders of \$41.2 million for 2015. Diluted earnings per share were \$1.01 for 2016, a 25.7% decrease from \$1.36 for 2015.

The change in net income from 2015 to 2016 was attributable to the following:

- Increased net interest income of \$13.0 million primarily due to organic growth,
- Increased provision for loan losses of \$26.1 million primarily due to an increase in additional reserves specifically allocated to the Company's taxi medallion portfolio, resulting from the transfer of the portfolio to loans held-for-sale,
- Decrease in noninterest income of \$1.3 million primarily resulting from a prior year insurance recovery (\$2.2 million), offset by current year increases in BOLI income (\$0.8 million),
- Noninterest expense increased approximately \$4.0 million primarily due to an increase in salaries and employee benefits (\$3.4 million), occupancy and equipment (\$1.0 million), FDIC insurance (\$0.8 million), data processing (\$0.4 million) and other expenses (\$0.6 million), offset by a prior year loss on extinguishment of debt (\$2.4 million), and
- Decreased income tax expense of \$8.2 million resulting from decrease in income before taxes.

## Net Interest Income

Fully taxable equivalent net interest income for 2017 totaled \$148.5 million, an increase of \$15.5 million, or 11.7%, from 2016. The increase in net interest income was due to an increase in average interest-earning assets, which grew by 9.4% to \$4.3 billion and a widening of the net interest margin by 7 basis-points. The increase in the net interest margin was attributed to an improved asset mix, including lower levels of cash held at the Federal Reserve Bank, partially offset by increases in deposit funding costs, as well as lower yields on securities. Average total loans increased by 13.6% to \$3.8 billion in 2017 from \$3.4 billion in 2016.

Fully taxable equivalent net interest income for 2016 totaled \$133.0 million, an increase of \$13.3 million, or 11.1%, from 2015. The increase in net interest income was due to an increase in average interest-earning assets, which grew by 16.7% to \$3.9 billion. Partially offsetting the increase in interest-earning assets was a 17 basis-point contraction in the net interest margin. The decrease in the net interest margin was attributed to higher levels of cash held at the Federal Reserve Bank, lower accretion of purchase accounting adjustments related to the Merger, long-term subordinated debt issued in June 2016, and an increase in rates paid on deposits. Average total loans increased by 20.1% to \$3.4 billion in 2016 from \$2.8 billion in 2015.

**Average Balance Sheets**

The following table sets forth certain information relating to our average assets and liabilities for the years ended December 31, 2017, 2016 and 2015 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,								
	2017			2016			2015		
	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate
	(dollars in thousands)								
<b>ASSETS</b>									
Interest-earning assets:									
Investment securities <sup>(1) (2)</sup>	\$ 393,144	\$ 12,290	3.13%	\$ 396,622	\$ 13,153	3.32%	\$ 482,703	\$ 16,128	3.34%
Loans <sup>(2) (3) (4)</sup>	3,811,922	170,314	4.47%	3,355,452	148,755	4.43%	2,793,952	126,133	4.51%
Federal funds sold and interest-earnings deposits with banks	70,527	711	1.01%	152,397	756	0.50%	65,513	178	0.27%
Restricted investment in bank stocks	27,093	1,421	5.24%	28,439	1,410	4.96%	27,335	1,081	3.95%
<b>Total interest-earning assets</b>	<b>4,302,686</b>	<b>184,736</b>	<b>4.29%</b>	<b>3,932,910</b>	<b>164,074</b>	<b>4.17%</b>	<b>3,369,503</b>	<b>143,520</b>	<b>4.26%</b>
Noninterest-earning assets:									
Allowance for loan losses	(28,276)			(32,554)			(17,905)		
Noninterest-earning assets	354,970			336,402			309,708		
<b>Total assets</b>	<b>\$4,629,380</b>			<b>\$4,236,758</b>			<b>\$3,661,306</b>		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>									
Savings, NOW, money market, interest checking									
	\$1,773,454	9,502	0.54%	\$1,544,838	6,754	0.44%	\$1,279,663	4,972	0.39%
Time deposits	1,015,552	14,168	1.40%	923,114	11,913	1.29%	752,380	8,784	1.17%
<b>Total interest-bearing deposits</b>	<b>2,789,006</b>	<b>23,670</b>	<b>0.85%</b>	<b>2,467,952</b>	<b>18,667</b>	<b>0.76%</b>	<b>2,032,043</b>	<b>13,756</b>	<b>0.68%</b>
Borrowings									
	529,445	9,178	1.73%	571,626	9,013	1.58%	565,408	8,181	1.45%
Subordinated debentures <sup>(5)</sup>	54,610	3,245	5.94%	54,534	3,246	5.95%	29,685	1,700	5.73%
Capital lease obligation	2,704	162	5.99%	2,829	170	6.01%	2,946	177	6.01%
<b>Total interest-bearing liabilities</b>	<b>3,375,765</b>	<b>36,255</b>	<b>1.07%</b>	<b>3,096,941</b>	<b>31,096</b>	<b>1.00%</b>	<b>2,630,894</b>	<b>23,814</b>	<b>0.91%</b>
Noninterest-bearing deposits	681,215			624,731			537,287		
Other liabilities	19,010			21,824			25,839		
Stockholders' equity	553,390			493,262			467,286		
<b>Total liabilities and stockholders' equity</b>	<b>\$4,629,380</b>			<b>\$4,236,758</b>			<b>\$3,661,306</b>		
Net interest income/interest rate spread <sup>(6)</sup>		148,481	3.22%		132,978	3.17%		119,706	3.35%
Tax-equivalent adjustment		(3,412)			(2,833)			(2,553)	
Net interest income as reported		<u>\$145,069</u>			<u>\$130,145</u>			<u>\$117,153</u>	
Net interest margin <sup>(7)</sup>			3.45%			3.38%			3.55%

(1) Average balances are based on amortized cost.

(2) Interest income is presented on a tax equivalent basis using 35% federal tax rate.

(3) Includes loan fee income.

(4) Loans include nonaccrual loans.

(5) Average balances are net of debt issuance costs of \$545, \$621 and \$812 as of December 31, 2017, December 31, 2016 and December 31, 2015, respectively. Amortization expense related to debt issuance costs included in interest expense were \$165, \$191 and \$89 as of December 31, 2017, December 31, 2016 and December 31, 2015, respectively.

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

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

**Rate/Volume Analysis**

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

	2017/2016			2016/2015		
	Increase (Decrease)			Increase (Decrease)		
	Due to Change in:			Due to Change in:		
	Average	Average	Net	Average	Average	Net
	Volume	Rate	Change	Volume	Rate	Change
	(dollars in thousands)					
<b>Interest income:</b>						
Investment securities:	\$ (109)	\$ (754)	\$ (863)	\$ (2,855)	\$ (120)	\$ (2,975)
Loans receivable and loans held-for-sale	20,395	1,164	21,559	24,893	(2,271)	22,622
Federal funds sold and interest-earnings deposits with banks	(825)	780	(45)	431	147	578
Restricted investment in bank stocks	(71)	82	11	55	274	329
Total interest income:	<u>\$ 19,390</u>	<u>\$ 1,272</u>	<u>\$ 20,662</u>	<u>\$ 22,524</u>	<u>\$ (1,970)</u>	<u>\$ 20,554</u>
<b>Interest expense:</b>						
Savings, NOW, money market, interest checking	\$ 1,225	\$ 1,523	\$ 2,748	\$ 1,159	\$ 623	\$ 1,782
Time deposits	1,290	965	2,255	2,203	926	3,129
Borrowings and subordinated debentures	(726)	890	164	1,564	814	2,378
Capital lease obligation	(7)	(1)	(8)	(7)	-	(7)
Total interest expense:	<u>\$ 1,782</u>	<u>\$ 3,377</u>	<u>\$ 5,159</u>	<u>\$ 4,919</u>	<u>\$ 2,363</u>	<u>\$ 7,282</u>
Net interest income:	<u>\$ 17,608</u>	<u>\$ (2,105)</u>	<u>\$ 15,503</u>	<u>\$ 17,605</u>	<u>\$ (4,333)</u>	<u>\$ 13,272</u>

**Provision for Loan Losses**

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

For the year ended December 31, 2017, the provision for loan losses was \$6.0 million, a decrease of \$32.7 million, compared to the provision for loan losses of \$38.7 million for 2016, due primarily to \$36.5 million in charge-offs of taxi medallion loans in 2016. These taxi medallion loans were transferred back to the loans held-for-investment portfolio in November 2017 at their fair value, with a modest earnings impact.

For the year ended December 31, 2016, the provision for loan losses was \$38.7 million, an increase of \$26.1 million, compared to the provision for loan losses of \$12.6 million for 2015. The increase was largely attributable to an increase in reserves allocated to the Bank's taxi medallion portfolio of approximately \$27.7 million resulting from the transfer of the portfolio to loans held-for-sale, offset by a reduction in reserves of \$1.5 million related to the movement of loans from the acquired portfolio into loans held-for-investment.

**Noninterest Income**

Noninterest income for the full-year 2017 decreased by \$1.7 million, or 17.3%, to \$8.2 million from \$9.9 million in 2016. The decrease was primarily the result of a \$2.6 million decrease in net gains on sale of investment securities, partly offset by an increase in BOLI income of \$0.6 million and higher gains of the sale of loans held-for-sale of \$0.5 million, primarily related to the sale of approximately \$50 million of non-relationship multifamily loans which resulted in a gain on sale of approximately \$550 thousand.



## Table of Contents

Noninterest income for the full-year 2016 decreased by \$1.3 million, or 11.2% to \$9.9 million from \$11.2 million in 2015. The decrease was primarily the result of a 2015 insurance recovery of \$2.2 million, offset by an increase in BOLI income of \$0.8 million and higher net investment securities gains, which increased by \$0.3 million to \$4.2 million for the year ended December 31, 2016 from \$3.9 million for the year ended December 31, 2015.

### **Noninterest Expense**

Noninterest expenses for the full-year 2017 increased by \$20.3 million, or 34.6% to \$78.8 million from \$58.5 million in 2016. The increase was primarily attributable to an increase of \$15.6 million in the valuation allowance for loans held-for-sale related to the Company's taxi medallion loans. The balance of the increase was attributable to an increased level of business and staff resulting from organic growth. Salaries and employee benefits increased by \$4.0 million, FDIC insurance increased by \$0.5 million and data processing increased by \$0.4 million.

Noninterest expenses for the full-year 2016 increased by \$4.0 million, or 7.4% to \$58.5 million from \$54.5 million in 2015. The increase was primarily attributable to an increased level of business and staff resulting from organic growth. Salary and employee benefits increased by \$3.3 million, occupancy and equipment expenses increased by \$1.0 million, FDIC insurance increased by \$0.8 million, data processing increased by \$0.4 million, marketing and advertising increased by \$0.2 million and other expenses increased by \$0.6 million, partially offset by a 2015 loss on an extinguishment of debt for \$2.4 million.

### **Income Taxes**

On December 22, 2017, H.R. 1, commonly known as the Tax Cuts and Jobs Act (the "Act"), was signed into law. The Act includes provisions that will affect the Company's income tax expense, including the reducing the federal tax rate from 35% to 21% effective January 1, 2018. As a result of the rate reduction, the Company was required to re-measure, through income tax expense in the period of enactment, its deferred tax assets and liabilities using the enacted rate at which the Company expects them to be recovered or settled. Pursuant to the Securities and Exchange Commission Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118"), given the amount and complexity of the changes in tax law resulting from the Tax Reform Act, the Company has not finalized the accounting for the income tax effects of the Tax Reform Act. This includes the re-measurement of deferred taxes.

The impact of the Tax Reform Act may differ from this estimate, during the one-year measurement period due to, among other things, further refinement of the Company's calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of the Tax Reform Act. As a result of the Tax Reform Act, the Company recorded a tax charge of approximately \$5.6 million due to a re-measurement of deferred tax assets and liabilities.

Income tax expense was \$25.3 million for the full-year 2017 compared to \$11.8 million for the full-year 2016 and \$19.9 million for the full-year 2015. Tax expense for 2017 included the aforementioned, estimated \$5.6 million charge to adjust the value of deferred tax assets to reflect the lower corporate tax rate, resulting from the Act. The higher level of income tax expense in 2017 also reflected increased pretax income. The effective tax rates were 36.9% in 2017, 27.5% for 2016 and 32.5% for 2015. Excluding the effect of the \$5.6 million charge, the effective tax rate in 2017 was 28.8%. The effective tax rate in 2016 from 2015 decreased due to a decrease in the proportion of income subject to income taxes.

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

### **Financial Condition Overview**

At December 31, 2017, the Company's total assets were \$5.1 billion, an increase of \$682 million from December 31, 2016. Total loans (including loans held-for-sale) were \$4.2 billion, an increase of \$642 million from December 31, 2016. Deposits were \$3.8 billion, an increase of \$451 million from December 31, 2016.

At December 31, 2016, the Company's total assets were \$4.4 billion, an increase of \$410 million from December 31, 2015. Total loans (including loans held-for-sale) were \$3.6 billion, an increase of \$455 million from December 31, 2015. Deposits were \$3.3 billion, an increase of \$553 million from December 31, 2015.

### **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 market area of Bergen, Union, Morris, Essex, Hudson, Mercer and Monmouth counties, New Jersey, as well as NYC's five boroughs, and commencing in 2018, Long Island through its Melville, New York 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.

## Table of Contents

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.

During 2017 and 2016, loan portfolio growth was positively impacted in several ways including (i) an increase in demand for small business lines of credit and business term loans as economic conditions remained strong (ii) industry consolidation and lending restrictions involving larger competitors allowing the Bank to gain market share, (iii) an increase in refinancing strategies employed by borrowers during the current low rate environment, and (iv) the Bank's success in attracting highly experienced commercial loan officers with substantial local market knowledge.

Total gross loans at December 31, 2017 totaled \$4.2 billion, an increase of \$695.4 million, or 20.0%, over gross loans at December 31, 2016 of \$3.5 billion. As of December 31, 2017, the Bank had transferred \$46.8 million of loans secured by NYC taxi medallions that were categorized as held-for-sale to loans held-for-investment. Gross loans were also reduced at December 31, 2017 by the sale of \$49.1 million of non-relationship multifamily loans which resulted in a gain on sale of approximately \$0.5 million. Excluding this transfer and sale, total gross loans at December 31, 2017 increased by \$698 million, or 20.1% over gross loans at December 31, 2016. The increase in gross loans was attributable to organic loan growth.

The largest component of our loan portfolio at December 31, 2017 and December 31, 2016 was commercial real estate loans. Our commercial real estate loans at December 31, 2017 totaled \$2.6 billion, an increase of \$388 million, or 17.6%, over commercial real estate loans at December 31, 2016 of \$2.2 billion. Our commercial loans totaled \$824.1 million at December 31, 2017, an increase of \$270.5 million, or 48.9%, over commercial loans at December 31, 2016 of \$554.1 million. Included in commercial loans at December 31, 2017 was the entire taxi medallion portfolio (\$46.8 million) that was the result of a transfer back to loans held-for-investment from the loans held-for-sale portfolio. Excluding this transfer of the taxi medallion portfolio, the commercial loan portfolio increased by \$223.7 million, or 40.4% over commercial loans at December 31, 2016.

Our commercial construction loans at December 31, 2017 totaled \$483.2 million, a decrease of \$3.0 million, or (0.6%), over commercial construction loans at December 31, 2016 of \$486.2 million. Our residential real estate loans totaled \$271.8 million at December 31, 2017, an increase of \$39.2 million, or 16.9%, over residential real estate loans at December 31, 2016 of \$232.5 million. Our consumer loans at December 31, 2017 totaled \$2.8 million, an increase of \$0.4 million, 18.0%, over consumer loans of \$2.4 million at December 31, 2016. The growth in our loan portfolio reflects the success of our business strategy, in particular emphasizing high-quality client service, which has led to continued client referrals.

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

	December 31,				
	2017	2016	2015	2014	2013
	(dollars in thousands)				
Commercial	\$ 824,082	\$ 553,576	\$ 570,116	\$ 499,816	\$ 229,688
Commercial real estate	2,592,909	2,204,710	1,966,696	1,634,510	536,539
Commercial construction	483,216	486,228	328,838	167,359	42,722
Residential real estate	271,795	232,547	233,690	234,967	150,571
Consumer	2,808	2,380	2,454	2,879	1,084
Gross loans	4,174,810	3,479,441	3,101,794	2,539,531	960,604
Net deferred (fees) costs	(3,354)	(3,609)	(2,787)	(890)	339
Loans receivable	4,171,456	3,475,832	3,099,007	2,538,641	960,943
Allowance for loan losses	(31,748)	(25,744)	(26,572)	(14,160)	(10,333)
Net loans receivable	<u>\$ 4,139,708</u>	<u>\$ 3,450,088</u>	<u>\$ 3,072,435</u>	<u>\$ 2,524,481</u>	<u>\$ 950,610</u>

## [Table of Contents](#)

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, 2017 remaining of contractual maturity.

	At December 31, 2017, Maturing			
	In One Year or Less	After One Year through Five Years	After Five Years	Total
	(dollars in thousands)			
Commercial	\$ 360,413	\$ 243,514	\$ 220,155	\$ 824,082
Commercial real estate	231,678	566,611	1,794,620	2,592,909
Commercial construction	428,099	55,117	-	483,216
Residential real estate	7,199	27,102	237,494	271,795
Consumer	2,448	325	35	2,808
Total	<u>\$ 1,029,837</u>	<u>\$ 892,669</u>	<u>\$ 2,252,304</u>	<u>\$ 4,174,810</u>
Loans with:				
Fixed rates	\$ 354,245	\$ 524,850	\$ 762,460	\$ 1,641,555
Variable rates	675,592	367,819	1,489,844	2,533,255
Total	<u>\$ 1,029,837</u>	<u>\$ 892,669</u>	<u>\$ 2,252,304</u>	<u>\$ 4,174,810</u>

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

## Asset Quality

**General.** One of our key objectives is to maintain a high level of asset quality. When a borrower fails to make a scheduled payment, we attempt to cure the deficiency by making personal contact with the borrower. Initial contacts typically are made 15 days after the date the payment is due, and late notices are sent approximately 15 days after the date the 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. All loans which are delinquent 30 days or more are reported to the board of directors of the Bank on a monthly basis.

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

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

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

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

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

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

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

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

	December 31,	
	2017	2016
(dollars in thousands)		
<b>Classified Loans:</b>		
Substandard	\$ 85,201	\$ 35,693
Doubtful	-	-
Loss	-	-
Total classified loans	85,201	35,693
<b>Special Mention Loans</b>	43,620	37,816
Total classified and special mention loans	\$ 128,821	\$ 73,509

During the year ended December 31, 2017, “substandard” loans, which include lower credit quality loans which possess higher risk characteristics than special mention assets, increased from \$35.7 million, or 1.0% of total loans receivable, at December 31, 2016 to \$83.5 million, or 2.0% of loans receivable, at December 31, 2017. The increase is primarily attributable to the entire taxi medallion portfolio (approximately \$46.8 million, or 1.1% of loans receivable) moving back to the loans held-for-investment category from the loans held-for-sale category.

