

FLUSHING FINANCIAL CORP  
Form 10-K  
March 17, 2008

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2007

Commission file number **000-24272**

**FLUSHING FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

**11-3209278**

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

**1979 Marcus Avenue, Suite E140, Lake Success, New York 11042**

(Address of principal executive offices)

**(718) 961-5400**

(Registrant's telephone number, including area code)

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

**Common Stock \$0.01 par value (and  
associated Preferred Stock Purchase Rights).**

**NASDAQ Global Select Market**

(Title of each class)

(Name of exchange on which registered)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in rule 405 of the Securities Act. o Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes x No

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

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

## Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

As of June 29, 2007, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$324,977,000. This figure is based on the closing price on that date on the NASDAQ Global Select Market for a share of the registrant's Common Stock, \$0.01 par value, which was \$16.06.

The number of shares of the registrant's Common Stock outstanding as of February 29, 2008 was 21,336,786 shares.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Company's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 20, 2008 are incorporated herein by reference in Part III.

---

---

TABLE OF CONTENTS

	<u>Page</u>
	<u>1</u>
<u>PART I</u>	
<u>Item 1. Business</u>	1
<u>GENERAL</u>	
<u>Overview</u>	1
<u>Market Area and Competition</u>	2
<u>Lending Activities</u>	3
<u>Loan Portfolio Composition</u>	3
<u>Loan Maturity and Repricing</u>	7
<u>Multi-Family Residential Lending</u>	7
<u>Commercial Real Estate Lending</u>	8
<u>One-to-Four Family Mortgage Lending - Mixed-Use Properties</u>	8
<u>One-to-Four Family Mortgage Lending - Residential Properties</u>	9
<u>Construction Loans</u>	10
<u>Small Business Administration Lending</u>	10
<u>Commercial Business and Other Lending</u>	10
<u>Loan Approval Procedures and Authority</u>	11
<u>Loan Concentrations</u>	11
<u>Loan Servicing</u>	11
<u>Asset Quality</u>	11
<u>Loan Collection</u>	11
<u>Delinquent Loans and Non-performing Assets</u>	12
<u>Real Estate Owned</u>	13
<u>Environmental Concerns Relating to Loans</u>	13
<u>Allowance for Loan Losses</u>	13
<u>Investment Activities</u>	17
<u>General</u>	17
<u>Mortgage-backed securities</u>	18
<u>Sources of Funds</u>	21
<u>General</u>	21
<u>Deposits</u>	21
<u>Borrowings</u>	25
<u>Subsidiary Activities</u>	26
<u>Personnel</u>	27
<u>Omnibus Incentive Plan</u>	27
<u>FEDERAL, STATE AND LOCAL TAXATION</u>	
<u>Federal Taxation</u>	27
<u>General</u>	27
<u>Bad Debt Reserves</u>	27
<u>Distributions</u>	27
<u>Corporate Alternative Minimum Tax</u>	28
<u>State and Local Taxation</u>	28
<u>New York State and New York City Taxation</u>	28
<u>Delaware State Taxation</u>	28

REGULATION

<u>General</u>	28
<u>Holding Company Regulation</u>	29
<u>Investment Powers</u>	30
<u>Real Estate Lending Standards</u>	30
<u>Loans-to-One Borrower Limits</u>	30
<u>Insurance of Accounts</u>	31
<u>Qualified Thrift Lender Test</u>	31
<u>Transactions with Affiliates</u>	32
<u>Restrictions on Dividends and Capital Distributions</u>	32
<u>Federal Home Loan Bank System</u>	33
<u>Assessments</u>	33
<u>Branching</u>	33
<u>Community Reinvestment</u>	33
<u>Brokered Deposits</u>	33
<u>Capital Requirements</u>	34
<u>General</u>	34
<u>Tangible Capital Requirement</u>	34
<u>Leverage and Core Capital Requirement</u>	34
<u>Risk-Based Requirement</u>	34
<u>Federal Reserve System</u>	35
<u>Financial Reporting</u>	35
<u>Standards for Safety and Soundness</u>	35
<u>Gramm-Leach-Bliley Act</u>	35
<u>USA Patriot Act</u>	36
<u>Prompt Corrective Action</u>	36
<u>Federal Securities Laws</u>	36
<u>Available Information</u>	37
<u>Item 1A. Risk Factors</u>	37
<u>Changes in Interest Rates May Significantly Impact the Company's Financial Condition and Results of Operations</u>	37
<u>The Bank's Lending Activities Involve Risks that May Be Exacerbated Depending on the Mix of Loan Types</u>	37
<u>The Markets in Which the Bank Operates Are Highly Competitive</u>	38
<u>The Company's Results of Operations May Be Adversely Affected by Changes in National and/or Local Economic Conditions</u>	38
<u>Changes in Laws and Regulations Could Adversely Affect Our Business</u>	39
<u>Certain Anti-Takeover Provisions May Increase the Costs to or Discourage an Acquiror</u>	39
<u>The Bank May Not Be Able To Successfully Implement Its New Commercial Business Banking Initiative</u>	39
<u>Item 1B. Unresolved Staff Comments</u>	39
<u>Item 2. Properties</u>	40
<u>Item 3. Legal Proceedings</u>	41
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	41