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

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

[Table of Contents](#)

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:

	At December 31,				
	2017	2016	2015	2014	2013
	(dollars in thousands)				
Nonaccrual loans	\$ 65,613	\$ 5,734	\$ 20,737	\$ 11,609	\$ 3,137
Nonaccrual loans (held-for-sale)	-	63,044	-	-	-
OREO	538	626	2,549	1,108	220
Total nonperforming assets <sup>(1)</sup>	<u>\$ 66,151</u>	<u>\$ 69,404</u>	<u>\$ 23,286</u>	<u>\$ 12,717</u>	<u>\$ 3,357</u>
Performing TDRs	<u>\$ 14,920</u>	<u>\$ 13,338</u>	<u>\$ 85,925</u>	<u>\$ 1,763</u>	<u>\$ 5,746</u>
Loans 90 days or greater past due and still accruing (non-PCI)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Loans 90 days or greater past due and still accruing (PCI)	<u>\$ 1,664</u>	<u>\$ 5,293</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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

Nonaccrual loans (excluding loans held-for-sale) to loans receivable	1.57%	0.16%	0.67%	0.46%	0.33%
Nonperforming assets to total assets	1.29%	1.57%	0.58%	0.37%	0.20%
Nonperforming assets, performing TDRs, and loans 90 days or greater past due and still accruing to total loans <sup>(2)</sup>	1.97%	2.48%	3.52%	0.62%	0.95%

(2) Includes loans held-for-sale.

**Allowance for Loan Losses and Related Provision**

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

At December 31, 2017, the allowance for loan losses was \$31.7 million, an increase of \$6.0 million or 23.3%, from \$25.7 million for the year ended December 31, 2016. The increase in the allowance for loan losses was primarily attributable to organic loan growth and an increase of provision to the acquired portfolio, slightly offset by decreases in specific reserves.

During the year ended December 31, 2017, the Bank recorded net recoveries of \$4 thousand, compared with \$39.5 million of net charge-offs during the year ended December 31, 2016. The allowance for loan losses as a percentage of loans receivable was 0.76% at December 31, 2017 and 0.74% at December 31, 2016. During 2016, the Bank charged-off \$36.7 million related to the taxi medallion loan portfolio, which contributed to the large decrease in net charge-off activity when compared to the current year.

**Five-Year Statistical Allowance for Loan Losses**

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

	Years Ended December 31,				
	2017	2016	2015	2014	2013
	(dollars in thousands)				
Balance at the January 1,	\$ 25,744	\$ 26,572	\$ 14,160	\$ 10,333	\$ 10,237
Charge-offs:					
Commercial-other	70	1,446	507	777	132
Commercial-taxi medallions	–	36,750	–	–	–
Commercial-lease financing receivable	–	1,147	–	–	–
Commercial real estate	155	107	–	–	–
Residential real estate	14	94	–	159	175
Consumer	–	29	31	–	22
Total charge-offs	239	39,573	538	936	329
Recoveries:					
Commercial-other	178	4	340	50	69
Commercial real estate	51	35	–	–	–
Residential real estate	12	3	2	19	–
Consumer	2	3	3	11	6
Total recoveries	243	45	345	80	75
Net charge-offs (recoveries)	(4)	39,528	193	856	254
Provision for loan losses	6,000	38,700	12,605	4,683	350
Balance at end of year	\$ 31,748	\$ 25,744	\$ 26,572	\$ 14,160	\$ 10,333
Ratio of net charge-offs (recoveries) during the year to average loans outstanding during the year	0.00%	1.18%	0.01%	0.05%	0.03%
Allowance for loan losses as a percentage of loans receivable at December 31,	0.76%	0.74%	0.86%	0.56%	1.08%

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

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

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

	Commercial		Residential real estate		Consumer		Unallocated	
	Amount of Allowance	Loans to Gross Loans	Amount of Allowance	Loans to Gross Loans	Amount of Allowance	Loans to Gross Loans	Amount of Allowance	Total Allowance
	(dollars in thousands)							
2017	\$ 30,090	93.4%	\$ 1,051	6.5%	\$ 2	0.1%	\$ 605	\$ 31,748
2016	24,005	93.2	957	6.7	3	0.1	779	25,744
2015	25,127	92.4	977	7.5	4	0.1	464	26,572
2014	12,121	90.6	1,113	9.3	7	0.1	919	14,160
2013	7,806	84.2	990	15.7	146	0.1	1,391	10,333

**Investments**

For the year ended December 31, 2017, the average volume of investment securities decreased by \$3.5 million to approximately \$393.1 million or 9.1% of average earning assets, from \$396.6 million on average, or 10.1% of average earning assets, in 2016. At December 31, 2017, the total investment portfolio amounted to \$435.3 million, an increase of \$82.0 million from December 31, 2016. At December 31, 2017, the principal components of the investment portfolio are U.S. Treasury and Government Agency Obligations, Federal Agency Obligations including mortgage-backed securities, Obligations of U.S. states and political subdivision, corporate bonds and notes, and other debt and equity securities.

Transfers of debt securities from the held-to-maturity category to the available-for-sale category are made at fair value at the date of transfer. The unrealized holding gain or loss at the date of the transfer is recognized in accumulated other comprehensive income, net of applicable taxes. During the quarter ended September 30, 2016 the Company transferred all securities previously categorized as held-to-maturity to available-for-sale classification. The transfer resulted in an increase of approximately \$210 million in amortized cost basis of securities and resulted in a net increase to accumulated other comprehensive income of \$7.4 million, net of tax. This transfer will enhance liquidity and increase flexibility with regard to asset-liability management and balance sheet composition.

During the year ended December 31, 2017, rate related factors decreased investment revenue by \$0.8 million. The tax-equivalent yield on investments decreased by 19 basis points to 3.13% from a yield of 3.32% during the year ended December 31, 2016. This was caused by the Company decreasing the size of its investment portfolio in an effort to deploy excess cash into loans.

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 balance sheet.

At December 31, 2017, the net unrealized loss carried as a component of accumulated other comprehensive income and included in stockholders' equity, net of tax, amounted to (\$1.2) million as compared with a net unrealized gain of \$0.9 million at December 31, 2016, resulting from changes in market conditions and interest rates at December 31, 2017. For additional information regarding the Company's investment portfolio, see Note 4, Note 17 and Note 22 of the Notes to the Consolidated Financial Statements.

During 2017, securities sold from the Company's available-for-sale portfolio amounted to \$29.5 million, as compared with \$85.3 million in 2016 and \$65.2 million in 2015. The gross realized gains on securities sold, called or matured amounted to approximately \$1.6 million in 2017, \$4.2 million in 2016 and \$3.9 million in 2015, while there were no gross realized losses, or impairment charges in 2017, 2016 and 2015.

The table below illustrates the maturity distribution and weighted average yield on a tax-equivalent basis for investment securities at December 31, 2017, 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		Market Value
	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	
(dollars in thousands)											
<b>Investment Securities Available-for-Sale</b>											
Federal Agency Obligations	\$ 2,507	1.79%	\$ 785	1.80%	\$ 3,298	1.98%	\$ 49,707	2.58%	\$ 56,297	2.50%	\$ 56,022
Residential Mortgage Pass-through Securities	12	2.51	582	2.59	7,546	2.26	175,369	2.93	183,509	2.90	181,891
Commercial Mortgage Pass-through Securities	-	-	4,054	2.40	-	-	-	-	4,054	2.40	4,054
Obligations of U.S. States and Political Subdivisions	652	4.21	6,613	3.99	24,211	4.65	99,247	4.61	130,723	4.58	131,128
Trust Preferred	-	-	-	-	1,579	2.00	2,998	7.01	4,577	5.28	4,671
Corporate Bonds and Notes	4,504	2.97	20,338	2.99	4,959	3.11	-	-	29,801	3.01	29,693
Asset-backed Securities	-	-	-	-	5,599	2.35	6,422	2.14	12,021	2.24	12,050
Certificates of Deposit	301	2.12	320	2.65	-	-	-	-	621	2.39	625
Equity Securities	-	-	-	-	-	-	11,843	0.04	11,843	0.04	11,728
Other Securities	3,422	0.02	-	-	-	-	-	-	3,422	0.02	3,422
<b>Total Investment Securities</b>	<b>\$ 11,398</b>	<b>1.87%</b>	<b>\$ 32,692</b>	<b>3.08%</b>	<b>\$ 47,192</b>	<b>3.56%</b>	<b>\$ 345,586</b>	<b>3.28%</b>	<b>\$ 436,868</b>	<b>3.26%</b>	<b>\$ 435,284</b>

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

The securities listed in the table above are either rated investment grade by Moody's and/or Standard and Poor's or have shadow credit ratings from a credit agency supporting an investment grade and conform to the Company's investment policy guidelines. There were no municipal securities, or corporate securities, of any single issuer exceeding 10% of stockholders' equity at December 31, 2017. Equity securities and other securities do not have a contractual maturity and are included in the "Due after ten years" maturity in the table above.

## [Table of Contents](#)

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.

	2017	2016	2015
	(dollars in thousands)		
<b>Investment Securities Available-for-Sale:</b>			
Federal agency obligations	\$ 56,022	\$ 52,837	\$ 29,146
Residential mortgage pass-through securities	181,891	72,497	44,910
Commercial mortgage pass-through securities	4,054	4,209	2,972
Obligations of U.S. States and political subdivisions	131,128	150,605	8,357
Trust preferred securities	4,671	5,666	16,255
Corporate bonds and notes	29,693	36,928	53,976
Asset-backed securities	12,050	14,583	19,725
Certificates of deposit	625	983	1,905
Equity securities	11,728	11,710	11,688
Other securities	3,422	3,272	6,836
Total	<u>\$ 435,284</u>	<u>\$ 353,290</u>	<u>\$ 195,770</u>
<b>Investment Securities Held-to-Maturity:</b>			
U.S. treasury & agency securities	\$ -	\$ -	\$ 28,471
Federal agency obligations	-	-	33,616
Residential mortgage pass-through securities	-	-	3,805
Commercial mortgage-backed securities	-	-	4,110
Obligations of U.S. States and political subdivisions	-	-	118,015
Corporate bonds and notes	-	-	36,039
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 224,056</u>
Total investment securities	<u>\$ 435,284</u>	<u>\$ 353,290</u>	<u>\$ 418,676</u>

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

### **Interest Rate Sensitivity Analysis**

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

We currently utilize net interest income simulation and economic value of equity ("EVE") models to measure the potential impact to the Bank of future changes in interest rates. As of December 31, 2017 and December 31, 2016, 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, 2017, we estimated that over the next one-year period a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 1.31%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 1.40%. As of December 31, 2016, 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 5.79%, while a 100 basis-point instantaneous decrease in the general level of interest rates would decrease our net interest income by 2.93%.

Based on our model, which was run as of December 31, 2017, we estimated that over the next three years, on a cumulative basis, a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 2.16%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 2.41%. As of December 31, 2016, 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 6.65%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 4.43%.



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, 2017, would decline by 12.83% with an instantaneous rate shock of up 200 basis points, and increase by 4.02% with an instantaneous rate shock of down 100 basis points. Our EVE as of December 31, 2016, would decline by 7.97% with an instantaneous rate shock of up 200 basis points, and increase by 2.96% 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, 2017.

Interest Rates (basis points)	Estimated EVE	Estimated Change in EVE		Interest Rates (basis points)	Estimated NII	Estimated Change in NII	
		Amount	%			Amount	%
+300	\$451,286	\$(112,800)	(20.00)%	+300	\$157,382	\$2,460	1.59%
+200	491,693	(72,393)	(12.83)	+200	156,944	2,022	1.31
+100	531,852	(32,234)	(5.71)	+100	156,376	1,454	0.94
0	564,086	-	0.0	0	154,922	-	0.0
-100	586,735	22,649	4.02	-100	152,700	(2,162)	(1.40)

### Estimates of Fair Value

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

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

### Impact of Inflation and Changing Prices

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

### Liquidity

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

At December 31, 2017, 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, 2017, liquid assets (cash and due from banks, interest-bearing deposits with banks and unencumbered investment securities) were \$423.4 million, which represented 8.3% of total assets and 9.5% of total deposits and borrowings, compared to \$428.2 million at December 31, 2016, which represented 9.7% of total assets and 11.2% 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, 2017, had the ability to borrow \$1.5 billion. In addition, at December 31, 2017, the Bank had in place borrowing capacity of \$25 million through correspondent banks. The Bank also has a credit facility established with the Federal Reserve Bank of New York for direct discount window borrowings with capacity based on pledged collateral of \$8.4 million. At December 31, 2017, the Bank had aggregate available and unused credit of approximately \$812 million, which represents the aforementioned facilities totaling \$1.5 billion net of \$720 million in outstanding borrowings and letters of credit. At December 31, 2017, outstanding commitments for the Bank to extend credit were \$678 million.

[Table of Contents](#)

Cash and cash equivalents totaled \$149.6 million on December 31, 2017, decreasing by \$50.8 million from \$200.4 million at December 31, 2016. Operating activities provided \$131.1 million in net cash. Investing activities used \$817.7 million in net cash, primarily reflecting an increase in loans and net cash flow from the securities portfolio. Financing activities provided \$635.8 million in net cash, primarily reflecting a net increase of \$450.9 million in deposits and net proceeds from FHLB advances of \$209.0 million, slightly offset by \$15.0 million in repayments of repurchase agreements.

**Deposits**

Deposits are our primary source of funds. Average total deposits increased \$378 million, or 12.2% to \$3.5 billion in 2017 from \$3.1 billion in 2016 and increased \$523.4 million, or 20.4% to \$3.1 billion in 2016 from 2015. During 2017 we saw substantial increases in demand accounts, money market accounts and time deposits. This was due to several promotional items as well as increased efforts to attract new customers.

The following table sets forth the year-to-date average balances and weighted average rates for various types of deposits for 2017, 2016 and 2015.

	2017		2016		2015	
	Balance	Rate	Balance	Rate	Balance	Rate
(dollars in thousands)						
Demand, noninterest-bearing	\$ 681,215	-	\$ 624,731	-	\$ 537,287	-
Demand, interest-bearing & NOW	603,796	0.36%	530,169	0.33%	450,359	0.36%
Money market accounts	983,956	0.71%	802,839	0.54%	609,797	0.45%
Savings	185,703	0.16%	211,830	0.29%	219,507	0.28%
Time	1,015,552	1.40%	923,114	1.29%	752,380	1.17%
Total Deposits	<u>\$3,470,221</u>	0.68%	<u>\$3,092,683</u>	0.60%	<u>\$2,569,330</u>	0.54%

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

	December 31, 2017		December 31, 2016	
	Amount	% of total	Amount	% of total
(dollars in thousands)				
Demand, noninterest-bearing	\$ 776,843	20.47%	\$ 694,977	20.78%
Demand, interest-bearing & NOW	636,339	16.77%	563,740	16.86%
Money market accounts	1,033,525	27.23%	911,867	27.27%
Savings	168,452	4.44%	205,551	6.15%
Time	1,179,969	31.09%	968,136	28.94%
Total Deposits	<u>\$ 3,795,128</u>	100.00%	<u>\$ 3,344,271</u>	100.00%

[Table of Contents](#)

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

	December 31, 2017	December 31, 2016
	(dollars in thousands)	
3 months or less	\$ 109,164	\$ 107,350
Over 3 to 6 months	125,474	72,972
Over 6 to 12 months	122,725	158,890
Over 12 months	320,078	228,201
<b>Total</b>	<b>\$ 677,441</b>	<b>\$ 567,413</b>

**Borrowings**

Borrowings consist of long and short-term advances from the Federal Home Loan Bank and securities sold under agreements to repurchase. Federal Home Loan Bank advances are secured, under the terms of a blanket collateral agreement, primarily by commercial mortgage loans. As of December 31, 2017, the Company had \$670.1 million in notes outstanding at a weighted average interest rate of 1.76%. As of December 31, 2016, the Company had \$476.3 million in notes outstanding at a weighted average interest rate of 1.69%.

**Contractual Obligations and Other Commitments**

The following table summarizes contractual obligations at December 31, 2017 and the effect such obligations are expected to have on liquidity and cash flows in future periods.

	Total	Less than 1 year	1 – 3 years	4 – 5 years	Over 5 years
	(dollars in thousands)				
<b>December 31, 2017</b>					
<b>Contractual obligations:</b>					
Operating lease obligations	\$ 16,272	\$ 2,821	\$ 5,096	\$ 3,374	\$ 4,981
<b>Other long-term liabilities/long-term debt:</b>					
Time Deposits	\$ 1,179,969	\$ 597,735	\$ 553,372	\$ 28,862	\$ -
Federal Home Loan Bank advances and repurchase agreements	670,077	505,077	120,000	45,000	-
Capital lease	2,634	294	641	641	1,058
Subordinated debentures	54,699	-	-	-	54,699
<b>Total other long-term liabilities/long-term debt</b>	<b>\$ 1,907,379</b>	<b>\$ 1,103,106</b>	<b>\$ 674,013</b>	<b>\$ 74,503</b>	<b>\$ 55,757</b>
<b>Other commercial commitments – off balance sheet:</b>					
Commitments under commercial loans and lines of credit	\$ 344,142	\$ 270,092	\$ 65,958	\$ 5,051	\$ 3,041
Home equity and other revolving lines of credit	44,483	16,133	8,531	13,642	6,177
Outstanding commercial mortgage loan commitments	254,710	245,484	9,226	-	-
Standby letters of credit	34,114	34,114	-	-	-
Overdraft protection lines	688	330	31	-	327
<b>Total off balance sheet arrangements and contractual obligations</b>	<b>\$ 678,137</b>	<b>\$ 566,153</b>	<b>\$ 83,746</b>	<b>\$ 18,693</b>	<b>\$ 9,545</b>
<b>Total contractual obligations and other commitments</b>	<b>\$ 2,601,788</b>	<b>\$ 1,672,080</b>	<b>\$ 762,855</b>	<b>\$ 96,570</b>	<b>\$ 70,283</b>

## Capital

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

The Company's Tier 1 leverage capital (defined as tangible stockholders' equity for common stock and Trust Preferred Capital Securities) at December 31, 2017 amounted to \$425.4 million or 8.9% of average total assets. At December 31, 2016, the Company's Tier 1 leverage capital amounted to \$390.2 million or 9.3% of average total assets. The increase in Tier 1 capital reflects the Company's retained earnings during 2017. Tier 1 capital at December 31, 2016 reflects its issuance of 1,659,794 shares of common stock at a price of \$24.25 per share for net proceeds of \$38.4 million. Tier 1 capital excludes the effect of FASB ASC 320-10-05, which amounted to (\$1.2) million of net unrealized losses, after tax, on securities available-for-sale at December 31, 2017 (and would be reported as a component of accumulated other comprehensive income which is included in stockholders' equity), and is reduced by goodwill and intangible assets, which amounted to \$148.3 million as of December 31, 2017. For information on goodwill and intangible assets, see Note 1 to the Consolidated Financial Statements.

United States bank regulators have issued guidelines establishing minimum capital standards related to the level of assets and off balance-sheet exposures adjusted for credit risk. Specifically, these guidelines categorize assets and off balance-sheet items into four risk-weightings and require banking institutions to maintain a minimum ratio of capital to risk-weighted assets. At December 31, 2017, the Company's CET 1, Tier 1 and total risk-based capital ratios were 9.2%, 9.3% and 11.0%, respectively. For information on risk-based capital and regulatory guidelines for the Parent Corporation and its bank subsidiary, see Note 16 to the Consolidated Financial Statements.

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

## Subordinated Debentures

During December 2003, Center Bancorp Statutory Trust II, a statutory business trust and wholly-owned subsidiary of the Parent Corporation issued \$5.0 million of MMCapS capital securities to investors due on January 23, 2034. The trust loaned the proceeds of this offering to the Company and received in exchange \$5.2 million of the Parent Corporation's subordinated debentures. The subordinated debentures are redeemable in whole or part. The floating interest rate on the subordinated debentures is three-month LIBOR plus 2.85% and re-prices quarterly. The rate at December 31, 2017 was 4.23%.