PART II

<u>Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	41
<u>Item 6. Selected Financial Data</u>	43
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	45
<u>General</u>	45
<u>Overview</u>	45
<u>Interest Rate Sensitivity Analysis</u>	49
<u>Interests Rate Risk</u>	51
<u>Analysis of Net Interest Income</u>	51
<u>Rate/Volume Analysis</u>	53
<u>Comparison of Operating Results for the Years Ended December 31, 2007 and 2006</u>	53
<u>Comparison of Operating Results for the Years Ended December 31, 2006 and 2005</u>	55
<u>Liquidity, Regulatory Capital and Capital Resources</u>	56
<u>Critical Accounting Policies</u>	58
<u>Contractual Obligations</u>	59
<u>Impact of New Accounting Standards</u>	60
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	62
<u>Item 8. Financial Statements and Supplementary Data</u>	63
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	106
<u>Item 9A. Controls and Procedures</u>	107
<u>Item 9B. Other Information</u>	107

PART III

<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	108
<u>Item 11. Executive Compensation</u>	108
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	108
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	109
<u>Item 14. Principal Accounting Fees and Services</u>	109

PART IV

<u>Item 15. Exhibits, Financial Statement Schedules</u>	109
<u>(a) 1. Financial Statements</u>	109
<u>(a) 2. Financial Statement Schedules</u>	109
<u>(a) 3. Exhibits Required by Securities and Exchange Commission Regulation S-K</u>	110

SIGNATURES

POWER OF ATTORNEY

**CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS**

Statements contained in this Annual Report on Form 10-K (this Annual Report) relating to plans, strategies, economic performance and trends, projections of results of specific activities or investments and other statements that are not descriptions of historical facts may be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking information is inherently subject to risks and uncertainties, and actual results could differ materially from those currently anticipated due to a number of factors, which include, but are not limited to, factors discussed under the captions Business General Allowance for Loan Losses and Business General Market Area and Competition in Item 1 below, Risk Factors in Item 1A below, in Management Discussion and Analysis of Financial Condition and Results of Operations Overview in Item 7 below, and elsewhere in this Annual Report and in other documents filed by the Company with the Securities and Exchange Commission from time to time. Forward-looking statements may be identified by terms such as may, will, should, could, expects, plans, intends, anticipates, believes, estimates, predicts, continue or similar terms or the negative of these terms. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. The Company has no obligation to update these forward-looking statements.

**PART I**

**Item 1. Business.**

**GENERAL**

**Overview**

Flushing Financial Corporation (the Holding Company) is a Delaware corporation organized in May 1994 at the direction of Flushing Savings Bank, FSB (the Bank). The Bank was organized in 1929 as a New York State chartered mutual savings bank. In 1994, the Bank converted to a federally chartered mutual savings bank and changed its name from Flushing Savings Bank to Flushing Savings Bank, FSB. The Bank converted from a federally chartered mutual savings bank to a federally chartered stock savings bank on November 21, 1995, at which time the Holding Company acquired all of the stock of the Bank. The primary business of the Holding Company at this time is the operation of its wholly owned subsidiary, the Bank. The Bank owns four subsidiaries: Flushing Commercial Bank, Flushing Preferred Funding Corporation, Flushing Service Corporation, and FSB Properties Inc. In November, 2006, the Bank launched an internet branch, iGObanking.com®. The activities of the Holding Company are primarily funded by dividends, if any, received from the Bank. Flushing Financial Corporation's common stock is traded on the NASDAQ Global Select Market under the symbol FFIC.