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

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

[Table of Contents](#)

**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.

**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.”

	<b>Page</b>
<a href="#">Report of Independent Registered Public Accounting Firm</a>	<a href="#">45</a>
<a href="#">Consolidated Statements of Condition</a>	<a href="#">46</a>
<a href="#">Consolidated Statements of Income</a>	<a href="#">47</a>
<a href="#">Consolidated Statements of Comprehensive Income</a>	<a href="#">48</a>
<a href="#">Consolidated Statements of Changes in Stockholders’ Equity</a>	<a href="#">49</a>
<a href="#">Consolidated Statements of Cash Flows</a>	<a href="#">50</a>
<a href="#">Notes to Consolidated Financial Statements</a>	<a href="#">51</a>

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

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

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

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

### Basis for Opinions

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

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

Our audits of the financial statements included performing procedures to assess the 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.

/s/ Crowe Horwath LLP

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

New York, New York  
March 6, 2018

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

	December 31,	
	2017	2016
<b>(in thousands, except for share and per share data)</b>		
<b>ASSETS</b>		
Cash and due from banks	\$ 52,565	\$ 37,150
Interest-bearing deposits with banks	97,017	163,249
Cash and cash equivalents	149,582	200,399
Securities available-for-sale	435,284	353,290
Loans held-for-sale	24,845	78,005
Loans receivable	4,171,456	3,475,832
Less: Allowance for loan losses	31,748	25,744
Net loans receivable	4,139,708	3,450,088
Investment in restricted stock, at cost	33,497	24,310
Bank premises and equipment, net	21,659	22,075
Accrued interest receivable	15,470	12,965
Bank owned life insurance	111,311	98,359
Other real estate owned	538	626
Goodwill	145,909	145,909
Core deposit intangibles	2,364	3,088
Other assets	28,275	37,234
<b>Total assets</b>	<b>\$ 5,108,442</b>	<b>\$ 4,426,348</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 776,843	\$ 694,977
Interest-bearing	3,018,285	2,649,294
Total deposits	3,795,128	3,344,271
Borrowings	670,077	476,280
Subordinated debentures	54,699	54,534
Accounts payable and accrued liabilities	23,101	20,231
<b>Total liabilities</b>	<b>4,543,005</b>	<b>3,895,316</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred Stock:		
Authorized 5,000,000 shares; issued -0- shares of Series B preferred stock at December 31, 2017 and December 31, 2016; outstanding -0- shares at December 31, 2017 and December 31, 2016	-	-
Common stock, no par value:		
Authorized 50,000,000 shares; issued 34,135,782 shares at December 31, 2017 and 34,012,229 shares at December 31, 2016; outstanding 32,071,860 shares at December 31, 2017 and 31,948,307 at December 31, 2016	412,546	412,726
Additional paid-in capital	13,602	11,407
Retained earnings	160,025	126,462
Treasury stock, at cost (2,063,922 shares at December 31, 2017 and December 31, 2016)	(16,717)	(16,717)
Accumulated other comprehensive loss	(4,019)	(2,846)
<b>Total stockholders' equity</b>	565,437	531,032
<b>Total liabilities and stockholders' equity</b>	<b>\$ 5,108,442</b>	<b>\$ 4,426,348</b>

*See the accompanying notes to the consolidated financial statements.*

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

	Years Ended December 31,		
	2017	2016	2015
<i>(dollars in thousands, except for per share data)</i>			
<b>Interest income:</b>			
Interest and fees on loans	\$ 168,824	\$ 147,982	\$ 125,493
Interest and dividends on investment securities:			
Taxable	6,799	7,266	10,665
Nontaxable	3,569	3,827	3,550
Dividends	1,421	1,410	1,081
Interest on federal funds sold and other short-term investments	711	756	178
<b>Total interest income</b>	<b>181,324</b>	<b>161,241</b>	<b>140,967</b>
<b>Interest expense:</b>			
Deposits	23,670	18,667	13,756
Borrowings	12,585	12,429	10,058
<b>Total interest expense</b>	<b>36,255</b>	<b>31,096</b>	<b>23,814</b>
<b>Net interest income</b>	<b>145,069</b>	<b>130,145</b>	<b>117,153</b>
Provision for loan losses	6,000	38,700	12,605
<b>Net interest income after provision for loan losses</b>	<b>139,069</b>	<b>91,445</b>	<b>104,548</b>
<b>Noninterest income:</b>			
Annuity and insurance commissions	39	191	242
Income on bank owned life insurance	3,181	2,559	1,782
Net gains on sale of loans held-for-sale	708	232	327
Deposit, loan and other income	2,680	2,704	2,667
Insurance recovery	-	-	2,224
Net gains on sale of investment securities	1,596	4,234	3,931
<b>Total noninterest income</b>	<b>8,204</b>	<b>9,920</b>	<b>11,173</b>
<b>Noninterest expense:</b>			
Salaries and employee benefits	35,128	31,030	27,685
Occupancy and equipment	8,163	8,571	7,587
FDIC insurance	3,485	2,940	2,110
Professional and consulting	2,863	2,979	2,951
Marketing and advertising	996	1,040	847
Data processing	4,543	4,141	3,703
Loss on extinguishment of debt	-	-	2,397
Amortization of core deposit intangible	724	820	917
Increase in valuation allowance, loans held-for-sale	15,592	-	-
Other expenses	7,265	6,986	6,287
<b>Total noninterest expenses</b>	<b>78,759</b>	<b>58,507</b>	<b>54,484</b>
<b>Income before income tax expense</b>	<b>68,514</b>	<b>42,858</b>	<b>61,237</b>
Income tax expense	25,294	11,776	19,926
<b>Net income</b>	<b>43,220</b>	<b>31,082</b>	<b>41,311</b>
Less: Preferred stock dividends	-	22	112
<b>Net income available to common stockholders</b>	<b>\$ 43,220</b>	<b>\$ 31,060</b>	<b>\$ 41,199</b>
<b>Earnings per common share:</b>			
Basic	\$ 1.35	\$ 1.02	\$ 1.37
Diluted	1.34	1.01	1.36
Dividends per common share	\$ 0.300	\$ 0.300	\$ 0.300

*See the accompanying notes to the consolidated financial statements.*



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

	Years Ended December 31,		
	2017	2016	2015
<b>(dollars in thousands)</b>			
Net income	\$ 43,220	\$ 31,082	\$ 41,311
Other comprehensive income:			
Unrealized gains and losses:			
Unrealized holding losses on available-for-sale securities arising during the period	(1,350)	(5,624)	(2,991)
Tax effect	532	2,142	1,196
Net of tax	(818)	(3,482)	(1,795)
Unrealized gains on securities transferred from held-to-maturity to available-for-sale during the period	-	10,069	-
Tax effect	-	(3,815)	-
Net of tax	-	6,254	-
Reclassification adjustment for realized gains included in net income	(1,596)	(4,234)	(3,931)
Tax effect	579	1,682	1,564
Net of tax	(1,017)	(2,552)	(2,367)
Amortization of unrealized net losses on held-to-maturity securities transferred from available-for-sale securities	-	1,986	220
Tax effect	-	(813)	(90)
Net of tax	-	1,173	130
Unrealized gains (losses) on cash flow hedges	710	219	(179)
Tax effect	(290)	(90)	73
Net of tax	420	129	(106)
Unrealized pension plan (losses) gains:			
Unrealized pension plan gains (losses) before reclassifications	(2)	(2)	485
Tax effect	1	1	(198)
Net of tax	(1)	(1)	287
Reclassification adjustment for realized losses included in net income	412	407	433
Tax effect	(169)	(165)	(177)
Net of tax	243	242	256
Total other comprehensive income (loss)	(1,173)	1,763	(3,595)
Total comprehensive income	\$ 42,047	\$ 32,845	\$ 37,716

*See the accompanying notes to the consolidated financial statements.*

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

	<u>Preferred Stock</u>	<u>Common Stock</u>	<u>Additional Paid In Capital</u>	<u>Retained Earnings</u>	<u>Treasury Stock</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
<b>(in thousands, except for share and per share data)</b>							
<b>Balance as of December 31, 2014</b>	\$ 11,250	\$ 374,287	\$ 6,015	\$ 72,398	\$(16,717)	\$ (1,014)	\$ 446,219
Net income	-	-	-	41,311	-	-	41,311
Other comprehensive loss, net of taxes	-	-	-	-	-	(3,595)	(3,595)
Dividends on series B preferred stock	-	-	-	(112)	-	-	(112)
Cash dividends declared on common stock (\$0.300 per share)	-	-	-	(8,991)	-	-	(8,991)
Exercise of 340,492 stock options	-	-	1,765	-	-	-	1,765
Restricted stock, net of forfeitures (69,258 shares)	-	-	-	-	-	-	-
Stock-based compensation expense	-	-	747	-	-	-	747
<b>Balance as of December 31, 2015</b>	\$ 11,250	\$ 374,287	\$ 8,527	\$ 104,606	\$(16,717)	\$ (4,609)	\$ 477,344
Net income	-	-	-	31,082	-	-	31,082
Other comprehensive income, net of taxes	-	-	-	-	-	1,763	1,763
Dividends on series B preferred stock	-	-	-	(22)	-	-	(22)
Cash dividends declared on common stock (\$0.300 per share)	-	-	-	(9,204)	-	-	(9,204)
Redemption of preferred stock	(11,250)	-	-	-	-	-	(11,250)
Exercise of stock options (136,429 shares)	-	-	767	-	-	-	767
Secondary offering of common stock, net of costs of \$1,811 (1,659,794 shares)	-	38,439	-	-	-	-	38,439
Restricted stock, net of forfeitures (70,019 shares)	-	-	-	-	-	-	-
Stock-based compensation expense	-	-	2,113	-	-	-	2,113
<b>Balance as of December 31, 2016</b>	\$ -	\$ 412,726	\$ 11,407	\$ 126,462	\$(16,717)	\$ (2,846)	\$ 531,032
Net income	-	-	-	43,220	-	-	43,220
Other comprehensive loss, net of taxes	-	-	-	-	-	(1,173)	(1,173)
Cash dividends declared on common stock (\$0.300 per share)	-	-	-	(9,657)	-	-	(9,657)
Issuance costs of common stock	-	(180)	-	-	-	-	(180)
Exercise of stock options (66,389 shares)	-	-	417	-	-	-	417
Restricted stock, net of forfeitures (57,164 shares)	-	-	-	-	-	-	-
Stock-based compensation expense	-	-	1,778	-	-	-	1,778
<b>Balance as of December 31, 2017</b>	\$ -	\$ 412,546	\$ 13,602	\$ 160,025	\$(16,717)	\$ (4,019)	\$ 565,437

*See the accompanying notes to the consolidated financial statements.*

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

(dollars in thousands)	Years Ended December 31,		
	2017	2016	2015
<b>Cash flows from operating activities</b>			
Net income	\$ 43,220	\$ 31,082	\$ 41,311
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of premises and equipment	3,151	2,704	2,309
Provision for loan losses	6,000	38,700	12,605
Increase to valuation allowance, loans held-for-sale	15,592	-	-
Amortization of intangibles	724	820	917
Net accretion of loans	(2,073)	(4,280)	(5,052)
Accretion on bank premises	(74)	(132)	(108)
Accretion on deposits	(31)	(172)	(470)
Accretion on borrowings	(203)	(307)	(441)
Net deferred income tax expense (benefit)	3,699	1,969	(3,493)
Stock-based compensation	1,778	2,113	747
Gains on sales of investment securities, net	(1,596)	(4,234)	(3,931)
Gains on sale of loans held-for-sale, net	(708)	(232)	(327)
Loans originated for resale	(9,083)	(10,004)	(20,834)
Proceeds from sale of loans held-for-sale	63,731	10,048	21,161
Net gains on disposition of premises and equipment	(8)	(57)	-
Net loss (gain) on sale of other real estate owned	82	(182)	164
Increase in cash surrender value of bank owned life insurance	(2,952)	(2,559)	(1,782)
Loss on extinguishment of debt	-	-	2,397
Amortization of premiums and accretion of discounts on investments securities, net	2,631	1,692	1,793
Amortization of subordinated debt issuance costs	165	191	89
Increase in accrued interest receivable	(2,505)	(420)	(845)
Decrease (increase) in other assets	5,706	(15,006)	1,101
Increase (decrease) in other liabilities	3,887	(2,022)	(1,080)
Net cash provided by operating activities	131,133	49,712	46,231
<b>Cash flows from investing activities</b>			
Investment securities available-for-sale:			
Purchases	(224,621)	(165,527)	(37,403)
Sales	29,543	85,253	65,231
Maturities, calls and principal repayments	109,104	137,587	62,007
Investment securities held-to-maturity:			
Purchases	-	(1,000)	(17,531)
Maturities and principal repayments	-	14,757	17,520
Net redemptions (purchases) of restricted investment in bank stocks	(9,187)	8,302	(9,077)
Loans held-for-sale payments	3,122	-	-
Net increase in loans	(714,159)	(490,777)	(557,881)
Purchases of premises and equipment	(2,661)	(2,702)	(3,881)
Purchases of bank owned life insurance	(10,000)	(16,999)	(24,501)
Proceeds from sale of premises and equipment	8	445	-
Proceeds from sale of other real estate owned	1,124	2,992	769
Net cash used in investing activities	(817,727)	(427,669)	(504,747)
<b>Cash flows from financing activities</b>			
Net increase in deposits	450,888	553,477	315,829
Increase in subordinated debt	-	-	50,000
Advances of FHLB borrowings	1,280,000	375,000	848,875
Repayments of FHLB borrowings	(1,071,000)	(570,000)	(656,400)
Repayment of repurchase agreement	(15,000)	-	(18,397)
Cash dividends paid on common stock	(9,612)	(9,067)	(8,996)
Cash dividends paid on preferred stock	-	(22)	(112)
Redemption of preferred stock	-	(11,250)	-
Issuance cost of common stock	(180)	-	-
Secondary offering of common stock	-	38,439	-
Tax benefit of options exercised	264	117	341
Proceeds from exercise of stock options	417	767	1,424
Net cash provided by financing activities	635,777	377,461	532,564
Net change in cash and cash equivalents	(50,817)	(496)	74,048
Cash and cash equivalents at beginning of period	200,399	200,895	126,847
Cash and cash equivalents at end of period	\$ 149,582	\$ 200,399	\$ 200,895

<b>Cash payments for:</b>						
Interest paid	\$	36,721	\$	30,862	\$	23,357
Income taxes paid		16,205		22,945		17,880

**Supplemental noncash disclosures:**

<b>Investing:</b>						
Transfer of loans to other real estate owned		1,118		887		2,374
Transfer of loan held-for-sale to loans held-for-investment		54,422		-		-
Transfer of loans held-for-investment to loans held-for-sale		73,916		77,817		-
Transfer from investment securities held-to-maturity to investment securities available-for-sale		-		209,855		-

*See the accompanying notes to the consolidated financial statements.*

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

**Note 1 - Summary of Significant Accounting Policies**

***Business***

ConnectOne Bancorp, Inc. (the “Parent Corporation”) is incorporated under the laws of the State of New Jersey and is a registered bank holding company. The Parent Corporation’s business currently consists of the operation of its wholly-owned subsidiary, ConnectOne Bank (the “Bank” and, collectively with the Parent Corporation and the Parent Corporation’s subsidiaries, the “Company”). The Bank’s subsidiaries include Union Investment Co. (a New Jersey investment company), Twin Bridge Investment Co. (a Delaware investment company), ConnectOne Preferred Funding Corp. (a New Jersey real estate investment trust), Center Financial Group, LLC (a New Jersey financial services company), Center Advertising, Inc. (a New Jersey advertising company), Morris Property Company, LLC, (a New Jersey limited liability company), Volosin Holdings, LLC, (a New Jersey limited liability company), and NJCB Spec-1, LLC (a New Jersey limited liability 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 other banking offices. Substantially all loans are secured with various types of collateral, including business assets, consumer assets and commercial/residential real estate. Each borrower’s ability to repay its loans is dependent on the conversion of assets, cash flows generated from the borrowers’ business, real estate rental and consumer wages.

***Basis of Financial Statement Presentation***

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

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

***Segments***

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

***Use of Estimates***

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

***Cash and Cash Equivalents***

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

***Investment Securities***

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

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

**Note 1 - Summary of Significant Accounting Policies – (continued)**

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

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

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

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

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

***Loans***

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

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

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

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

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

**Note 1 - Summary of Significant Accounting Policies – (continued)**

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

***Allowance for Loan Losses***

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

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

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

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

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

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

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

**Note 1 - Summary of Significant Accounting Policies – (continued)**

***Purchased Credit-Impaired Loans***

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

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

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

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

***Derivatives***

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

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

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

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



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

**Note 1 - 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 39 years. Furniture, fixtures and equipment are depreciated using the straight-line (or accelerated) method with useful lives ranging from 3 to 10 years.

***Other Real Estate Owned***

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

***Employee Benefit Plans***

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

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

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

***Stock-Based Compensation***

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

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. A Black-Scholes model is used to estimate the fair value of stock options while the market price of the Company’s common stock at the date of grant is used for restricted stock awards. See Note 19 of the Notes to Consolidated Financial Statements for a further discussion.

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

**Note 1 - Summary of Significant Accounting Policies – (continued)**

***Treasury Stock***

Subject to limitations applicable to the Parent Corporation, treasury stock purchases may be made from time to time as, in the opinion of management, market conditions warrant, in the open market or in privately negotiated transactions. Shares repurchased are added to the corporate treasury and will be used for future stock dividends and other issuances. The repurchased shares are recorded as treasury stock, which results in a decrease in stockholders' equity. Treasury stock is recorded using the cost method and accordingly is presented as a reduction of stockholders' equity. During the years ended December 31, 2017, 2016 and 2015, the Parent Corporation did not purchase any of its shares.

***Goodwill***

Goodwill arises from business combinations and is generally determined as of the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Company has selected December 31, as the date to perform the annual impairment test. No impairment charge was deemed necessary for the years ended December 31, 2017, 2016 and 2015.

***Other Intangible Assets***

Other intangible assets consist of core deposits 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 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.

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

**Note 1 - Summary of Significant Accounting Policies – (continued)**

***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 2016 and 2015 to conform to the classifications presented in 2017. Such reclassifications had no impact on net income or stockholders’ equity.

**Note 2 – New Authoritative Accounting Guidance**

ASU No. 2018-02, “*Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.*” In February 2018, the FASB amended existing guidance to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (“Tax Act”). Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this Update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption, including adoption in an interim period, permitted. ASU 2018-02 is effective for fiscal years beginning after December 15, 2018. We believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

ASU 2018-01, “*Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842.*” ASU 2018-01 provides an optional transition practical expedient for the adoption of ASU 2016-02 that, if elected, would not require an organization to reconsider their accounting for existing land easements that are not currently accounted for under the old leases standard; and Clarify that new or modified land easements should be evaluated under ASU 2016-02, once an entity has adopted the new standard. ASU 2018-01 is effective for fiscal years beginning after December 15, 2018. We believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

ASU No. 2017-12, “*Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.*” ASU No. 2017-12 refines and expands hedge accounting for both financial (e.g., interest rate) and commodity risks. Its provisions create more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes. It also makes certain targeted improvements to simplify the application of hedge accounting guidance. ASU 2017-12 will be effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Although management continues to evaluate the potential impact of ASU 2017-12 on our consolidated financial statements, at this time, we believe the adoption of this standard will not have a significant impact on our consolidated financial statements.