The Holding Company also owns Flushing Financial Capital Trust II, Flushing Financial Capital Trust III, and Flushing Financial Capital Trust IV (the Trusts), special purpose business trusts formed during 2007 to issue capital securities. The Trusts used the proceeds from the issuance of these capital securities, and the proceeds from the issuance of their common stock, to purchase junior subordinated debentures from the Holding Company. In accordance with the requirements of FASB Interpretation No. 46R, the Trusts are not included in the consolidated financial statements of the Holding Company. The Holding Company previously owned Flushing Financial Capital Trust I (the Trust), which was a special purpose business trust formed in 2002 similar to the Trusts discussed above. The Trust called its outstanding capital securities during July 2007, and was then liquidated. Prior to 2004, the Trust was included in the consolidated financial statements of the Company. Effective January 1, 2004, in accordance with the requirements of FASB Interpretation No. 46R, the Trust was deconsolidated.

Unless otherwise disclosed, the information presented in this Annual Report reflects the financial condition and results of operations of the Holding Company, the Bank and the Bank's subsidiaries on a consolidated basis (collectively, the Company). At December 31, 2007, the Company had total assets of \$3.4 billion, deposits of \$2.0 billion and stockholders' equity of \$233.7 million.

The Bank's principal business is attracting retail deposits from the general public and investing those deposits together with funds generated from ongoing operations and borrowings, primarily in (1) originations and purchases of one-to-four family (focusing on mixed-use properties - properties that contain both residential dwelling units and commercial units), multi-family residential and commercial real estate mortgage loans; (2) construction loans, primarily for multi-family residential properties; (3) Small Business Administration (SBA) loans and other small business loans; (4) mortgage loan surrogates such as mortgage-backed securities; and (5) U.S. government securities, corporate fixed-

income securities and other marketable securities. The Bank also originates certain other consumer loans. The Bank's revenues are derived principally from interest on its mortgage and other loans and mortgage-backed securities portfolio, and interest and dividends on other investments in its securities portfolio. The Bank's primary sources of funds are deposits, Federal Home Loan Bank of New York ( FHLB-NY ) borrowings, repurchase agreements, principal and interest payments on loans, mortgage-backed and other securities, proceeds from sales of securities and, to a lesser extent, proceeds from sales of loans. As a federal savings bank, the Bank's primary regulator is the Office of Thrift Supervision ( OTS ). The Bank's deposits are insured to the maximum allowable amount by the Federal Deposit Insurance Corporation ( FDIC ). Additionally, the Bank is a member of the Federal Home Loan Bank ( FHLB ) system.

In addition to operating the Bank, the Holding Company invests primarily in U.S. government securities, mortgage-backed securities, and corporate securities. The Holding Company also holds a note evidencing a loan that it made to an employee benefit trust established by the Holding Company for the purpose of holding shares for allocation or distribution under certain employee benefit plans of the Holding Company and the Bank (the Employee Benefit Trust ). The funds provided by this loan enabled the Employee Benefit Trust to acquire 2,328,750 shares, or 8% of the common stock issued in our initial public offering.

On June 30, 2006, the Company acquired all of the outstanding common stock of Atlantic Liberty Financial Corporation ( Atlantic Liberty ), the parent holding company for Atlantic Liberty Savings, F.A., based in Brooklyn, New York. The aggregate purchase price was \$42.5 million, which consisted of \$14.7 million of cash, common stock valued at \$26.6 million, and \$1.3 million assigned to the fair value of Atlantic Liberty's outstanding stock options. Under the terms of the Agreement and Plan of Merger, dated December 20, 2005, Atlantic Liberty's shareholders received \$24.00 in cash, 1.43 Holding Company shares per Atlantic Liberty share owned, or a combination thereof, subject to aggregate allocation to all Atlantic Liberty's shareholders of 65% stock / 35% cash. In connection with the merger, the Company issued 1.6 million shares of common stock, the value of which was determined based on the closing price of the Company's common stock on the announcement date of December 21, 2005, and two days prior to and after the announcement date. The Company acquired \$186.9 million in assets, \$116.2 million in net loans and assumed \$106.8 million in deposits. This acquisition provided the Bank a presence on Montague Street and on Avenue J in Brooklyn, two highly attractive markets.

During 2006, the Bank established a business banking unit. The Bank's business plan includes a transition from a traditional thrift to a more commercial like banking institution by focusing on the development of a full complement of commercial business deposit, loan and cash management products.

On November 27, 2006, the Bank launched an internet branch, iGObanking.com®, as a new division which provides the Bank access to markets outside its geographic locations. Accounts can be opened online at www.iGObanking.com or by mail.

During 2007, the Bank formed a wholly owned subsidiary, Flushing Commercial Bank, a New York State chartered commercial bank, for the limited purpose of accepting municipal deposits and state funds, including certain court ordered funds from New York State Courts, in the State of New York. The commercial bank was formed in response to a New York State Finance Law which requires that municipal deposits and state funds must be deposited into a bank or trust company designated by the New York State Comptroller. The Bank is not considered a bank or trust company for this purpose. The commercial bank offers a full range of deposit products to municipalities and New York State, similar to the products currently being offered by the Bank, but does not make loans. To date, the operations of Flushing Commercial Bank have not been material.

### **Market Area and Competition**

The Bank is a community oriented savings institution offering a wide variety of financial services to meet the needs of the communities it serves. The Bank's main office is in Flushing, New York, located in the Borough of Queens. At December 31, 2007, the Bank operated out of its main office and thirteen branch offices, located in the New York City Boroughs of Queens, Brooklyn, and Manhattan, and in Nassau County, New York. The Bank also operates an internet branch, iGObanking.com®. The Bank maintains its executive offices in Lake Success in Nassau County, New York. Substantially all of the Bank's mortgage loans are secured by properties located in the New York City metropolitan area. During the last three years, real estate values in the New York City metropolitan area have been stable, which has favorably impacted the Bank's asset quality. See Asset Quality and Risk Factors Local Economic Conditions included in Item 1A of this Annual Report. There can be no assurance that the stability of these economic factors will continue.

The Bank faces intense and increasing competition both in making loans and in attracting deposits. The Bank's market area has a high density of financial institutions, many of which have greater financial resources, name recognition and market presence than the Bank, and all of which are competitors of the Bank to varying degrees. Particularly intense competition exists for deposits and in all of the lending activities emphasized by the Bank. The internet banking arena, which the Bank entered in November 2006, also has many larger financial institutions which have greater financial resources, name recognition and market presence than the Bank. The future earnings prospects of the Bank will be affected by the Bank's ability to compete effectively with other financial institutions and to implement its business strategies. See "Risk Factors The Markets in Which the Bank Operates Are Highly Competitive" included in Item 1A of this Annual Report.

For a discussion of the Company's business strategies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Management Strategy" included in Item 7 of this Annual Report.

### **Lending Activities**

*Loan Portfolio Composition.* The Bank's loan portfolio consists primarily of mortgage loans secured by multi-family residential, commercial real estate, one-to-four family mixed-use property, one-to-four family residential property, and construction loans. In addition, the Bank also offers SBA loans, other small business loans and consumer loans. Substantially all the Bank's mortgage loans are secured by properties located within the Bank's market area. At December 31, 2007, the Bank had gross loans outstanding of \$2,694.7 million (before the allowance for loan losses and net deferred costs).

Beginning in late 2001, the Bank shifted its focus from originating one-to-four family residential property mortgage loans to the origination of multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans. These loans generally have higher yields than one-to-four family residential properties, and include prepayment penalties that the Bank collects if the loans pay in full prior to the contractual maturity. From December 31, 2001 to December 31, 2007, multi-family residential mortgage loans increased \$594.8 million, or 160.9%, commercial real estate mortgage loans increased \$411.4 million, or 191.9%, one-to-four family mixed-use property mortgage loans increased \$577.1 million, or 525.6%, while one-to-four family residential property mortgage loans decreased \$190.3 million, or 54.1%. The Bank expects to continue this emphasis through marketing and by maintaining competitive interest rates and origination fees. The Bank's marketing efforts include frequent contacts with mortgage brokers and other professionals who serve as referral sources. From time-to-time, the Bank may purchase loans from mortgage bankers and other financial institutions. Loans purchased comply with the Bank's underwriting standards.

Fully underwritten one-to-four family residential mortgage loans generally are considered by the banking industry to have less risk than other types of loans. Multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans generally have higher yields than one-to-four family residential property mortgage loans and shorter terms to maturity, but typically involve higher principal amounts and generally expose the lender to a greater risk of credit loss than one-to-four family residential property mortgage loans. The Bank's increased emphasis on multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans has increased the overall level of credit risk inherent in the Bank's loan portfolio. The greater risk associated with multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans could require the Bank to increase its provision for loan losses and to maintain an allowance for loan losses as a percentage of total loans in excess of the allowance currently maintained by the Bank. To date, the Bank has not experienced significant losses in its multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loan portfolios, and has determined that, at this time, additional provisions are not required.