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

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

**Note 2. New Authoritative Accounting Guidance – (continued)**

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

ASU No. 2016-15, “*Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*” provides guidance on the following eight specific cash flow issues: (1) Debt prepayment or debt extinguishment costs; (2) Settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; (3) Contingent consideration payments made after a business combination; (4) Proceeds from the settlement of insurance claims; (5) Proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (6) Distributions received from equity method investees; (7) Beneficial interests in securitization transactions; and (8) Separately identifiable cash flows and application of the predominance principle. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments in this update should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. Although management continues to evaluate the potential impact of ASU 2016-05 on our consolidated financial statements, at this time, we believe the adoption of this standard will not have a significant impact to on consolidated financial statements.

ASU No. 2016-13, “*Financial Instruments – Credit Losses (Topic 326): Assets Measured at Amortized Cost*.” ASU 2016-13 requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates and affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company has formed a CECL committee that is assessing our data and system needs. The Company has also met with multiple third-party vendors who may provide assistance in implementation and model creation. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the ASU is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the ASU on our consolidated financial statements.

ASU No. 2016-02, “*Leases (Topic 842)*” requires the recognition of a right of use asset and related lease liability by lessees for leases classified as operating leases under current GAAP. Topic 842, which replaces the current guidance under Topic 840, retains a distinction between finance leases and operating leases. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee also will not significantly change from current GAAP. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize right of use assets and lease liabilities. Topic 842 will be effective for the Company for reporting periods beginning January 1, 2019, with early adoption permitted. The Company must apply a modified retrospective transition approach for the applicable leases existing at, or entered into after, the beginning of the earliest comparative period presented in the consolidated financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. The Company is currently leasing seventeen properties as branch locations and is leasing certain office equipment. The adoption of ASU 2016-02 will result in increases to the Company’s assets and liabilities. We are currently in the process of evaluating all of our leases for compliance with the new ASU.

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

**Note 2. New Authoritative Accounting Guidance – (continued)**

ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01, among other things; (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. The Company has selected a third-party vendor to measure the fair value of the loans held-for-investment portfolio using the exit price notion as required by amendment (iv) above. ASU 2016-01 will be effective for the Company on January 1, 2018 and will not have a significant impact on our consolidated financial statements.

ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Our revenue is comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and noninterest income, the portion of which that is covered by ASU 2014-09, is not material to our results of operations. ASU 2014-09 was originally going to be effective for us on January 1, 2017; however, the FASB recently issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606) - Deferral of the Effective Date* which deferred the effective date of ASU 2014-09 by one year to January 1, 2018. ASU 2014-09 will be effective for the Company on January 1, 2018 using a modified retrospective transition approach and will not have a significant impact on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*. The amendments relate to when another party, along with the entity, is involved in providing a good or service to a customer. The amendments in this update affect the guidance in ASU No. 2014-09 above, which is not yet effective. The effective date will be the same as the effective date of ASU No. 2014-09.

In April 2016, the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. The amendments clarify the following two aspects of Topic 606: identifying performance obligations, and the licensing implementation guidance. The amendments in this update are intended to improve the operability and understandability of the licensing implementation guidance. The amendments in this update affect the guidance in ASU No. 2014-09 above, which is not yet effective. The effective date will be the same as the effective date of ASU No. 2014-09.

In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*. The amendments do not change the core revenue recognition principle in Topic 606. The amendments provide clarifying guidance in certain narrow areas and add some practical expedients.

In December 2016, the FASB issued ASU No. 2016-20, *Revenue from Contracts with Customers (Topic 606): Technical Corrections and Improvements*. The FASB board decided to issue a separate update for technical corrections and improvements to Topic 606 and other Topics amended by ASU No. 2014-09 to increase awareness of the proposals and to expedite improvements to ASU No. 2014-09. The amendment affects narrow aspects of the guidance issued in ASU No. 2014-09.

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

**Note 3. Earnings per Common Share**

Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) No. 260-10-45 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (“EPS”). The restricted stock awards and certain restricted stock units 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,		
	2017	2016	2015
	(in thousands, except per share amounts)		
Net income available to common stockholders	\$ 43,220	\$ 31,060	\$ 41,199
Earnings allocated to participating securities	(141)	(147)	(157)
Income attributable to common stock	<u>\$ 43,079</u>	<u>\$ 30,913</u>	<u>\$ 41,042</u>
Weighted average common shares outstanding, including participating securities	31,943	30,453	29,989
Weighted average participating securities	(41)	(54)	(51)
Weighted average common shares outstanding	31,902	30,399	29,938
Incremental shares from assumed conversions of options, performance units and restricted shares	335	291	346
Weighted average common and equivalent shares outstanding	<u>32,237</u>	<u>30,690</u>	<u>30,284</u>
Earnings per common share:			
Basic	\$ 1.35	\$ 1.02	\$ 1.37
Diluted	1.34	1.01	1.36

There were no antidilutive common share equivalents as of December 31, 2017, 2016 and 2015.

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

**Note 4 - Investment Securities**

The Company's investment securities are classified as available-for-sale at December 31, 2017 and December 31, 2016. 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, 2017 and December 31, 2016. Fair value is based upon either quoted market prices, or in certain cases where there is limited activity in the market for a particular instrument, assumptions are made to determine their fair value. See Note 22 of the Notes to Consolidated Financial Statements for a further discussion.

Transfers of debt securities from the held-to-maturity category to the available-for-sale category are made at fair value at the date of transfer. For transfers from the available-for-sale category to the held-to maturity category the unrealized holding gain or loss at the date of transfer remains in accumulated other comprehensive income, a component of stockholders' equity and in the carrying value of the held-to-maturity investment security. Unrealized holding gains or losses that remain in accumulated other comprehensive income are amortized or accreted out of other comprehensive income with an offsetting entry to interest income as a yield adjustment through earnings over the remaining terms of the securities. For transfers from the held-to-maturity category to the available-for-sale category unrealized holding gain or loss at the date of the transfer shall be recognized in accumulated other comprehensive income, net of tax.

During the year ended December 31, 2016, the Company transferred all securities previously categorized as held-to-maturity to available-for-sale classification. The transfer resulted in an increase of approximately \$210 million in amortized cost basis of available-for-sale securities and resulted in a net increase to accumulated other comprehensive income of \$7.4 million, net of tax. The transfer enhanced liquidity and increased flexibility with regard to asset-liability management and balance sheet composition. As a result of the transfer, the Company believes it has tainted its held-to-maturity classification and judgment will be required in the future in determining when circumstances have changed such that management can assert that it has the intent and ability to hold debt securities to maturity. Based on this guidance, the Company does not expect to classify any securities as held-to-maturity within the near future.

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

**Note 4 - Investment Securities – (continued)**

The following tables present information related to the Company's portfolio of securities available-for-sale and held-to-maturity at December 31, 2017 and 2016.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in thousands)			
<b>December 31, 2017</b>				
<b>Investment securities available-for-sale</b>				
Federal agency obligations	\$ 56,297	\$ 141	\$ (416)	\$ 56,022
Residential mortgage pass-through securities	183,509	330	(1,948)	181,891
Commercial mortgage pass-through securities	4,054	3	(3)	4,054
Obligations of U.S. states and political subdivisions	130,723	1,739	(1,334)	131,128
Trust preferred securities	4,577	205	(111)	4,671
Corporate bonds and notes	29,801	163	(271)	29,693
Asset-backed securities	12,021	66	(37)	12,050
Certificates of deposit	621	4	-	625
Equity securities	11,843	235	(350)	11,728
Other securities	3,422	-	-	3,422
<b>Total securities available-for-sale</b>	<b>\$ 436,868</b>	<b>\$ 2,886</b>	<b>\$ (4,470)</b>	<b>\$ 435,284</b>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in thousands)			
<b>December 31, 2016</b>				
<b>Investment securities available-for-sale</b>				
Federal agency obligations	\$ 52,826	\$ 282	\$ (271)	\$ 52,837
Residential mortgage pass-through securities	72,922	519	(944)	72,497
Commercial mortgage pass-through securities	4,186	23	-	4,209
Obligations of U.S. states and political subdivisions	148,747	2,789	(931)	150,605
Trust preferred securities	5,575	242	(151)	5,666
Corporate bonds and notes	36,717	586	(375)	36,928
Asset-backed securities	14,867	2	(286)	14,583
Certificates of deposit	973	10	-	983
Equity securities	11,843	192	(325)	11,710
Other securities	3,272	-	-	3,272
<b>Total securities available-for-sale</b>	<b>\$ 351,928</b>	<b>\$ 4,645</b>	<b>\$ (3,283)</b>	<b>\$ 353,290</b>

Investment securities having a carrying value of approximately \$157.8 million and \$121.9 million at December 31, 2017 and December 31, 2016, respectively, were pledged to secure public deposits, borrowings, repurchase agreements, Federal Reserve Discount Window borrowings and Federal Home Loan Bank advances and for other purposes required or permitted by law. As of December 31, 2017 and December 31, 2016, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.



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

**Note 4 - Investment Securities – (continued)**

The following table presents information for investments in securities available-for-sale at December 31, 2017, 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, 2017	
	Amortized Cost	Fair Value
	(dollars in thousands)	
<b>Investment Securities Available-for-Sale:</b>		
Due in one year or less	\$ 7,964	\$ 7,985
Due after one year through five years	28,056	28,294
Due after five years through ten years	39,646	40,069
Due after ten years	158,374	157,841
Residential mortgage pass-through securities	183,509	181,891
Commercial mortgage pass-through securities	4,054	4,054
Equity securities	11,843	11,728
Other securities	3,422	3,422
Total securities available-for-sale	<u>\$ 436,868</u>	<u>\$ 435,284</u>

Gross gains and losses from the sales, calls, and maturities of investment securities for the years ended December 31, 2017, 2016 and 2015 were as follows:

	Years Ended December 31,		
	2017	2016	2015
	(dollars in thousands)		
<b>Proceeds</b>	<u>\$ 29,543</u>	<u>\$ 85,253</u>	<u>\$ 65,231</u>
Gross gains on sales of investment securities	\$ 1,596	\$ 4,234	\$ 3,931
Gross losses on sales of investment securities	-	-	-
Net gains on sales of investment securities	1,596	4,234	3,931
Less: tax provision on net gains	(579)	(1,682)	(1,564)
Net gains on sales of investment securities, after tax	<u>\$ 1,017</u>	<u>\$ 2,552</u>	<u>\$ 2,367</u>

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

**Note 4 - Investment Securities – (continued)**

***Other-than-Temporarily Impaired Investments***

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

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

***Temporarily Impaired Investments***

The Company does not believe that any of the unrealized losses, which were comprised of 112 and 84 investment securities as of December 31, 2017 and December 31, 2016, respectively, represent an other-than-temporary impairment. The gross unrealized losses associated with U.S. Treasury and agency securities, federal agency obligations, mortgage-backed securities, corporate bonds, tax-exempt securities, asset-backed securities, trust preferred securities, mutual funds and equity securities are not considered to be other-than-temporary because management believes these unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer.

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

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

The Company evaluates all securities with unrealized losses quarterly to determine whether the loss is other-than-temporary. Unrealized losses in the corporate debt securities category consist primarily of senior unsecured corporate debt securities issued by large financial institutions, insurance companies and other corporate issuers. Single issuer corporate trust preferred securities are also included, and in the case of one holding the market valuation loss is largely based upon the floating rate coupon and corresponding market valuation. Neither that trust preferred issuer, nor any other corporate issuers, have defaulted on interest payments. The unrealized loss in equity securities consists of losses on other bank equities. The decline in fair value is due in large part to the lack of an active trading market for these securities, changes in market credit spreads and rating agency downgrades. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2017.

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

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

**Note 4 - Investment Securities – (continued)**

The following tables indicate gross unrealized losses not recognized in income and fair value, aggregated by investment category and the length of time individual securities have been in a continuous unrealized loss position at December 31, 2017 and 2016. There were no investments held-to-maturity as of December 31, 2017 and 2016.

	December 31, 2017					
	Total		Less than 12 Months		12 Months or Longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(dollars in thousands)					
<b>Investment Securities Available-for-Sale:</b>						
Federal agency obligation	\$ 39,813	\$ (416)	\$ 28,407	\$ (213)	\$ 11,406	\$ (203)
Residential mortgage pass-through securities	148,574	(1,948)	117,556	(1,146)	31,018	(802)
Commercial mortgage pass-through securities	1,198	(3)	1,198	(3)	-	-
Obligations of U.S. states and political subdivisions	57,685	(1,334)	17,909	(246)	39,776	(1,088)
Trust preferred securities	1,469	(111)	-	-	1,469	(111)
Corporate bonds and notes	11,074	(271)	1,965	(21)	9,109	(250)
Asset-backed securities	7,428	(37)	993	(2)	6,435	(35)
Equity securities	11,116	(350)	-	-	11,116	(350)
<b>Total Temporarily Impaired Securities</b>	<b>\$ 278,357</b>	<b>\$ (4,470)</b>	<b>\$ 168,028</b>	<b>\$ (1,631)</b>	<b>\$ 110,329</b>	<b>\$ (2,839)</b>

	December 31, 2016					
	Total		Less than 12 Months		12 Months or Longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(dollars in thousands)					
<b>Investment Securities Available-for-Sale:</b>						
Federal agency obligation	\$ 22,672	\$ (271)	\$ 21,416	\$ (262)	\$ 1,256	\$ (9)
Residential mortgage pass-through securities	50,136	(944)	49,817	(937)	319	(7)
Obligations of U.S. states and political subdivisions	52,307	(931)	52,307	(931)	-	-
Trust preferred securities	1,427	(151)	-	-	1,427	(151)
Corporate bonds and notes	15,930	(375)	7,671	(265)	8,259	(110)
Asset-backed securities	13,404	(286)	3,743	(88)	9,661	(198)
Equity securities	11,467	(325)	-	-	11,467	(325)
<b>Total Temporarily Impaired Securities</b>	<b>\$ 167,343</b>	<b>\$ (3,283)</b>	<b>\$ 134,954</b>	<b>\$ (2,483)</b>	<b>\$ 32,389</b>	<b>\$ (800)</b>

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

**Note 5 - Loans and the Allowance for Loan Losses**

**Loans Receivable:** The following table sets forth the composition of the Company's loan portfolio segments, including net deferred fees, as of December 31, 2017 and December 31, 2016:

	2017	2016
	(dollars in thousands)	
Commercial	\$ 824,082	\$ 553,576
Commercial real estate	2,592,909	2,204,710
Commercial construction	483,216	486,228
Residential real estate	271,795	232,547
Consumer	2,808	2,380
Gross loans	4,174,810	3,479,441
Net deferred fees	(3,354)	(3,609)
Loans receivable	<u>\$ 4,171,456</u>	<u>\$ 3,475,832</u>

At December 31, 2017 and 2016, loan balances of approximately \$1.9 billion and \$1.7 billion, respectively, were pledged to secure borrowings from the Federal Home Loan Bank.

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

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

**Loans Held-For-Sale:** The following table presents loans held-for-sale by loan segment as of December 31, 2017 and December 31, 2016:

	2017	2016
	(dollars in thousands)	
Commercial	\$ -	\$ 70,105
Commercial real estate	24,475	7,712
Residential mortgage loans	370	188
Total carrying amount	<u>\$ 24,845</u>	<u>\$ 78,005</u>

As of December 31, 2016, the commercial loans held-for-sale segment included the Company's entire taxi medallion portfolio, with a carrying value of \$65.6 million (with an unpaid principal balance of \$102.1 million). During the fourth quarter of 2017, the Bank's entire taxi medallion loan portfolio was transferred back to loans held-for-investment from the held-for-sale designation. As of December 31, 2017, the loans secured by NYC taxi medallions, predominantly corporate medallions, had a carrying value of \$46.8 million, compared to \$65.6 million as of December 31, 2016.

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

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

**Purchased Credit-Impaired Loans:** The Company holds purchased loans for which there was, at their acquisition date, evidence of deterioration of credit quality since their origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans is as follows as of December 31, 2017 and December 31, 2016.

	2017	2016
	(dollars in thousands)	
Commercial	\$ 2,683	\$ 7,098
Commercial real estate	-	982
Total carrying amount	<u>\$ 2,683</u>	<u>\$ 8,080</u>

For those purchased loans disclosed above, the Company did not increase the allowance for loan losses for the year ended December 31, 2017 and 2016. No allowances for loan losses were reversed during 2017 and 2016.

The accretable yield, or income expected to be collected, on the purchased credit-impaired loans above is as follows as of December 31, 2017 and December 31, 2016.

	2017	2016
	(dollars in thousands)	
Balance at January 1,	\$ 2,860	\$ 3,599
Accretion of income	(1,473)	(739)
Balance at December 31,	<u>\$ 1,387</u>	<u>\$ 2,860</u>

**Loans Receivable on Nonaccrual Status:** The following tables present nonaccrual loans included in loans receivable by loan segment as of December 31, 2017 and December 31, 2016:

	2017	2016
	(dollars in thousands)	
Commercial	\$ 47,363	\$ 1,460
Commercial real estate	12,757	1,081
Commercial construction	-	-
Residential real estate	5,493	3,193
Total loans receivable on nonaccrual status	<u>\$ 65,613</u>	<u>\$ 5,734</u>

The increase in nonaccrual loans is primarily attributable to the entire taxi medallion portfolio (approximately \$46.8 million, or 1.1% of loans receivable) moving back to the loans held-for-investment category from the loans held-for-sale category.

Nonaccrual loans and loans 90 days or greater past due and still accruing include both smaller balance homogeneous loans that are collectively evaluated for impairment and loans individually evaluated for impairment.

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

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

**Credit Quality Indicators:** The Company continuously monitors the credit quality of its loans receivable. In addition to its internal monitoring, the Company utilizes the services of a third-party loan review firm to periodically validate the credit quality of its loans receivable on a sample basis. Credit quality is monitored by reviewing certain credit quality indicators. Assets classified “Pass” are deemed to possess average to superior credit quality, requiring no more than normal attention. Assets classified as “Special Mention” have generally acceptable credit quality yet possess higher risk characteristics/circumstances than satisfactory assets. Such conditions include strained liquidity, slow pay, stale financial statements, or other conditions that require more stringent attention from the lending staff. These conditions, if not corrected, may weaken the loan quality or inadequately protect the Company’s credit position at some future date. Assets are classified “Substandard” if the asset has a well-defined weakness that requires management’s attention to a greater degree than for loans classified special mention. Such weakness, if left uncorrected, could possibly result in the compromised ability of the loan to perform to contractual requirements. An asset is classified as “Doubtful” if it is inadequately protected by the net worth and/or paying capacity of the obligor or of the collateral, if any, that secures the obligation. Assets classified as doubtful include assets for which there is a “distinct possibility” that a degree of loss will occur if the inadequacies are not corrected. All loans past due 90 days or greater and all impaired loans are included in the appropriate category below. The following table presents information about the loan credit quality by loan segment of gross loans (which exclude net deferred fees) at December 31, 2017 and 2016:

	December 31, 2017				
	Pass	Special Mention	Substandard	Doubtful	Total
	(dollars in thousands)				
Commercial	\$ 767,020	\$ 3,764	\$ 53,298	\$ -	\$ 824,082
Commercial real estate	2,534,973	34,335	23,601	-	2,592,909
Commercial construction	475,066	5,521	2,629	-	483,216
Residential real estate	266,163	-	5,632	-	271,795
Consumer	2,767	-	41	-	2,808
Gross loans	<u>\$ 4,045,989</u>	<u>\$ 43,620</u>	<u>\$ 85,201</u>	<u>\$ -</u>	<u>\$ 4,174,810</u>
	December 31, 2016				
	Pass	Special Mention	Substandard	Doubtful	Total
	(dollars in thousands)				
Commercial	\$ 539,961	\$ 3,255	\$ 10,360	\$ -	\$ 553,576
Commercial real estate	2,154,343	31,173	19,194	-	2,204,710
Commercial construction	480,319	3,388	2,521	-	486,228
Residential real estate	228,990	-	3,557	-	232,547
Consumer	2,318	-	62	-	2,380
Gross loans	<u>\$ 3,405,931</u>	<u>\$ 37,816</u>	<u>\$ 35,694</u>	<u>\$ -</u>	<u>\$ 3,479,441</u>

The increase in the Substandard classification is primarily attributable to the entire taxi medallion portfolio (approximately \$46.8 million, or 1.1% of loans receivable) moving back to the loans held-for-investment category from the loans held-for-sale category.

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

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

The following table provides an analysis of the impaired loans by segment at December 31, 2017, 2016 and

	December 31, 2017				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
(dollars in thousands)					
<b>No Related Allowance Recorded</b>					
Commercial	\$ 49,761	\$ 101,066		\$ 10,552	\$ 161
Commercial real estate	23,905	23,976		24,099	585
Commercial construction	6,662	6,662		5,509	322
Residential real estate	3,203	3,442		3,255	-
Consumer	-	-		-	-
<b>Total</b>	<b>\$ 83,531</b>	<b>\$ 135,146</b>		<b>\$ 43,415</b>	<b>\$ 1,068</b>
<b>With An Allowance Recorded</b>					
Commercial real estate	\$ 1,133	\$ 1,133	\$ 39	\$ 1,152	\$ 51
<b>Total</b>					
Commercial	\$ 49,761	\$ 101,066	\$ -	\$ 10,765	\$ 161
Commercial real estate	25,038	25,109	39	25,251	636
Commercial construction	6,662	6,662	-	5,509	322
Residential real estate	3,203	3,442	-	3,255	-
Consumer	-	-	-	-	-
<b>Total (including related allowance)</b>	<b>\$ 84,664</b>	<b>\$ 136,279</b>	<b>\$ 39</b>	<b>\$ 44,567</b>	<b>\$ 1,119</b>
(dollars in thousands)					
December 31, 2016					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>No Related Allowance Recorded</b>					
Commercial	\$ 3,637	\$ 4,063		\$ 4,052	\$ 64
Commercial real estate	18,288	18,288		18,532	250
Commercial construction	5,909	5,909		5,308	79
Residential real estate	1,851	2,055		1,908	19
Consumer	62	62		72	4
<b>Total</b>	<b>\$ 29,747</b>	<b>\$ 30,377</b>		<b>\$ 29,872</b>	<b>\$ 416</b>
<b>With An Allowance Recorded</b>					
Commercial real estate	\$ 1,244	\$ 1,244	\$ 145	\$ 1,274	\$ -
<b>Total</b>					
Commercial	\$ 3,637	\$ 4,063	\$ -	\$ 4,052	\$ 64
Commercial real estate	19,532	19,532	145	19,806	250
Commercial construction	5,909	5,909	-	5,308	79
Residential real estate	1,851	2,055	-	1,908	19
Consumer	62	62	-	72	4
<b>Total (including related allowance)</b>	<b>\$ 30,991</b>	<b>\$ 31,621</b>	<b>\$ 145</b>	<b>\$ 31,146</b>	<b>\$ 416</b>

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

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

	December 31, 2015				
No Related Allowance Recorded	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(dollars in thousands)				
Commercial	\$ 610	\$ 645		\$ 686	\$ -
Commercial real estate	15,517	16,512		6,363	60
Commercial construction	2,149	2,141		1,535	-
Residential real estate	3,954	4,329		3,322	10
Consumer	87	86		96	5
<b>Total</b>	<b>\$ 22,317</b>	<b>\$ 23,713</b>		<b>\$ 12,002</b>	<b>\$ 75</b>
With An Allowance Recorded					
Commercial	\$ 84,787	\$ 84,449	\$ 6,725	\$ 55,445	\$ 1,895
<b>Total</b>					
Commercial	\$ 85,397	\$ 85,094	\$ 6,725	\$ 56,131	\$ 1,895
Commercial real estate	15,517	16,512	-	6,363	60
Commercial construction	2,149	2,141	-	1,535	-
Residential real estate	3,954	4,329	-	3,322	10
Consumer	87	86	-	96	5
<b>Total</b>	<b>\$ 107,104</b>	<b>\$ 108,162</b>	<b>\$ 6,725</b>	<b>\$ 67,447</b>	<b>\$ 1,970</b>

The increase in recorded investment of impaired loans is primarily attributable to the entire taxi medallion portfolio (approximately \$46.8 million, or 1.1% of loans receivable) moving back to the loans held-for-investment category from the loans held-for-sale category.

Included in the impaired loans table are \$14.9 million, \$13.3 million and \$85.9 million of performing TDRs as of December 31, 2017, 2016 and 2015, respectively. Cash basis interest and interest income recognized on accrual basis approximate each other.



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

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

**Aging Analysis:** The following table provides an analysis of the aging of the loans by segment, excluding net deferred fees that are past due at December 31, 2017 and December 31, 2016 by class (dollars in thousands):

December 31, 2017							
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans Receivable
Commercial	\$ 1,708	\$ 183	\$ 1,664	\$ 47,363	\$ 50,918	\$ 773,164	\$ 824,082
Commercial real estate	545	1,475	-	12,757	14,777	2,578,132	2,592,909
Commercial construction	-	-	-	-	-	483,216	483,216
Residential real estate	1,578	-	-	5,493	7,071	264,724	271,795
Consumer	18	-	-	-	18	2,790	2,808
Total	<u>\$ 3,849</u>	<u>\$ 1,658</u>	<u>\$ 1,664</u>	<u>\$ 65,613</u>	<u>\$ 72,784</u>	<u>\$ 4,102,026</u>	<u>\$ 4,174,810</u>

The amount reported 90 days or greater past due and still accruing as of December 31, 2017 are comprised of PCI loans, net of their fair value marks, which are accreting income per their valuation at date of acquisition. There were no non-PCI loans 90 days or greater past due and still accruing as of December 31, 2017.

December 31, 2016							
	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	\$ 475	\$ 18	\$ 4,630	\$ 1,460	\$ 6,583	\$ 546,993	\$ 553,576
Commercial real estate	4,928	1,584	663	1,081	8,256	2,196,454	2,204,710
Commercial construction	-	-	-	-	-	486,228	486,228
Residential real estate	2,131	388	-	3,193	5,712	226,835	232,547
Consumer	-	-	-	-	-	2,380	2,380
Total	<u>\$ 7,534</u>	<u>\$ 1,990</u>	<u>\$ 5,293</u>	<u>\$ 5,734</u>	<u>\$ 20,551</u>	<u>\$ 3,458,890</u>	<u>\$ 3,479,441</u>

The amount reported 90 days or greater past due and still accruing as of December 31, 2016 are comprised of PCI loans, net of their fair value marks, which are accreting income per their valuation at date of acquisition. There were no non-PCI loans 90 days or greater past due and still accruing as of December 31, 2016.

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

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

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

	December 31, 2017						Total
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	
(dollars in thousands)							
<u>Allowance for loan losses</u>							
Individually evaluated for impairment	\$ -	\$ 39	\$ -	\$ -	\$ -	\$ -	\$ 39
Collectively evaluated for impairment	8,032	15,472	4,747	1,051	2	605	29,909
Acquired portfolio	200	1,600	-	-	-	-	1,800
Acquired with deteriorated credit quality	-	-	-	-	-	-	-
<b>Total</b>	<b>\$ 8,232</b>	<b>\$ 17,111</b>	<b>\$ 4,747</b>	<b>\$ 1,051</b>	<b>\$ 2</b>	<b>\$ 605</b>	<b>\$ 31,748</b>

	December 31, 2016						Total
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	
(dollars in thousands)							
<u>Gross loans</u>							
Individually evaluated for impairment	\$ 49,761	\$ 25,038	\$ 6,662	\$ 3,203	\$ -	\$ -	\$ 84,664
Collectively evaluated for impairment	757,923	2,190,686	476,554	212,350	2,338	-	3,639,851
Acquired portfolio	13,715	377,185	-	56,242	470	-	447,612
Acquired with deteriorated credit quality	2,683	-	-	-	-	-	2,683
<b>Total</b>	<b>\$ 824,082</b>	<b>\$ 2,592,909</b>	<b>\$ 483,216</b>	<b>\$ 271,795</b>	<b>\$ 2,808</b>	<b>\$ -</b>	<b>\$4,174,810</b>

	December 31, 2016						Total
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	
(dollars in thousands)							
<u>Allowance for loan losses</u>							
Individually evaluated for impairment	\$ -	\$ 145	\$ -	\$ -	\$ -	\$ -	\$ 145
Collectively evaluated for impairment	6,632	12,438	4,789	958	3	779	25,599
Acquired portfolio	-	-	-	-	-	-	-
Acquired with deteriorated credit quality	-	-	-	-	-	-	-
<b>Total</b>	<b>\$ 6,632</b>	<b>\$ 12,583</b>	<b>\$ 4,789</b>	<b>\$ 958</b>	<b>\$ 3</b>	<b>\$ 779</b>	<b>\$ 25,744</b>

	December 31, 2016						Total
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	
(dollars in thousands)							
<u>Gross loans</u>							
Individually evaluated for impairment	\$ 3,637	\$ 19,532	\$ 5,909	\$ 1,851	\$ 62	\$ -	\$ 30,991
Collectively evaluated for impairment	517,869	1,621,745	478,865	163,686	1,757	-	2,783,922
Acquired portfolio	24,972	562,451	1,454	67,010	561	-	656,448
Acquired with deteriorated credit quality	7,098	982	-	-	-	-	8,080
<b>Total</b>	<b>\$ 553,576</b>	<b>\$ 2,204,710</b>	<b>\$ 486,228</b>	<b>\$ 232,547</b>	<b>\$ 2,380</b>	<b>\$ -</b>	<b>\$3,479,441</b>

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

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

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

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

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

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance at January 1, 2016	\$ 10,949	\$ 10,926	\$ 3,253	\$ 976	\$ 4	\$ 464	\$ 26,572
Loan charge-offs	(39,343)	(107)	-	(94)	(29)	-	(39,573)
Recoveries	4	35	-	3	3	-	45
Provision for loan losses	35,022	1,729	1,536	73	25	315	38,700
Balance at December 31, 2016	<u>\$ 6,632</u>	<u>\$ 12,583</u>	<u>\$ 4,789</u>	<u>\$ 958</u>	<u>\$ 3</u>	<u>\$ 779</u>	<u>\$ 25,744</u>

	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(dollars in thousands)						
Balance at January 1, 2015	\$ 3,083	\$ 7,799	\$ 1,239	\$ 1,113	\$ 7	\$ 919	\$ 14,160
Loans charge-offs	(101)	(406)	-	-	(31)	-	(538)
Recoveries	13	327	-	2	3	-	345
Provision for loan losses	7,954	3,206	2,014	(139)	25	(455)	12,605
Balance at December 31, 2015	<u>\$ 10,949</u>	<u>\$ 10,926</u>	<u>\$ 3,253</u>	<u>\$ 976</u>	<u>\$ 4</u>	<u>\$ 464</u>	<u>\$ 26,572</u>

For the year ended December 31, 2016, the loan charge-offs within the commercial loan segment were primarily made up of \$36.7 million in charge-offs related to the taxi medallion portfolio and a \$1.1 million charge related to a lease financing receivable of the former Union Center operations building.

The \$36.7 million charge on the taxi medallion portfolio occurred in conjunction with the transfer of the taxi medallion loans to loans held-for-sale. The amount transferred to loans held-for-sale as of December 31, 2016 had a carrying value of \$65.6 million following the charge-off.

**Troubled Debt Restructurings**

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

At December 31, 2017, there were no commitments to lend additional funds to borrowers whose loans were on nonaccrual status or were contractually past due 90 days or greater and still accruing interest, or whose terms have been modified in troubled debt restructurings.

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

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

The following table presents loans by segment modified as troubled debt restructurings and the related changes to the allowance for loan and leases losses that occurred during the year ended December 31, 2017 and December 31, 2016:

	December 31, 2017		December 31, 2016	
	(dollars in thousands)			
	Recorded Investment	ALLL	Recorded Investment	ALLL
<b>Troubled debt restructurings</b>				
Balance January 1,	\$ 13,818	\$ -	\$ 86,629	\$ 4,500
Additions	10,378	-	26,325	8,250
Payoffs/paydowns	(3,098)		(2,616)	
Transfers	(580)	-	(96,520)	-
Other	-	-	-	(12,750)
Balance December 31,	<u>\$ 20,518</u>	<u>\$ -</u>	<u>\$ 13,818</u>	<u>\$ -</u>

TDRs totaled \$20.5 million at December 31, 2017, of which \$5.6 million were on nonaccrual status and \$14.9 million were performing under restructured terms. At December 31, 2016, TDRs totaled \$13.8 million, of which \$0.5 million were on nonaccrual status and \$13.3 million were performing under restructured terms. As of December 31, 2017, the taxi medallion loans that were modified in a troubled debt restructuring in 2016 and 2015 were transferred back to the loans held-for-investment category from the loans held-for-sale category. As of December 31, 2017, all taxi medallion loans remain on nonaccrual status.

The following table presents loans by segment modified as troubled debt restructurings that occurred during the year ended December 31, 2017 (dollars in thousands):

	Number of Loans	Pre-Modification	Post-Modification
		Outstanding	Outstanding
		Recorded Investment	Recorded Investment
(dollars in thousands)			
<b>Troubled debt restructurings:</b>			
Commercial	1	\$ 692	\$ 692
Commercial real estate	2	3,007	3,007
Commercial construction	2	6,662	6,662
Residential real estate	1	17	17
Consumer	-	-	-
<b>Total</b>	<u>6</u>	<u>\$ 10,378</u>	<u>\$ 10,378</u>

TDRs as of December 31, 2017 did not increase the ALLL during the year ended December 31, 2017. There were no charge-offs in connection with a loan modification at the time of modification during the year ended December 31, 2017. There were no TDRs for which there was a payment default within twelve months following the modification during the year ended December 31, 2017.

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

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

The following table presents loans by segment modified as troubled debt restructurings that occurred during the year ended December 31, 2016:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
(dollars in thousands)			
<b>Troubled debt restructurings:</b>			
Commercial	19	\$ 22,420	\$ 22,420
Commercial real estate	3	2,155	2,155
Commercial construction	1	1,750	1,750
Residential real estate	-	-	-
Consumer	-	-	-
<b>Total</b>	<b>23</b>	<b>\$ 26,325</b>	<b>\$ 26,325</b>

Included in the above troubled debt restructurings were 15 loans secured by 27 New York City taxi medallions totaling \$18.5 million as of the date of the respective modifications. These loan modifications included interest rate reductions and maturity extensions. All 15 loans were accruing prior to modification, while 14 remained in accrual status post-modification. As of December 31, 2016, the taxi medallion loans that were modified in a troubled debt restructuring in 2016 were transferred to the loans held-for-sale category (along with the 2015 taxi medallion modified troubled debt restructurings) and, concurrently, were put on nonaccrual.

There were no charge-offs in connection with a loan modification at the time of modification during the year ended December 31, 2016. There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ended December 31, 2016.

The following table presents loans by segment modified as troubled debt restructurings that occurred during the year ended December 31, 2015:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
(dollars in thousands)			
<b>Troubled debt restructurings:</b>			
Commercial	48	\$ 78,466	\$ 78,466
Commercial real estate	3	5,049	5,049
Commercial construction	1	661	661
Residential real estate	1	110	110
Consumer	1	4	4
<b>Total</b>	<b>54</b>	<b>\$ 84,290</b>	<b>\$ 84,290</b>

The increase in TDRs was due to loans secured by New York City taxi medallions that were modified during the second quarter of 2015. The modifications consisted of a deferral of principal amortization from approximately 25-30 year amortization to interest-only. There was no extension of the loans' contractual maturity dates, there was no forgiveness of principal, and the interest rates on these loans were increased from approximately 3%-3.25% to 3.75%. These loans were accruing prior to modification and remained in accrual status post-modification.

There were no charge-offs in connection with a loan modification at the time of modification during the year ended December 31, 2015. There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ended December 31, 2015.

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

**Note 6 - Premises and Equipment**

Premises and equipment are summarized as follows:

	Estimated Useful Life (Years)	(dollars in thousands)	
		2017	2016
Land	-	\$ 2,403	\$ 2,403
Buildings	10-25	16,092	16,027
Furniture, fixtures and equipment	3-7	30,077	29,039
Leasehold improvements	10-20	13,775	12,908
Subtotal		62,347	60,377
Less: accumulated depreciation and amortization		40,154	37,700
Subtotal		22,193	22,677
Less: fair value adjustment for acquired leases		(534)	(602)
Total premises and equipment, net		\$ 21,659	\$ 22,075

Depreciation and amortization expense of premises and equipment was \$3.2 million, \$2.7 million and \$2.3 million for 2017, 2016 and 2015, respectively.

**Capital Leases:** As a result of the Merger, the Company acquired a lease agreement for a building under a capital lease. The lease arrangement requires monthly payments through 2028.

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

	(dollars in thousands)	
	2017	2016
Capital Lease	\$ 3,408	\$ 3,422
Less: accumulated amortization	1,526	1,369
	\$ 1,882	\$ 2,053

The following is a schedule by year of future minimum lease payments under the capitalized lease, together with the present value of net minimum lease payments at December 31, 2017 (dollars in thousands):

2018	\$ 294
2019	321
2020	321
2021	321
2022	321
Thereafter	2,056
Total minimum lease payments	3,634
Less amount representing interest	1,000
Present value of net minimum lease payments	\$ 2,634

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

**Note 6 - Premises and Equipment – (continued)**

**Operating Leases:** Occupancy and equipment expense includes rentals for premises and equipment of \$2.3 million in 2017, \$2.5 million in 2016 and \$2.1 million in 2015. At December 31, 2017, the Company was obligated under a number of non-cancelable leases for premises and equipment, many of which provide for increased rentals based upon increases in real estate taxes and the cost of living index. These leases, most of which have renewal provisions, are principally operating leases.

Future minimum lease payments under these leases are as follows (dollars in thousands):

2018	\$ 2,821
2019	2,713
2020	2,382
2021	1,998
2022	1,376
Thereafter	4,981

**Note 7 - Goodwill and Other Intangible Assets**

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

Step zero impairment testing is an assessment of qualitative factors that affect the likelihood of impairment. Based upon management’s review, the Company’s intangible assets were not impaired and there has been no impairment through December 31, 2017. 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:

	2017	2016
	(dollars in thousands)	
Balance, January 1	\$ 145,909	\$ 145,909
Acquired goodwill	-	-
Impairment	-	-
Balance, December 31,	<u>\$ 145,909</u>	<u>\$ 145,909</u>

**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)		
<b>As of December 31, 2017:</b>			
Core deposit intangibles	<u>\$ 6,011</u>	<u>\$ (3,647)</u>	<u>\$ 2,364</u>
<b>As of December 31, 2016:</b>			
Core deposit intangibles	<u>\$ 6,011</u>	<u>\$ (2,923)</u>	<u>\$ 3,088</u>

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

**Note 7 - Goodwill and Other Intangible Assets – continued**

Aggregate amortization expense was \$724,000, \$820,000 and \$917,000 for 2017, 2016 and 2015, respectively. Estimated amortization expense for each of the next five years (dollars in thousands):

2018	\$ 627
2019	531
2020	434
2021	338
2022	241

**Note 8 – Deposits**

*Time Deposits*

As of December 31, 2017 and 2016, the Company's total time deposits were \$1.2 billion and \$968.1 million, respectively. Included in time deposits were brokered time deposits of \$358.7 million and \$294.5 million as of December 31, 2017 and 2016, respectively. As of December 31, 2017, the contractual maturities of these time deposits were as follows (dollars in thousands):

2018	\$ 597,726
2019	447,841
2020	105,531
2021	25,251
2022	3,611
Total	<u>\$1,179,960</u>

The amount of time deposits with balances of \$250,000 or more was \$198.3 million and \$106.5 million as of December 31, 2017 and 2016, respectively. Included in time deposits with balances of \$250,000 or more were brokered time deposits with balances of \$250,000 or more of \$-0- and \$6.6 million as of December 31, 2017 and 2016, respectively.