The Bank's mortgage loan portfolio consists of adjustable rate mortgage (ARM) loans and fixed-rate mortgage loans. Interest rates charged by the Bank on loans are affected primarily by the demand for such loans, the supply of money available for lending purposes, the rate offered by the Bank's competitors and the creditworthiness of the borrower. Many of those factors are, in turn, affected by regional and national economic conditions, and the fiscal, monetary and tax policies of the federal government.

In general, consumers show a preference for ARM loans in periods of high interest rates and for fixed-rate loans when interest rates are low. In periods of declining interest rates, the Bank may experience refinancing activity in ARM loans, as borrowers show a preference to lock-in the lower rates available on fixed-rate loans. In the case of ARM loans originated by the Bank, volume and adjustment periods are affected by the interest rates and other market factors as



discussed above as well as consumer preferences. The Bank has not in the past, nor does it currently, originate ARM loans that provide for negative amortization.

In recent years, the Bank has grown its construction loan portfolio. The Bank obtains a first lien position on the underlying collateral, and generally obtains personal guarantees on construction loans. These loans generally have a term of two years or less. Construction loans involve a greater degree of risk than other loans because, among other things, the underwriting of such loans is based on an estimated value of the developed property, which can be difficult to ascertain in light of uncertainties inherent in such estimations. In addition, construction lending entails the risk that the project may not be completed due to cost overruns or changes in market conditions. The greater risk associated with construction loans could require the Bank to increase its provision for loan losses, and to maintain an allowance for loan losses as a percentage of total loans in excess of the allowance currently maintained by the Bank. To date, the Bank has not incurred significant losses in its construction loan portfolio.

The business banking unit was formed in 2006 to focus on loans to businesses located within the Bank's market area. These loans are generally personally guaranteed by the owners, and may be secured by the assets of the business. The interest rate on these loans is generally an adjustable rate based on a published index, usually the prime rate. These loans, while providing a higher rate of return to the Bank, also present a higher level of risk. The greater risk associated with business loans could require the Bank to increase its provision for loan losses, and to maintain an allowance for loan losses as a percentage of total loans in excess of the allowance currently maintained by the Bank. To date, the Bank has not incurred significant losses in its business loan portfolio.

The Bank's lending activities are subject to federal and state laws and regulations. See Regulation.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth the composition of the Bank's loan portfolio at the dates indicated.

At December 31,

	2007		2006		2005		2004		2003	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
<i>(Dollars in thousands)</i>										
<b>Mortgage Loans:</b>										
Multi-family residential	\$ 964,455	35.79%	\$ 870,912	37.52%	\$ 788,071	41.92%	\$ 646,922	42.61%	\$ 541,837	42.53%
Commercial real estate	625,843	23.23	519,552	22.38	399,081	21.23	334,048	22.00	290,332	22.79
One-to-four family - mixed-use property	686,921	25.49	588,092	25.33	477,775	25.42	332,805	21.92	226,225	17.76
One-to-four family - residential (1)	161,666	6.01	161,889	6.98	134,641	7.17	151,737	10.00	178,474	14.01
Co-operative apartment (2)	7,070	0.26	8,059	0.35	2,161	0.11	3,132	0.21	3,729	0.29
Construction	119,745	4.44	104,488	4.50	49,522	2.63	31,460	2.07	23,622	1.85
<b>Gross mortgage loans</b>	<b>2,565,700</b>	<b>95.22</b>	<b>2,252,992</b>	<b>97.06</b>	<b>1,851,251</b>	<b>98.48</b>	<b>1,500,104</b>	<b>98.81</b>	<b>1,264,219</b>	<b>99.23</b>
<b>Small Business</b>										
Administration loans	18,922	0.70	17,521	0.75	9,239	0.49	5,633	0.37	4,931	0.39
Commercial business and other loans	110,046	4.08	50,899	2.19	19,362	1.03	12,505	0.82	4,894	0.38
<b>Gross loans</b>	<b>2,694,668</b>	<b>100.00%</b>	<b>2,321,412</b>	<b>100.00%</b>	<b>1,879,852</b>	<b>100.00%</b>	<b>1,518,242</b>	<b>100.00%</b>	<b>1,274,044</b>	<b>100.00%</b>
Unearned loan fees and deferred costs, net	14,083		10,393		8,409		4,798		2,030	
Less: Allowance for loan losses	(6,633)		(7,057)		(6,385)		(6,533)		(6,553)	
<b>Loans, net</b>	<b>\$ 2,702,118</b>		<b>\$ 2,324,748</b>		<b>\$ 1,881,876</b>		<b>\$ 1,516,507</b>		<b>\$ 1,269,521</b>	

(1) One-to-four family residential mortgage loans also include home equity and condominium loans. At December 31, 2007, gross home equity loans totaled \$36.1 million and condominium loans totaled \$8.7 million.