**Note 9 – FHLB Borrowings**

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

	December 31, 2017		December 31, 2016	
	Amount	Rate	Amount	Rate
	(dollars in thousands)			
Total FHLB borrowings	<u>\$ 670,077</u>	1.76%	<u>\$ 461,280</u>	1.55%
By remaining period to maturity:				
Less than 1 year	\$ 505,077	1.59%	\$ 231,280	1.02%
1 year through less than 2 years	35,000	1.60%	130,000	1.84%
2 years through less than 3 years	85,000	2.65%	35,000	1.60%
3 years through less than 4 years	45,000	2.15%	65,000	2.82%
4 years through 5 years	-	-	-	-
Total borrowings	<u>\$ 670,077</u>	1.76%	<u>\$ 461,280</u>	1.55%

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.



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

**Note 9 – FHLB Borrowings – (continued)**

Three of the FHLB notes (\$2.5 million and \$7.5 million each due April 2, 2018, and \$5.0 million due July 16, 2018) contain a convertible option which allows the FHLB, at quarterly intervals, to convert the fixed convertible advance into replacement funding for the same or lesser principal based on any advance then offered by the FHLB at its current market rate. The Company has the option to repay these advances, if converted, without penalty. The remaining advances are payable at stated maturity, with a prepayment penalty for fixed rate advances. All FHLB advances are fixed rate. The advances at December 31, 2017 were primarily collateralized by approximately \$1.5 billion of commercial mortgage loans, net of required over collateralization amounts, under a blanket lien arrangement. At December 31, 2017 the Company had remaining borrowing capacity of approximately \$829 million with the FHLB.

**Note 10 – Securities Sold under Agreements to Repurchase**

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

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

	2017	2016	2015
	(dollars in thousands)		
Average daily balance during the year	\$ 6,781	\$ 15,000	\$ 22,890
Average interest rate during the year	5.95%	5.95%	5.92%
Maximum month-end balance during the year	\$ 15,000	\$ 15,000	\$ 31,000
Weighted average interest rate during the year	5.95%	5.95%	5.92%

The table below shows the remaining contractual maturity of repurchase agreements by fair value of collateral pledged:

	December 31, 2017				Total
	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	
Repurchase agreements and repurchase-to-maturity transactions:					
U.S. Treasury and agency securities	\$ -	\$ -	\$ -	\$ -	\$ -
Residential mortgage pass-through securities	-	-	-	-	-
Total Borrowings	\$ -	\$ -	\$ -	\$ -	\$ -
Amounts related to repurchase agreements not included in offsetting disclosure in Note 13.					\$ -

	December 31, 2016				Total
	Remaining Contractual Maturity of the Agreements				
	(dollars in thousands)				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	
Repurchase agreements and repurchase-to-maturity transactions:					
U.S. Treasury and agency securities	\$ -	\$ -	\$ -	\$ -	\$ -
Residential mortgage pass-through securities	-	-	-	16,826	16,826
Total Borrowings	\$ -	\$ -	\$ -	\$ 16,826	\$ 16,826
Amounts related to agreements not included in offsetting disclosure in Note 13.					\$ 1,826

The fair value of securities pledged to secure repurchase agreements may decline. The Company manages this risk by having a policy to pledge securities valued at 8% above the gross outstanding balance of the repurchase agreement. Securities sold under agreements to repurchase are secured by securities with a carrying amount of \$0 million and \$16.8 million at year-end 2017 and 2016.

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

**Note 11 - Subordinated Debentures**

During 2003, the Company formed a statutory business trust, which exists for the exclusive purpose of (i) issuing Trust Securities representing undivided beneficial interests in the assets of the Trust; (ii) investing the gross proceeds of the Trust securities in junior subordinated deferrable interest debentures (subordinated debentures) of the Company; and (iii) engaging in only those activities necessary or incidental thereto. On December 19, 2003, Center Bancorp Statutory Trust II, a statutory business trust and wholly-owned subsidiary of the Parent Corporation issued \$5.0 million of, MMCapS capital securities to investors due on January 23, 2034. The capital securities presently qualify as Tier 1 capital. The trust loaned the proceeds of this offering to the Company and received in exchange \$5.2 million of the Parent Corporation's subordinated debentures. The subordinated debentures are redeemable in whole or in part prior to maturity. The floating interest rate on the subordinate debentures is three-month LIBOR plus 2.85% and reprices quarterly. The rate at December 31, 2017 was 4.23%. These subordinated debentures and the related income effects are not eliminated in the consolidated financial statements as the statutory business trust is not consolidated in accordance with FASB ASC 810-10. Distributions on the subordinated debentures owned by the subsidiary trust have been classified as interest expense in the Consolidated Statements of Income.

The following table summarizes the mandatory redeemable trust preferred securities of the Company's Statutory Trust II at December 31, 2017 and December 31, 2016.

<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	01/23/2034	01/23/2009

In June 2015, the Parent Corporation issued \$50.0 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "Notes"). The Notes are non-callable for five years, have a stated maturity of July 1, 2025, and bear interest at a fixed rate of 5.75% per year, from and including June 30, 2015 to, but excluding July 1, 2020. From and including July 1, 2020 to the maturity date or early redemption date, the interest rate will reset quarterly to a level equal to the then current three-month LIBOR rate plus 393 basis points. As of December 31, 2017, unamortized costs related to the debt issuance were \$456,000.

**Note 12 - Income Taxes**

The current and deferred amounts of income tax expense for 2017, 2016 and 2015 are as follows:

	2017	2016	2015
	(dollars in thousands)		
<b><u>Current:</u></b>			
Federal	\$ 21,090	\$ 10,173	\$ 22,512
State	505	(366)	907
Subtotal	21,595	9,807	23,419
<b><u>Deferred:</u></b>			
Federal	3,876	2,682	(3,835)
State	(177)	(713)	342
Subtotal	3,699	1,969	(3,493)
Income tax expense	\$ 25,294	\$ 11,776	\$ 19,926

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

**Note 12 - Income Taxes – (continued)**

The Tax Reform Act was signed into law on December 22, 2017. Pursuant to the Securities and Exchange Commission Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), given the amount and complexity of the changes in tax law resulting from the Tax Reform Act, the Company has not finalized the accounting for the income tax effects of the Tax Reform Act. This includes the re-measurement of deferred taxes. The impact of the Tax Reform Act may differ from this estimate, during the one-year measurement period due to, among other things, further refinement of the Company’s calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of the Tax Reform Act. As a result of the Tax Reform Act, the Company recorded a tax charge of approximately \$5.6 million primarily due to a re-measurement of deferred tax assets and liabilities.

Actual income tax expense differs from the tax computed based on pre-tax income and the applicable statutory federal tax rate for the following reasons:

	2017	2016	2015
	(dollars in thousands)		
Income before income tax expense	\$ 68,514	\$ 42,858	\$ 61,237
Federal statutory rate	35%	35%	35%
Computed “expected” Federal income tax expense	23,980	15,000	21,433
State tax, net of federal tax benefit	213	(701)	812
Impact of Tax Reform Act	5,623	-	-
Bank owned life insurance	(1,113)	(896)	(624)
Tax-exempt interest and dividends	(2,123)	(1,714)	(1,584)
Tax benefits from stock based compensation	(348)	-	-
Other, net	(938)	87	(111)
Income tax expense	<u>\$ 25,294</u>	<u>\$ 11,776</u>	<u>\$ 19,926</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax asset and deferred tax liability at December 31, 2017 and 2016 are presented in the following table:

	2017	2016
	(dollars in thousands)	
<b>Deferred tax assets:</b>		
Allowance for loan losses	8,848	10,374
Purchase accounting	2,310	4,881
Pension actuarial losses	1,647	2,439
New Jersey net operating loss	1,310	1,004
Deferred compensation	1,184	2,277
Unrealized losses on securities and swaps	483	-
Deferred loan costs, net of fees	474	613
Accrued rent	459	617
Capital lease	211	139
Nonaccrual interest	158	470
Other	7	14
Total deferred tax assets	<u>\$ 17,091</u>	<u>\$ 22,828</u>
<b>Deferred tax liabilities:</b>		
Employee benefit plans	\$ (1,501)	\$ (2,275)
Depreciation	(434)	(1,039)
Prepaid expenses	(174)	(345)
Market discount accretion	(60)	(235)
Unrealized gains on securities and swaps	(224)	(449)
Other	(28)	(33)
Total deferred tax liabilities	<u>(2,421)</u>	<u>(4,376)</u>
Net deferred tax assets	<u>\$ 14,670</u>	<u>\$ 18,452</u>

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

**Note 12 - Income Taxes – (continued)**

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets for state purposes is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible, while for Federal purposes the deferred tax assets can also be realized through tax carrybacks. Management considers the scheduled reversal of deferred tax liabilities, the projected future taxable income, and tax planning strategies in making this assessment. During 2017 and 2016, 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 2014 tax return year and forward. The Company's state income tax returns are generally open from the 2013 and later tax return years based on individual state statutes of limitations.

**Note 13 – Offsetting Assets and Liabilities**

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

The Company also entered into an agreement to sell securities subject to an obligation to repurchase the same or similar securities, referred to as a repurchase agreement. Under this agreement, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated statement of condition, while the securities underlying the repurchase agreements remain in the respective investment securities account, therefore there is no offsetting or netting of the investment securities assets with the repurchase agreement liability. The following table presents information about financial instruments that are eligible for offset as of December 31, 2017 and December 31, 2016:

	Gross Amounts Recognized	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross Amounts Not Offset		
				Financial Instruments Recognized	Cash or Financial Instrument Collateral	Net Amount
<b>December 31, 2017</b>						
<b>Assets:</b>						
Interest rate swaps	\$ 798	\$ -	\$ 798	\$ -	\$ -	\$ 798
<b>Liabilities:</b>						
Repurchase agreements	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>December 31, 2016</b>						
<b>Assets:</b>						
Interest rate swaps	\$ 88	\$ -	\$ 88	\$ -	\$ -	\$ 88
<b>Liabilities:</b>						
Repurchase agreements	\$ 15,000	\$ -	\$ 15,000	\$ -	\$ 15,000	\$ -

For the year ended December 31, 2017 and 2016 there was no financial collateral pledged to our interest rate swaps. As these swap positions were not within the contractually agreed upon collateral requirement there was no collateral pledged to, or from, the respective counterparties.

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

**Note 14 - Commitments, Contingencies and Concentrations of Credit Risk**

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

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

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

The following table provides a summary of financial instruments with off-balance sheet risk at December 31, 2017 and 2016:

	2017	2016
	(dollars in thousands)	
Commitments under commercial loans and lines of credit	\$ 344,142	\$ 267,865
Home equity and other revolving lines of credit	44,483	52,788
Outstanding commercial mortgage loan commitments	254,710	263,395
Standby letters of credit	34,114	18,331
Overdraft protection lines	688	733
Total	<u>\$ 678,137</u>	<u>\$ 603,112</u>

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

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

Loans to principal officers, directors, and their affiliates during the years ended December 31, 2017 and 2016 were as follows:

	2017	2016
	(dollars in thousands)	
Balance, January 1,	\$ 49,710	\$ 39,232
New loans	11,089	25,274
Repayments	(4,499)	(14,796)
Balance, December 31,	<u>\$ 56,300</u>	<u>\$ 49,710</u>

Deposits from principal officers, directors, and their affiliates at December 31, 2017 and 2016 were \$42.4 million and \$47.7 million respectively.

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

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

**Note 16 - Stockholders' Equity and Regulatory Requirements**

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing the Basel Committee on Banking Supervisions' capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2017, 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 adequately capitalized, 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, 2017 and 2016, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

The following is a summary of the Bank's and the Parent Corporation's actual capital amounts and ratios as of December 31, 2017 and 2016, 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)			
<b>December 31, 2017</b>						
Leverage (Tier 1) capital	\$ 468,899	9.84%	\$ 190,665	4.00%	\$ 238,332	5.00%
Risk-Based Capital:						
CET 1	\$ 468,899	10.21%	\$ 206,721	4.50%	\$ 298,597	6.50%
Tier 1	468,899	10.21%	275,628	6.00%	367,504	8.00%
Total	500,647	10.90%	367,504	8.00%	459,379	10.00%
<b>December 31, 2016</b>						
Leverage (Tier 1) capital	\$ 434,067	10.34%	\$ 167,996	4.00%	\$ 209,995	5.00%
Risk-Based Capital:						
CET 1	\$ 434,067	10.98%	\$ 177,944	4.50%	\$ 257,030	6.50%
Tier 1	434,067	10.98%	237,258	6.00%	316,344	8.00%
Total	459,811	11.63%	316,344	8.00%	395,430	10.00%

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

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

			Minimum Capital Adequacy		For Classification as Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
The Company	(dollars in thousands)					
<b>December 31, 2017</b>						
Leverage (Tier 1) capital	\$ 425,407	8.92%	\$ 190,728	4.00%	N/A	N/A
<b>Risk-Based Capital:</b>						
CET 1	\$ 420,252	9.15%	\$ 206,742	4.50%	N/A	N/A
Tier 1	425,407	9.26%	275,656	6.00%	N/A	N/A
Total	507,155	11.04%	367,542	8.00%	N/A	N/A
<b>December 31, 2016</b>						
Leverage (Tier 1) capital	\$ 390,205	9.29%	\$ 168,048	4.00%	N/A	N/A
<b>Risk-Based Capital:</b>						
CET 1	\$ 385,050	9.74%	\$ 177,967	4.50%	N/A	N/A
Tier 1	390,205	9.87%	237,289	6.00%	N/A	N/A
Total	465,949	11.78%	316,386	8.00%	N/A	N/A

The new Basel III rules require a “capital conservation buffer,” for both the Company and the Bank. When fully phased in on January 1, 2019, each of the Company and the Bank will be required to maintain a 2.5% capital conservation buffer, above and beyond the capital levels otherwise required under applicable regulation. The implementation of this capital conservation buffer began on January 1, 2016 at a level of 0.625%, and will increase by 0.625% on each subsequent January 1 until it reaches 2.5% on January 1, 2019. Under this guidance banking institutions with a CET1, Tier 1 Capital Ratio and Total Risk Based Capital Ratio above the minimum regulatory adequate capital ratios but below the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers, based on the amount of the shortfall.

As of December 31, 2017 both the Company and Bank satisfy the capital conservation buffer requirements applicable to them. The lowest ratio at the Company is the Total Risk Based Capital Ratio which was 1.79% above the minimum buffer ratio and, at the Bank, the lowest ratio was the Total Risk Based Capital Ratio which was 1.65% above the minimum buffer ratio.

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

**Note 17 - Comprehensive Income**

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

Details about Accumulated Other Comprehensive Income Components	Amounts Reclassified from Accumulated Other Comprehensive Income			Affected Line Item in the Consolidated Statements of Income
	Twelve Months Ended December 31,			
(dollars in thousands)	2017	2016	2015	
Sale of investment securities available-for-sale	\$ 1,596	\$ 4,234	\$ 3,931	Net gains on sale of investment securities
	(579)	(1,682)	(1,564)	Income tax expense
	1,017	2,552	2,367	
Amortization of unrealized holding (losses) gains on securities transferred from available-for-sale to held-to-maturity	-	(1,986)	(220)	Interest income
	-	813	90	Income tax benefit
	-	(1,173)	(130)	
Amortization of pension plan net actuarial losses	(412)	(407)	(433)	Salaries and employee benefits
	169	165	177	Income tax benefit
	(243)	(242)	(256)	
Total reclassification	<u>\$ 774</u>	<u>\$ 1,137</u>	<u>\$ 1,981</u>	

Accumulated other comprehensive loss at December 31, 2017 and 2016 consisted of the following:

	2017	2016
	(dollars in thousands)	
Investment securities available-for-sale, net of tax	\$ (902)	\$ 933
Cash flow hedge, net of tax	472	52
Unamortized component of securities transferred from available-for-sale to held-to-maturity, net of tax	-	-
Defined benefit pension and post-retirement plans, net of tax	(3,589)	(3,831)
Total	<u>\$ (4,019)</u>	<u>\$ (2,846)</u>

Included in AOCI as of December 31, 2017 is an estimated \$747,000 of stranded tax effects related to the change in the U.S federal corporate income tax rate in the 2017 Tax Cuts and Jobs Act.



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

**Note 18 - Pension and Other Benefits**

**Defined Benefit Plans**

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

The following table sets forth changes in projected benefit obligation, changes in fair value of plan assets, funded status, and amounts recognized in the consolidated statements of condition for the Company's pension plans at December 31, 2017 and 2016.

	2017	2016
	(dollars in thousands)	
<b>Change in Benefit Obligation:</b>		
Projected benefit obligation at January 1,	\$ 12,682	\$ 13,068
Interest cost	478	514
Actuarial (gain) loss	642	216
Benefits paid	-	-
Settlements	(910)	(1,116)
Projected benefit obligation at December 31,	<u>\$ 12,892</u>	<u>\$ 12,682</u>
<b>Change in Plan Assets:</b>		
Fair value of plan assets at January 1,	\$ 12,002	\$ 10,287
Actual return on plan assets	1,517	831
Employer contributions	-	2,000
Benefits paid	-	-
Settlements	(910)	(1,116)
Fair value of plan assets at December 31,	<u>\$ 12,609</u>	<u>\$ 12,002</u>
Funded status	<u>\$ (283)</u>	<u>\$ (680)</u>

The accumulated benefit obligation was \$12.9 million and \$12.7 million as of the year ended December 31, 2017 and 2016, respectively.

Amounts recognized as a component of accumulated other comprehensive loss as of year-end that have not been recognized as a component of the net periodic pension expense for the plan are presented in the following table. The Company expects to recognize approximately \$366,000 of the net actuarial loss reported in the following table as of December 31, 2017 as a component of net periodic pension expense during 2018.

	2017	2016
	(dollars in thousands)	
Net actuarial loss recognized in accumulated other comprehensive income	<u>\$ 5,860</u>	<u>\$ 6,272</u>

The net periodic pension expense and other comprehensive income (before tax) for 2017, 2016 and 2015 includes the following:

	2017	2016	2015
	(dollars in thousands)		
Interest cost	\$ 478	\$ 514	\$ 519
Expected return on plan assets	(640)	(617)	(562)
Net amortization	412	407	433
Recognized settlement loss	-	-	650
Total net periodic pension expense	<u>\$ 250</u>	<u>\$ 304</u>	<u>\$ 1,040</u>
Total gain recognized in other comprehensive income	(410)	(405)	(918)
Total recognized in net periodic expense and other comprehensive income (before tax)	<u>\$ (160)</u>	<u>\$ (101)</u>	<u>\$ 122</u>

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

**Note 18 – Pension and Other Benefits – (continued)**

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

	2017	2016	2015
Discount rate	3.41%	3.88%	4.06%
Rate of compensation increase	N/A	N/A	N/A

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

	2017	2016	2015
	(dollars in thousands)		
Discount rate	3.88%	4.06%	3.76%
Expected long-term return on plan assets	5.50%	5.50%	5.50%
Rate of compensation increase	N/A	N/A	N/A

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

**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, 2017 and 2016, target allocation, and expected long-term rate of return by asset are as follows:

	Target Allocation	% of Plan Assets – Year Ended 2017	% of Plan Assets – Year Ended 2016	Weighted Average Expected Long-Term Rate of Return
<b>Equity Securities</b>				
Domestic	42%	41%	44%	3.2%
International	10%	8%	8%	0.7%
Debt and/or fixed income securities	46%	49%	47%	1.6%
Cash and other alternative investments, including real estate funds, hedge funds and equity structured notes	2%	2%	1%	0%
<b>Total</b>	<u>100%</u>	<u>\$ 100%</u>	<u>\$ 100%</u>	<u>\$ 5.5%</u>

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

**Note 18 - Pension and Other Benefits – (continued)**

The fair values of the Company's pension plan assets at December 31, 2017 and 2016, by asset class, are as follows:

<u>Asset Class</u>	<u>December 31,</u> <u>2017</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices</u> <u>in Active</u> <u>Markets for</u> <u>Identical Assets</u> <u>(Level 1)</u>	<u>Significant</u> <u>Other</u> <u>Observable</u> <u>Inputs</u> <u>(Level 2)</u>	<u>Significant</u> <u>Unobservable</u> <u>Inputs</u> <u>(Level 3)</u>
		(dollars in thousands)		
Cash	\$ 175	\$ 175	\$ -	\$ -
Equity securities:				
U.S. companies	5,175	5,175	-	-
International companies	1,056	1,056	-	-
Debt and/or fixed income securities	6,139	6,139		
Real estate funds	64	64	-	-
<b>Total</b>	<b>\$ 12,609</b>	<b>\$ 12,609</b>	<b>\$ -</b>	<b>\$ -</b>

<u>Asset Class</u>	<u>December 31,</u> <u>2016</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices</u> <u>in Active</u> <u>Markets for</u> <u>Identical Assets</u> <u>(Level 1)</u>	<u>Significant</u> <u>Other</u> <u>Observable</u> <u>Inputs</u> <u>(Level 2)</u>	<u>Significant</u> <u>Unobservable</u> <u>Inputs</u> <u>(Level 3)</u>
		(dollars in thousands)		
Cash	\$ 19	\$ 19	\$ -	\$ -
Equity securities:				
U.S. companies	5,221	5,221	-	-
International companies	1,005	1,005	-	-
Debt and/or fixed income securities	5,689	5,689		
Real estate funds	68	68	-	-
<b>Total</b>	<b>\$ 12,002</b>	<b>\$ 12,002</b>	<b>\$ -</b>	<b>\$ -</b>

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

**Note 18 - Pension and Other Benefits – (continued)**

***Fair Value of Plan Assets***

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

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

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

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

***Cash Flows***

***Contributions***

The Bank expects to contribute \$2,000,000 to its Pension Trust in 2018.

***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):

2018	\$ 719
2019	729
2020	728
2021	739
2022	728
2023-2027	3,559

***401(k) Benefit Plan***

The Company maintains a 401(k) employee savings plan to provide for defined contributions which covers substantially all employees of the Company. Beginning with the 2013 Plan Year, the Plan was amended to provide for a 3% non-elective safe harbor contribution for all participants. For 2017, 2016 and 2015, employer contributions amounted to \$383,000, \$351,000 and \$338,000, respectively.

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

**Note 19 - Stock Based Compensation**

The Company's stockholders approved the 2017 Equity Compensation Plan ("the Plan") on May 23, 2017. The Plan eliminates all remaining issuable shares under previous plans and is the only outstanding plan as of December 31, 2017. 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, 2017 are 750,000. The Company intends to issue all shares under the Plan in the form of newly issued shares.

Restricted stock and option awards 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 awards 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 and performance units do not.

All awards are issued at fair value of the underlying shares at the grant date. The Company expenses the cost of the awards ratably over the vesting period. Forfeiture rates are not estimated but are handled on a case-by-case basis.

No options were issued during the year ended December 31, 2017 or 2016. An aggregate of 57,164 restricted shares and 24,891 performance units were granted and awarded, respectively, during the year ended December 31, 2017 compared to 72,920 and 64,434 granted and awarded, respectively, for the year ended December 31, 2016.

Option activity under the Company's option plans as of and for the year ended December 31, 2017 were as follows:

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2016	358,367	\$ 6.26		
Granted	-	-		
Exercised	(66,389)	6.61		
Forfeited/cancelled/expired	-	-		
Outstanding at December 31, 2017	<u>291,978</u>	<u>\$ 6.18</u>	<u>1.97</u>	<u>\$ 5,714,355</u>
Exercisable at December 31, 2017	<u>288,446</u>	<u>\$ 6.08</u>	<u>1.93</u>	<u>\$ 5,673,725</u>

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, 2017 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, 2017. This amount changes based on the fair market value of the Parent Corporation's stock.

Information related to stock option exercises during 2017:	<u>2017</u>
Intrinsic value of options exercised	\$ 1,270,521
Cash received from options exercised	417,000
Tax benefit realized from options exercised	264,000

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

**Note 19 - Stock Based Compensation – (continued)**

The aggregate intrinsic value of exercised options above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the date of exercise and the exercise price, multiplied by the number of in-the-money options) of all options that were exercised during the year ending December 31, 2017. The tax benefit is calculated on any non-qualified options exercised during the period using a 36% tax rate.

The below table represents information regarding restricted shares currently outstanding at December 31, 2017:

	Nonvested Shares	Weighted- Average Grant Date Fair Value
Nonvested at December 31, 2016	111,273	\$ 16.81
Granted	57,164	23.82
Vested	(65,359)	16.49
Forfeited/cancelled/expired	-	-
Nonvested at December 31, 2017	103,078	\$ 20.41

As of December 31, 2017, there was \$1,073,000 of total unrecognized compensation cost related to nonvested restricted shares granted under the plans. The cost is expected to be recognized over a weighted average period of 1.4 years.

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

	Units (expected)	Units (maximum)	Weighted Average Grant Date Fair Value
Unearned at December 31, 2016	151,572	189,455	\$ 18.47
Awarded	24,891	37,336	22.75
Forfeited	-	-	-
Adjustments	(25,269)	-	18.47
Unearned at December 31, 2017	151,194	226,791	\$ 19.19

At December 31, 2017, compensation cost of approximately \$836,000 related to nonvested awards not yet recognized is expected to be recognized over a weighted-average period of 0.7 years.

**Note 20 - Dividends and Other Restrictions**

Certain restrictions, including capital requirements, exist on the availability of undistributed net profits of the Bank for the future payment of dividends to the Parent Corporation. A dividend may not be paid if it would impair the capital of the Bank. At December 31, 2017, approximately \$133.1 million was available for payment of dividends based on regulatory guidelines.

**Note 21 – Derivatives**

The Company utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swap does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

Interest rate swaps were entered into on April 13, 2017, August 24, 2015, October 15, 2014 and December 30, 2014, each with a respective notional amount of \$25.0 million and were designated as a cash flow hedge of a Federal Home Loan Bank advance. The swaps were determined to be fully effective during the period presented and therefore no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swaps is recorded in other assets (liabilities) with changes in fair value recorded in other comprehensive income (loss). The amount included in accumulated other comprehensive income (loss) would be reclassified to current earnings should the hedges no longer be considered effective. The Company expects the hedges to remain fully effective during the remaining term of the swaps.

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

**Note 21 – Derivatives – (continued)**

Summary information about the interest rate swap designated as a cash flow hedges as of year-end is as follows (dollars in thousands):

	December 31, 2017	December 31, 2016
Notional amount	\$ 100,000	\$ 75,000
Weighted average pay rates	1.66%	1.59%
Weighted average receive rates	1.23%	0.69%
Weighted average maturity	2.4 years	2.8 years
Fair value	\$ 798	\$ 88

Interest expense recorded on these swap transactions totaled approximately \$406,200, \$668,300, and \$763,500 during 2017, 2016, and 2015 is reported as a component of interest expense on FHLB Advances.

**Cash Flow Hedge**

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

(dollars in thousands)	2017		
	Amount of gain (loss) recognized in OCI (Effective Portion)	Amount of gain (loss) reclassified from OCI to interest income	Amount of gain (loss) recognized in other Noninterest income (Ineffective Portion)
Interest rate contracts	\$ 710	\$ -	\$ -

(dollars in thousands)	2016		
	Amount of gain (loss) recognized in OCI (Effective Portion)	Amount of gain (loss) reclassified from OCI to interest income	Amount of gain (loss) recognized in other Noninterest income (Ineffective Portion)
Interest rate contracts	\$ 219	\$ -	\$ -

The following table reflects the cash flow hedges included in the Consolidated Balance Sheets as of December 31, 2017 and December 31, 2016:

(dollars in thousands)	2017		2016	
	Notional Amount	Fair Value	Notional Amount	Fair Value
<b>Included in other assets/(liabilities):</b>				
Interest rate swaps related to FHLB Advances	\$ 100,000	\$ 798	\$ 75,000	\$ 88

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, 2017, December 31, 2016 and December 31, 2015.

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

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

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

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

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

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

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

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

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

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

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

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a recurring basis at December 31, 2017 and December 31, 2016:

*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**

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

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2017 and December 31, 2016 are as follows:

	<u>December 31, 2017</u>			
	<u>Fair Value Measurements at Reporting Date Using</u>			
	<u>Quoted Prices</u>		<u>Significant</u>	
	<u>in Active</u>		<u>Other</u>	<u>Significant</u>
	<u>Markets for</u>		<u>Observable</u>	<u>Unobservable</u>
	<u>Identical</u>		<u>Inputs</u>	<u>Inputs</u>
	<u>Assets</u>		<u>(Level 2)</u>	<u>(Level 3)</u>
	<u>(Level 1)</u>		<u>(Level 2)</u>	<u>(Level 3)</u>
	(dollars in thousands)			
<b>Recurring fair value measurements:</b>				
<b>Assets</b>				
<b>Investment securities:</b>				
<u>Available-for-sale:</u>				
Federal agency obligations	\$ 56,022	\$ -	\$ 56,022	\$ -
Residential mortgage pass-through securities	181,891	-	181,891	-
Commercial mortgage pass-through securities	4,054	-	4,054	-
Obligations of U.S. states and political subdivision	131,128	-	121,496	9,632
Trust preferred securities	4,671	-	4,671	-
Corporate bonds and notes	29,693	-	29,693	-
Asset-backed securities	12,050	-	12,050	-
Certificates of deposit	625	-	625	-
Equity securities	11,728	11,728	-	-
Other securities	3,422	3,422	-	-
<b>Total available-for-sale</b>	<b>435,284</b>	<b>15,150</b>	<b>410,502</b>	<b>9,632</b>
Derivatives	798	-	798	-
<b>Total assets</b>	<b>\$ 436,082</b>	<b>\$ 15,150</b>	<b>\$ 411,300</b>	<b>\$ 9,632</b>

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

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

	December 31, 2016			
	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)			
<b>Recurring fair value measurements:</b>				
<b>Assets</b>				
<b>Investment securities:</b>				
<b>Available-for-sale:</b>				
Federal agency obligations	\$ 52,837	\$ -	\$ 52,837	\$ -
Residential mortgage pass-through securities	72,497	-	72,497	-
Commercial mortgage pass-through securities	4,209	-	4,209	-
Obligations of U.S. states and political subdivision	150,605	-	132,387	18,218
Trust preferred securities	5,666	-	5,666	-
Corporate bonds and notes	36,928	-	36,928	-
Asset-backed securities	14,583	-	14,583	-
Certificates of deposit	983	-	983	-
Equity securities	11,710	11,710	-	-
Other securities	3,272	3,272	-	-
<b>Total available-for-sale</b>	<b>353,290</b>	<b>14,982</b>	<b>320,090</b>	<b>18,218</b>
Derivatives	88	-	88	-
<b>Total assets</b>	<b>\$ 353,378</b>	<b>\$ 14,982</b>	<b>\$ 320,178</b>	<b>\$ 18,218</b>

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2017 and 2016.

**Assets Measured at Fair Value on a Non-Recurring Basis**

The Company may be required periodically to measure certain assets at fair value on a non-recurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of lower of cost or fair value accounting or impairment write-downs of individual assets. The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a non-recurring basis at December 31, 2017 and December 31, 2016:

*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. Management obtains quotes or bids on all or part of these loans directly from the purchasing financial institutions (Level 2).

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

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

Other loans held-for-sale are carried at the lower of aggregate cost or estimated fair value. A portion of these loans, taxi medallion loans, have no material observable trading in any market. The approach to determining fair value involved several steps, including a detailed collateral analysis of the underlying medallions, performance projections for individual loans, discounted cash flow modeling and consideration of indicative bids, which at December 31, 2016 did not necessarily contemplate whole loan sales (Level 3).

*Impaired Loans*

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

For assets measured at fair value on a non-recurring basis, the fair value measurements at December 31, 2017 and December 31, 2016 are as follows:

	December 31, 2017	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)
<u>Assets measured at fair value on a nonrecurring basis:</u>				
Impaired loans:		(dollars in thousands)		
Commercial real estate	\$ 1,094	\$ -	\$ -	\$ 1,094

	December 31, 2016	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)
<u>Assets measured at fair value on a nonrecurring basis:</u>				
Impaired loans:		(dollars in thousands)		
Commercial real estate	\$ 1,099	\$ -	\$ -	\$ 1,099

Loans held-for-sale:				
Commercial	70,105	-	4,509	65,596
Commercial real estate	7,712	-	7,712	-

Impaired Loans - Collateral dependent impaired loans at December 31, 2017 that required a valuation allowance were \$1.1 million with a related valuation allowance of \$39 thousand, compared to \$1.2 million with a related valuation allowance of \$0.1 million at December 31, 2016.

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

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

**Assets Measured With Significant Unobservable Level 3 Inputs**

*Recurring basis*

The tables below present a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2017 and year ended December 31, 2016:

	Municipal Securities
	(dollars in thousands)
Beginning balance, January 1, 2017	\$ 18,218
Principal paydowns	(8,586)
Ending balance, December 31, 2017	\$ 9,632
	Municipal Securities
	(dollars in thousands)
Beginning balance, January 1, 2016	\$ -
Other <sup>(1)</sup>	18,335
Principal paydowns	(117)
Ending balance, December 31, 2016	\$ 18,218

(1) Includes transfers from held-to-maturity to available-for-sale designation

The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a recurring basis at December 31, 2017 and December 31, 2016. The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 hierarchy.

December 31, 2017

	Fair Value	Valuation Techniques	Unobservable Input	Range
		(dollars in thousands)		
Securities available-for-sale:				
Municipal securities	\$ 9,632	Discounted cash flows	Discount rate	2.9%

December 31, 2016

	Fair Value	Valuation Techniques	Unobservable Input	Range
		(dollars in thousands)		
Securities available-for-sale:				
Municipal securities	\$ 18,218	Discounted cash flows	Discount rate	2.8%

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

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

*Non-recurring basis*

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

December 31, 2017

	Fair Value	Valuation Techniques	Unobservable Input	Range (weighed average)
(dollars in thousands)				
<b>Impaired loans:</b>				
Commercial real estate	\$ 1,094	Appraisals of collateral value	Comparable sales	0% - 10% (5%)

December 31, 2016

	Fair Value	Valuation Techniques (weightings)	Unobservable Input	Range (weighed average)
(dollars in thousands)				
<b>Impaired loans:</b>				
Commercial real estate	\$ 1,099	Appraisals of collateral value	Comparable sales	0% - 15% (6%)
<b>Loans held-for-sale:</b>				
Commercial taxi medallion loans	\$ 65,596	Market approach (70%)	Indications under securitized transactions expressed as a price to unpaid principal balance	40 - 100 (59)
		Discounted cash flows (30%)	Discount Rate	14%

**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.

**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.

**Investment Securities Held-to-Maturity.** The fair value of the Company's investment securities held-to-maturity was primarily measured using information from a third-party pricing service. If quoted prices were not available, fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. In cases where there may be limited or less transparent information provided by the Company's third-party pricing service, fair value may be estimated by the use of secondary pricing services or through the use of non-binding third-party broker quotes.

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

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

**Loans.** The fair value of the Company's loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans were segregated by types such as commercial, residential and consumer loans. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price and therefore, while permissible for presentation purposes under ASC 825-10, do not conform to ASC 820-10.

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

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

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

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

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

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of December 31, 2017 and December 31, 2016:

	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(dollars in thousands)					
<b>December 31, 2017</b>					
Financial assets:					
Cash and due from banks	\$ 149,582	\$ 149,582	\$ 149,582	\$ -	\$ -
Investment securities available-for-sale	435,284	435,284	15,150	410,502	9,632
Restricted investment in bank stocks	33,497	n/a	n/a	n/a	n/a
Loans held-for-sale	24,845	24,845	-	370	24,475
Net loans	4,139,708	4,118,542	-	-	4,118,542
Derivatives	798	798	-	798	-
Accrued interest receivable	15,470	15,470	-	1,900	13,570
Financial liabilities:					
Noninterest-bearing deposits	776,843	776,843	776,843	-	-
Interest-bearing deposits	3,018,285	3,018,285	1,842,151	1,176,134	-
Borrowings	670,077	669,680	-	669,680	-
Subordinated debentures	54,699	57,340	-	57,340	-
Accrued interest payable	3,707	3,707	-	3,707	-
<b>December 31, 2016</b>					
Financial assets:					
Cash and due from banks	\$ 200,399	\$ 200,399	\$ 200,399	\$ -	\$ -
Investment securities available-for-sale	353,290	353,290	14,982	320,090	18,218
Restricted investment in bank stocks	24,310	n/a	n/a	n/a	n/a
Loans held-for-sale	78,005	78,005	-	12,409	65,596
Net loans	3,450,088	3,462,138	-	-	3,462,138
Derivatives	88	88	-	88	-
Accrued interest receivable	12,965	12,965	-	2,026	10,939
Financial liabilities:					
Noninterest-bearing deposits	694,977	694,977	694,977	-	-
Interest-bearing deposits	2,649,294	2,649,717	1,681,044	968,673	-
Borrowings	476,280	478,286	-	478,286	-
Subordinated debentures	54,534	55,901	-	55,901	-
Accrued interest payable	4,142	4,142	-	4,142	-

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

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

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

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

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

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

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

**Note 23 - Parent Corporation Only Financial Statements**

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



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

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

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

Condensed Statements of Condition

	At December 31,	
	2017	2016
(dollars in thousands)		
<b>ASSETS</b>		
Cash and cash equivalents	\$ 7,506	\$ 7,008
Investment in subsidiaries	614,083	580,048
Securities available-for-sale	779	730
Other assets	322	426
Total assets	<u>\$ 622,690</u>	<u>\$ 588,212</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Other liabilities	\$ 2,554	\$ 2,646
Subordinated debentures	54,699	54,534
Stockholders' equity	565,437	531,032
Total liabilities and stockholders' equity	<u>\$ 622,690</u>	<u>\$ 588,212</u>

Condensed Statements of Income

	For Years Ended December 31,		
	2017	2016	2015
(dollars in thousands)			
<b>Income:</b>			
Dividend income from subsidiaries	\$ 13,000	\$ 12,400	\$ 10,537
Other income	13	8	7
Total Income	13,013	12,408	10,544
Expenses	(3,251)	(3,252)	(1,705)
Income before equity in undistributed earnings of subsidiaries	9,762	9,156	8,839
Equity in undistributed earnings of subsidiaries	33,458	21,926	32,472
Net Income	<u>\$ 43,220</u>	<u>\$ 31,082</u>	<u>\$ 41,311</u>