(2) Consists of loans secured by shares representing interests in individual co-operative units that are generally owner occupied.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth the Bank's loan originations (including the net effect of refinancings) and the changes in the Bank's portfolio of loans, including purchases, sales and principal reductions for the years indicated:

(In thousands)	For the years ended December 31,		
	2007	2006	2005
<b>Mortgage Loans</b>			
At beginning of year	\$ 2,252,992	\$ 1,851,251	\$ 1,500,104
Mortgage loans originated:			
Multi-family residential	222,625	166,744	222,065
Commercial real estate	165,440	150,804	103,090
One-to-four family mixed-use property	159,331	154,456	186,700
One-to-four family residential	36,397	13,786	13,186
Co-operative apartment	828	125	
Construction	54,151	73,107	46,414
Total mortgage loans originated	638,772	559,022	571,455
Mortgage loans purchased:			
Multi-family residential	8,717		1,009
Commercial real estate	2,902	3,087	
Construction		1,980	
Acquisition of Atlantic Liberty loans:			
Multi-family residential		16,299	
Commercial real estate		31,914	
One-to-four family mixed-use property		9,333	
One-to-four family residential		51,033	
Co-operative apartment		6,665	
Construction		13,781	
Total mortgage loans purchased/acquired	11,619	134,092	1,009
Less:			
Principal reductions	284,608	270,416	217,199
Mortgage loan sales	53,075	20,957	4,118
Mortgage loan foreclosures			
At end of year	\$ 2,565,700	\$ 2,252,992	\$ 1,851,251
<b>SBA, Commercial Business &amp; Other Loans</b>			
At beginning of year	\$ 68,420	\$ 28,601	\$ 18,138
Loans originated:			
SBA loans	12,840	19,914	12,249
Small business loans (1)	92,240	49,909	12,410
Other loans	1,953	1,671	1,537
Total other loans originated	107,033	71,494	26,196
Less:			
Sales	4,925	7,477	6,630

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

Repayments (1)	41,090	24,116	8,940
Charge-offs	470	82	163
	<u>          </u>	<u>          </u>	<u>          </u>
At end of year	\$ 128,968	\$ 68,420	\$ 28,601
	<u>          </u>	<u>          </u>	<u>          </u>

1) 2006 includes an \$11.5 million loan to Atlantic Liberty prior to the merger.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

*Loan Maturity and Repricing.* The following table shows the maturity of the Bank's commercial mortgage loan, construction loan and non-mortgage loan portfolios at December 31, 2007. Scheduled repayments are shown in the maturity category in which the payments become due.

<i>(In thousands)</i>	Commercial Mortgage Loans	Construction	SBA	Commercial Business and Other	Total
Amounts due within one year	\$ 68,505	\$ 98,282	\$ 7,729	\$ 54,692	\$ 229,208
Amounts due after one year:					
One to two years	60,932	16,396	1,992	31,701	111,021
Two to three years	51,594	5,067	1,929	13,806	72,396
Three to five years	106,524		3,163	6,128	115,815
Over five years	338,288		4,109	3,719	346,116
Total due after one year	557,338	21,463	11,193	55,354	645,348
Total amounts due	\$ 625,843	\$ 119,745	\$ 18,922	\$ 110,046	\$ 874,556
Sensitivity of loans to changes in interest rates - loans due after one year:					
Fixed rate loans	\$ 118,998	\$ 10,570	\$ 116	\$ 45,273	\$ 174,957
Adjustable rate loans	438,340	10,893	11,077	10,081	470,391
Total loans due after one year	\$ 557,338	\$ 21,463	\$ 11,193	\$ 55,354	\$ 645,348

*Multi-Family Residential Lending.* Loans secured by multi-family residential properties were \$964.5 million, or 35.79% of gross loans, at December 31, 2007. The Bank's multi-family residential mortgage loans had an average principal balance of \$497,000 at December 31, 2007, and the largest multi-family residential mortgage loan held in the Bank's portfolio had a principal balance of \$11.2 million. The Bank offers both fixed-rate and adjustable rate multi-family residential mortgage loans, with maturities up to 30 years.

In underwriting multi-family residential mortgage loans, the Bank reviews the expected net operating income generated by the real estate collateral securing the loan, the age and condition of the collateral, the financial resources and income level of the borrower and the borrower's experience in owning or managing similar properties. The Bank typically requires debt service coverage of at least 125% of the monthly loan payment. The Bank generally originates these loans up to only 75% of the appraised value or the purchase price of the property, whichever is less. Any loan with a final loan-to-value ratio in excess of 75% must be approved by either the Board of Directors or its Executive Committee as an exception to policy. The Bank generally relies on the income generated by the property as the primary means by which the loan is repaid. However, personal guarantees may be obtained for additional security from these borrowers. The Bank typically orders an environmental report on its multifamily and commercial real estate loans.

Loans secured by multi-family residential property generally involve a greater degree of risk than residential mortgage loans and carry larger loan balances. The increased credit risk is a result of several factors, including the concentration of principal in a smaller number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty in evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family residential property is typically dependent upon the successful operation of the related property. If the cash flow from the property is reduced, the borrower's ability to repay the loan may be impaired. Loans secured by multi-family residential property also may involve a greater degree of environmental risk. The Bank seeks to protect against this risk through obtaining an environmental report. See Asset Quality Real Estate Owned.

The Bank's fixed-rate multi-family mortgage loans are originated for terms up to 15 years and are competitively priced based on market conditions and the Bank's cost of funds. The Bank originated and purchased \$72.1 million, \$47.0 million and \$44.3 million of fixed-rate multi-family mortgage loans in 2007, 2006 and 2005, respectively. At December 31, 2007, \$244.8 million, or 25.4%, of the Bank's multi-family mortgage loans consisted of fixed rate loans.

## Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The Bank offers ARM loans with adjustment periods typically of five years and for terms of up to 30 years. Interest rates on ARM loans currently offered by the Bank are adjusted at the beginning of each adjustment period based upon a fixed spread above the FHLB-NY corresponding Regular Advance Rate. From time to time, the Bank may

originate ARM loans at an initial rate lower than the index as a result of a discount on the spread for the initial adjustment period. Multi-family adjustable-rate mortgage loans generally are not subject to limitations on interest rate increases either on an adjustment period or aggregate basis over the life of the loan. The Bank originated and purchased multi-family ARM loans totaling \$159.3 million, \$119.8 million and \$178.8 million during 2007, 2006 and 2005, respectively. At December 31, 2007, \$719.6 million, or 74.6%, of the Bank's multi-family mortgage loans consisted of ARM loans.

*Commercial Real Estate Lending.* Loans secured by commercial real estate were \$625.8 million, or 23.23% of the Bank's gross loans, at December 31, 2007. The Bank's commercial real estate mortgage loans are secured by improved properties such as office buildings, hotels/motels, nursing homes, small business facilities, strip shopping centers, warehouses, and, to a lesser extent, religious facilities. At December 31, 2007, the Bank's commercial real estate mortgage loans had an average principal balance of \$778,000, and the largest of such loans, which was secured by a multi-tenant shopping center, had a principal balance of \$11.5 million. Commercial real estate mortgage loans are generally originated in a range of \$100,000 to \$6.0 million. Commercial real estate mortgage loans are generally offered at adjustable rates tied to a market index for terms of five to 15 years, with adjustment periods from one to five years. Commercial real estate mortgage loans are also made at fixed interest rates for terms of seven, 10 or 15 years.

In underwriting commercial real estate mortgage loans, the Bank employs the same underwriting standards and procedures as are employed in underwriting multi-family residential mortgage loans.

Commercial real estate mortgage loans generally carry larger loan balances than one-to-four family residential mortgage loans and involve a greater degree of credit risk for the same reasons applicable to multi-family loans.

The Bank's fixed-rate commercial mortgage loans are originated for terms up to 20 years and are competitively priced based on market conditions and the Bank's cost of funds. The Bank originated and purchased \$28.4 million, \$20.5 million and \$17.7 million of fixed-rate commercial mortgage loans in 2007, 2006 and 2005, respectively. At December 31, 2007, \$149.8 million, or 23.9%, of the Bank's commercial mortgage loans consisted of fixed rate loans.

The Bank offers ARM loans with adjustment periods of one to five years and for terms of up to 15 years. Interest rates on ARM loans currently offered by the Bank are adjusted at the beginning of each adjustment period based upon a fixed spread above the FHLB-NY corresponding Regular Advance Rate. From time to time, the Bank may originate ARM loans at an initial rate lower than the index as a result of a discount on the spread for the initial adjustment period. Commercial adjustable-rate mortgage loans generally are not subject to limitations on interest rate increases either on an adjustment period or aggregate basis over the life of the loan. The Bank originated and purchased commercial ARM loans totaling \$140.0 million, \$133.4 million and \$85.4 million during 2007, 2006 and 2005, respectively. At December 31, 2007, \$476.1 million, or 76.1%, of the Bank's commercial mortgage loans consisted of ARM loans.