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

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

Condensed Statements of Cash Flows

	For Years Ended December 31		
	2017	2016	2015
	(dollars in thousands)		
<b>Cash flows from operating activities:</b>			
Net income	\$ 43,220	\$ 31,082	\$ 41,311
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiary	(33,458)	(21,926)	(32,472)
Increase in other assets	269	2,023	(820)
Increase (decrease) in other liabilities	(151)	544	(752)
Net cash provided by operating activities	<u>9,880</u>	<u>11,723</u>	<u>7,267</u>
<b>Cash flows from investing activities:</b>			
Purchase of available-for-sale securities	(7)	-	-
Capital infusion to subsidiary	-	(38,439)	(35,000)
Net cash used in investing activities	<u>(7)</u>	<u>(38,439)</u>	<u>(35,000)</u>
<b>Cash flows from financing activities:</b>			
Proceeds from subordinated debt	-	-	50,000
Cash dividends on common stock	(9,612)	(9,067)	(8,996)
Cash dividends on preferred stock	-	(22)	(112)
Issuance cost of common stock	(180)	-	-
Secondary offering of common stock	-	38,439	-
Redemption of preferred stock	-	(11,250)	-
Proceeds from exercise of stock options	417	767	1,424
Net cash used in financing activities	<u>(9,375)</u>	<u>18,867</u>	<u>42,316</u>
Decrease in cash and cash equivalents	498	(7,849)	14,583
Cash and cash equivalents at January 1,	7,008	14,857	274
Cash and cash equivalents at December 31,	<u>\$ 7,506</u>	<u>\$ 7,008</u>	<u>\$ 14,857</u>

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

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

	2017			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	(dollars in thousands, except per share data)			
Total interest income	\$ 50,211	\$ 46,338	\$ 43,691	\$ 41,084
Total interest expense	10,403	9,319	8,590	7,943
Net interest income	39,808	37,019	35,101	33,141
Provision for loan losses	2,000	1,450	1,450	1,100
Total other income, net of securities gains	2,024	1,756	1,422	1,406
Net securities gains	-	-	-	1,596
Other expenses	16,566	18,641	25,303	18,249
Income before income taxes	23,266	18,684	9,770	16,794
Income tax expense	12,686	5,607	2,087	4,914
Net income	10,580	13,077	7,683	11,880
Earnings per share:				
Basic	\$ 0.33	\$ 0.41	\$ 0.24	\$ 0.37
Diluted	0.33	0.41	0.24	0.37

	2016			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	(dollars in thousands, except per share data)			
Total interest income	\$ 41,499	\$ 41,178	\$ 40,038	\$ 38,526
Total interest expense	8,092	8,154	7,644	7,206
Net interest income	33,407	33,024	32,394	31,320
Provision for loan losses	25,200	6,750	3,750	3,000
Total other income, net of securities gains	1,573	1,445	1,467	1,202
Net securities gains	-	4,131	103	-
Other expense	15,252	14,551	14,352	14,353
(Loss) income before income taxes	(5,472)	17,299	15,862	15,169
Income tax (benefit) expense	(3,448)	5,443	5,003	4,778
Net income (loss)	(2,024)	11,856	10,859	10,391
Preferred dividends	-	-	-	22
Net income available to common stockholders	\$ (2,024)	\$ 11,856	\$ 10,859	\$ 10,369
(Loss) earnings per share:				
Basic	\$ (0.07)	\$ 0.39	\$ 0.36	\$ 0.35
Diluted	(0.07)	0.39	0.36	0.34

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

Other expenses for the second quarter of 2017 had a notable increase that was mainly attributable to an increase in valuation allowance for our loans held-for-sale. Income taxes for the fourth quarter of 2017 had a notable increase that was mainly attributable to a charge against the Company's deferred tax assets of \$5.6 million due to the impact of Tax Cuts and Jobs Act of 2017.

The provision for loan losses for the fourth quarter 2016 was a notable increase that was mainly attributable to the transfer of the Company's taxi medallion portfolio to loans held-for-sale.

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

**Note 25 – Subsequent Event**

On January 11, 2018, the Parent Corporation issued \$75.0 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the “Notes”). The Notes will bear interest at 5.20% annually from, and including, the date of initial issuance to, but excluding, February 1, 2023, payable semi-annually in arrears. From and including February 1, 2023 through maturity or earlier redemption, the interest rate shall reset quarterly to an interest rate per annum equal to the then current three-month LIBOR rate plus 284 basis points (2.84%) payable quarterly in arrears. If three-month LIBOR is not available for any reason, then the rate for that interest period will be determined by such alternate method as provided in the Supplemental Indenture. Interest on the Notes will be paid on February 1 and August 1 commencing August 1, 2018 to but not including February 1, 2023, and from and including February 1, 2023, on February 1, May 1, August 1, and November 1, of each year to but excluding the stated maturity date, unless in any case previously redeemed.

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

None.

**Item 9A. Controls and Procedures**

**(a) Evaluation of Disclosure Controls and Procedures**

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

Under the supervision and with the participation of its management, including the Company’s Chief Executive Officer and Chief Financial Officer, the Company evaluated the effectiveness of the design and operation of the Company’s disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) and 15d-15(e) as of December 31, 2017. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of such date.

**(b) Management’s Report on Internal Control over Financial Reporting**

The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) of the Exchange Act. The Company’s internal control system is a process designed to provide reasonable assurance to the Company’s management, Board of Directors and shareholders regarding the reliability of financial reporting and the preparation and fair presentation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on our financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As part of the Company’s program to comply with Section 404 of the Sarbanes-Oxley Act of 2002, our management assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2017 (the “Assessment”). In making this Assessment, management used the control criteria framework of the Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission published in its report entitled Internal Control - Integrated Framework (2013). Management’s Assessment included an evaluation of the design of the Company’s internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its Assessment with the Audit Committee.

Based on this Assessment, management determined that, as of December 31, 2017, the Company’s internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP, the independent registered public accounting firm that audited the Company’s consolidated financial statements included in this Annual Report on Form 10-K, has issued an audit report on the Company’s internal control over financial reporting as of December 31, 2017. The report is included in this item under the heading “Report of Independent Registered Public Accounting Firm.”

**(c) Changes in Internal Controls over Financial Reporting**

There have been no changes in the Company’s internal controls over financial reporting that occurred during the Company’s last fiscal quarter to which this report relates that have materially affected, or are reasonable likely to materially affect, the Company’s internal control over financial reporting.

**Item 9B. Other Information**

None.

## PART III

### **Item 10. Directors and Executive Officers of the Registrant**

Information required by this part is included in the definitive Proxy Statement for the Company's 2018 Annual Meeting under the captions "ELECTION OF DIRECTORS" and "SECTION 16(A) BENEFICIAL OWNERSHIP REPORTS COMPLIANCE," each of which is incorporated herein by reference. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2018.

### **Item 11. Executive Compensation**

Information concerning executive compensation is included in the definitive Proxy Statement for the Company's 2018 Annual Meeting under the captions "EXECUTIVE COMPENSATION" and "DIRECTOR COMPENSATION", which is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2018.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information concerning security ownership of certain beneficial owners and management is included in the definitive Proxy statement for the Company's 2018 Annual Meeting under the caption "SECURITY OWNERSHIP OF MANAGEMENT", which is incorporated herein by reference. It is expected that such Proxy statement will be filed with the Securities and Exchange Commission no later than April 30, 2018.

### **Item 13. Certain Relationships and Related Transactions**

Information concerning certain relationships and related transactions is included in the definitive Proxy Statement for the Company's 2018 Annual Meeting under the caption "INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS", which is incorporated herein by reference. It is expected that such Proxy statement will be filed with the Securities and Exchange Commission no later than April 30, 2018.

### **Item 14. Principal Accounting Fees and Services**

The information concerning principal accountant fees and services as well as related pre-approval policies under the caption "RATIFICATION OF INDEPENDENT AUDITORS" in the Proxy Statement for the Company's 2018 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2018.

**PART IV****Item 15. Exhibits, Financial Statement Schedules**

## (a) (1) Financial Statements and Schedules:

The following Financial Statements and Supplementary Data are filed as part of this annual report:

<a href="#">Report of Independent Registered Public Accounting Firm</a>	<a href="#">45</a>
<a href="#">Consolidated Statements of Condition</a>	<a href="#">46</a>
<a href="#">Consolidated Statements of Income</a>	<a href="#">47</a>
<a href="#">Consolidated Statements of Comprehensive Income</a>	<a href="#">48</a>
<a href="#">Consolidated Statements of Changes in Stockholders' Equity</a>	<a href="#">49</a>
<a href="#">Consolidated Statements of Cash Flows</a>	<a href="#">50</a>
<a href="#">Notes to Consolidated Financial Statements</a>	<a href="#">51</a>

## (b) Exhibits (numbered in accordance with Item 601 of Regulation S-K) filed herewith or incorporated by reference as part of this annual report.

<u>Exhibit No.</u>	<u>Description</u>
<a href="#">3.1</a>	<a href="#">The Registrant's Restated Certificate of Incorporation is incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on July 1, 2014.</a>
<a href="#">3.2</a>	<a href="#">The Registrant's Amended and Restated By-Laws are incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed with the SEC on July 1, 2014.</a>
<a href="#">10.1</a>	<a href="#">Center Bancorp, Inc. 2009 Equity Incentive Plan is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 1, 2009.</a>
<a href="#">10.2</a>	<a href="#">Indenture dated as of December 19, 2003, between the Registrant and Wilmington Trust Company relating to \$5.0 million aggregate principal amount of floating rate debentures is incorporated by reference to Exhibit 10.16 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.</a>
<a href="#">10.3</a>	<a href="#">Amended and restated Declaration of Trust of Center Bancorp Statutory Trust II, dated as of December 19, 2003 is incorporated by reference to Exhibit 10.17 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.</a>
<a href="#">10.4</a>	<a href="#">Guarantee Agreement between Registrant and Wilmington Trust Company dated as of December 19, 2003 is incorporated by reference to Exhibit 10.18 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.</a>
<a href="#">10.5</a>	<a href="#">The Registrant's Amended and Restated 2003 Non-Employee Director Stock Option Plan, as amended and restated, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated March 5, 2008.</a>
<a href="#">10.6</a>	<a href="#">Open Market Share Purchase Incentive Plan is incorporated by reference to exhibit 10.1 to the Registrant's Current Report on Form 8-K dated February 27, 2006.</a>
<a href="#">10.7</a>	<a href="#">Amendment to 2003 Amended and Restated Non-Employee Director Stock Option Plan is incorporated by reference to Exhibit 10.8 to the Registrant's Current Report on Form 8-K filed with the SEC on January 21, 2014.</a>
<a href="#">10.8</a>	<a href="#">Second Amended and Restated Employment Agreement, dated as of June 1, 2017, by and among the Registrant, ConnectOne Bank and Frank Sorrentino III, is incorporated by reference to Exhibit 10.1 to the Registrant's Current report on Form 8-K filed with the SEC on June 5, 2017. *</a>
<a href="#">10.9</a>	<a href="#">Amended and Restated Employment Agreement dated as of June 1, 2017, by and among the Registrant, ConnectOne Bank and William S. Burns, is incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on June 5, 2017 *</a>
<a href="#">10.10</a>	<a href="#">Form of Change in Control Agreement by and between the Company and Laura Criscione dated December 19, 2013 is incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on December 20, 2013. *</a>

## Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
<u>10.11</u>	<u>North Jersey Community Bank 2006 Equity Compensation Plan (1)</u>
<u>10.12</u>	<u>North Jersey Community Bank 2008 Equity Compensation Plan (1)</u>
<u>10.13</u>	<u>North Jersey Community Bank 2009 Equity Compensation Plan (1)</u>
<u>10.14</u>	<u>2012 Equity Compensation Plan (1)</u>
<u>10.15</u>	<u>Indenture dated June 30, 2015 with U.S. Bank, National Association as Trustee (2)</u>
<u>10.16</u>	<u>Indenture dated January 17, 2018, between the Company and U.S. Bank National Association as Trustee <sup>(3)</sup></u>
<u>10.17</u>	<u>Employment Agreement by and among the Registrant, ConnectOne Bank and Elizabeth Magennis dated June 1, 2017 is incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on June 5, 2017. *</u>
<u>10.18</u>	<u>Employment Agreement by and among the Registrant, ConnectOne Bank and Christopher Ewing dated June 1, 2017 is incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the SEC on June 5, 2017</u>
<u>10.19</u>	<u>First Supplemental Indenture dated January 17, 2018, between the Company and U.S. Bank National Association as Trustee <sup>(3)</sup></u>
<u>12.1</u>	<u>Statement of Ratios of Earnings to Fixed Charges</u>
<u>21.1</u>	<u>Subsidiaries of the Registrant</u>
<u>23.1</u>	<u>Consent of Crowe Horwath LLP</u>
<u>31.1</u>	<u>Personal certification of the chief executive officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.</u>



## Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
<u>31.2</u>	<u>Personal certification of the chief financial officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>32</u>	<u>Personal certification of the chief executive officer and the chief financial officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002.</u>
101 .INS	XBRL instance document
101 .SCH	XBRL Taxonomy Extension Schema Document
101 .CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101 .DEF	XBRL Taxonomy Extension Definition Linkbase Document
101 .LAB	XBRL Taxonomy Extension Label Linkbase Document
101 .PRE	XBRL Taxonomy Extension Presentation Linkbase Document

\* Management contract on compensatory plan or arrangement.

- (1) Incorporated by reference from Exhibits 10.15, 10.16, 10.17 and 10.18, the Registrant's Annual Report on Form 10-K for the year ending December 31, 2014
- (2) Incorporated by reference from Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed July 2, 2015
- (3) Incorporated by reference from Exhibits 4.1 and 4.2 of Registrant's Current Report on Form 8-K filed January 17, 2018

All financial statement schedules are omitted because they are either inapplicable or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

**SIGNATURES**

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

March 6, 2018

**CONNECTONE BANCORP, INC.**

By:

/s/ Frank Sorrentino III  
Frank Sorrentino III  
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, the following persons on behalf of the Registrant, in the capacities described below on March 6, 2018, have signed this report below.

/s/ Frank Sorrentino III Frank Sorrentino III	Chairman of the Board & Chief Executive Officer (principal executive officer)
/s/ William S. Burns William S. Burns	Executive Vice President & Chief Financial Officer (principal financial and accounting officer)
/s/ Stephen Boswell Stephen Boswell	Director
/s/ Frank Baier Frank Baier	Director
/s/ Frank Huttle III Frank Huttle III	Director
/s/ Michael Kempner Michael Kempner	Director
/s/ Joseph Parisi, Jr. Joseph Parisi, Jr.	Director
/s/ Frederick S. Fish Frederick S. Fish	Director
/s/ Nicholas Minoia Nicholas Minoia	Director
/s/ Harold Schechter Harold Schechter	Director
/s/ William A. Thompson William A. Thompson	Director
/s/ Alexander Bol Alexander Bol	Director

- 112 -

---

[\(Back To Top\)](#)

## **Section 2: EX-12.1 (STATEMENT OF RATIOS OF EARNINGS TO FIXED CHARGES)**

**Exhibit 12.1**

**Statement of Ratios of Earnings to Fixed Charges**

Year ended December 31,				
<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
(Dollars in Thousands)				

Earnings:					
1. Income after income taxes	\$ 43,220	\$ 31,082	\$ 41,311	\$ 18,565	\$ 19,925
2. Plus: interest expense	36,255	31,096	23,814	14,808	11,082
3. Earnings including interest on deposits	79,475	62,178	65,125	33,373	31,007
4. Less: interest on deposits	23,669	18,667	13,756	8,260	5,219
5. Earnings excluding interest on deposits	\$ 55,806	\$ 43,511	\$ 51,369	\$ 25,113	\$ 25,788
Fixed Charges:					
6. Interest expense (Line 2)	\$ 36,255	\$ 31,096	\$ 23,814	\$ 14,808	\$ 11,082
7. Less: interest expense on deposits (Line 4)	23,669	18,667	13,756	8,260	5,219
8. Excluding interest on deposits	\$ 12,586	\$ 12,429	\$ 10,058	\$ 6,548	\$ 5,863
Ratio of Earnings to Fixed Charges:					
Including interest on deposits (line 3 divided by Line 6)	2.19	2.00	2.73	2.25	2.80
Excluding interest on deposits (line 5 divided by Line 8)	4.43	3.50	5.11	3.84	4.40

[\(Back To Top\)](#)

## Section 3: EX-21.1 (SUBSIDIARIES OF THE REGISTRANT)

Exhibit 21.1

### Subsidiaries of the Registrant as of December 31, 2017

The following table sets forth the names of the registrant's direct and indirect subsidiaries and the state or other jurisdiction of incorporation of each such entity. In each case, the names of the listed subsidiaries are the same as the names under which such subsidiaries do business.

Name	Incorporation
ConnectOne Bank	New Jersey
Center Bancorp Statutory Trust II	Delaware
Union Investment Co.	New Jersey
Center Financial Group, LLC	New Jersey
Center Advertising Corporation	New Jersey
Morris Property Company, LLC	New Jersey
Twin Bridge Investment Co.	Delaware
Volosin Holdings, LLC	New Jersey
Twin Bridge Capital Corporation	New Jersey
ConnectOne Preferred Funding Corp.	New Jersey
NJCB Spec-1, LLC	New Jersey
*Greenbrook Consulting, LLC	New Jersey

\*ConnectOne Bank owns 49% interest in Greenbrook Title Agency, LLC

[\(Back To Top\)](#)

## Section 4: EX-23.1 (CONSENT OF CROWE HORWATH LLP)

Exhibit 23.1

### Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement No. 333-221705 on Form S-3 and Registration Statement Nos. 333-197239, 333-160111 and 333-148323 on Form S-8 of ConnectOne Bancorp, Inc. of our report dated March 6, 2018, relating to the consolidated financial statements of ConnectOne Bancorp, Inc. and Subsidiaries and the effectiveness of internal control over financial reporting, which report appears in this Annual Report on Form 10-K of ConnectOne Bancorp, Inc. for the year ended December 31, 2017.

/s/ Crowe Horwath LLP

Crowe Horwath LLP  
New York, New York  
March 6, 2018

## **Section 5: EX-31.1 (PERSONAL CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER)**

**Exhibit 31.1**

### **CERTIFICATIONS**

I, Frank Sorrentino III, certify that:

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

Date: March 6, 2018

By: /s/ Frank Sorrentino III

Frank Sorrentino III  
Chairman and Chief Executive Officer

## **Section 6: EX-31.2 (PERSONAL CERTIFICATION OF THE CHIEF FINANCIAL OFFICER)**

## CERTIFICATIONS

I, William S. Burns, certify that:

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

Date: March 6, 2018

By: /s/ William S. Burns  
 William S. Burns  
 Executive Vice President and  
 Chief Financial Officer

[\(Back To Top\)](#)

## Section 7: EX-32 (PERSONAL CERTIFICATION)

Exhibit 32

### CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned, Frank Sorrentino III and William S. Burns hereby jointly certify as follows:

They are the Chief Executive Officer and the Chief Financial Officer, respectively, of ConnectOne Bancorp, Inc. (the "Company");

To the best of their knowledge, the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "Report") complies in all material respects with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and

To the best of their knowledge, based upon a review of the Report, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 6, 2018

By: /s/ Frank Sorrentino III  
Frank Sorrentino III  
Chairman and Chief Executive Officer

Date: March 6, 2018

By: /s/ William S. Burns  
William S. Burns  
Executive Vice President and  
Chief Financial Officer

---

[\(Back To Top\)](#)