*One-to-Four Family Mortgage Lending - Mixed-Use Properties.* The Bank offers mortgage loans secured by one-to-four family mixed-use properties. These properties contain up to four residential dwelling units and a commercial unit. The Bank offers both fixed-rate and adjustable-rate one-to-four family mixed-use property mortgage loans with maturities of up to 30 years and a general maximum loan amount of \$1,000,000. Loan originations primarily result from applications received from mortgage brokers and mortgage bankers, existing or past customers, and persons who respond to Bank marketing efforts and referrals. One-to-four family mixed-use property mortgage loans were \$686.9 million, or 25.49% of gross loans, at December 31, 2007.

During the three-year period ended December 31, 2007, the Bank focused its origination efforts with respect to one-to-four family mortgage loans on mixed-use properties. The primary income-producing units of these properties are the residential dwelling units. One-to-four family mixed-use property mortgage loans generally have a higher interest rate than residential mortgage loans. One-to-four family mixed-use property mortgage loans also have a higher degree of risk than residential mortgage loans, as repayment of the loan is usually dependent on the income produced from renting the residential units and the commercial unit. At December 31, 2007, one-to-four family mixed-use property mortgage loans amounted to \$686.9 million, as compared to \$588.1 million at December 31, 2006, \$477.8 million at December 31, 2005, and \$332.8 million at December 31, 2004, representing an increase of \$354.1 million during the three-year period.

In underwriting one-to-four family mixed-use property mortgage loans, the Bank employs the same underwriting standards as are employed in underwriting multi-family residential mortgage loans.

The Bank's fixed-rate one-to-four family mixed-use property mortgage loans are originated for terms of up to 30 years and are competitively priced based on market conditions and the Bank's cost of funds. The Bank originated and purchased \$33.7 million, \$30.8 million and \$39.4 million of fixed-rate one-to-four family mixed-use property mortgage





loans in 2007, 2006 and 2005, respectively. At December 31, 2007, \$171.2 million, or 24.9%, of the Bank's one-to-four family mixed-use property mortgage loans consisted of fixed rate loans.

The Bank offers adjustable-rate one-to-four family mixed-use property mortgage loans with adjustment periods typically of five years and for terms of up to 30 years. Interest rates on ARM loans currently offered by the Bank are adjusted at the beginning of each adjustment period based upon a fixed spread above the FHLB-NY corresponding Regular Advance Rate. From time to time, the Bank may originate ARM loans at an initial rate lower than the index as a result of a discount on the spread for the initial adjustment period. One-to-four family mixed-use property adjustable-rate mortgage loans generally are not subject to limitations on interest rate increases either on an adjustment period or aggregate basis over the life of the loan. The Bank originated and purchased one-to-four family mixed-use property ARM loans totaling \$125.7 million, \$123.7 million and \$147.3 million during 2007, 2006 and 2005, respectively. At December 31, 2007, \$515.7 million, or 75.1%, of the Bank's one-to-four family mixed-use property mortgage loans consisted of ARM loans.

*One-to-Four Family Mortgage Lending - Residential Properties.* The Bank offers mortgage loans secured by one-to-four family residential properties, including townhouses and condominium units. For purposes of the description contained in this section, one-to-four family residential mortgage loans, co-operative apartment loans and home equity loans are collectively referred to herein as residential mortgage loans. The Bank offers both fixed-rate and adjustable-rate residential mortgage loans with maturities of up to 30 years and a general maximum loan amount of \$750,000. Loan originations generally result from applications received from mortgage brokers and mortgage bankers, existing or past customers, and referrals. Residential mortgage loans were \$168.7 million, or 6.27% of gross loans, at December 31, 2007.

The Bank generally originates residential mortgage loans in amounts up to 80% of the appraised value or the sale price, whichever is less. The Bank may make residential mortgage loans with loan-to-value ratios of up to 90% of the appraised value of the mortgaged property; however, private mortgage insurance is required whenever loan-to-value ratios exceed 80% of the appraised value of the property securing the loan.

The Bank originates residential mortgage loans to self-employed individuals within the Bank's local community without verification of the borrower's level of income, provided that the borrower's stated income is considered reasonable for the borrower's type of business. These loans involve a higher degree of risk as compared to the Bank's other fully underwritten residential mortgage loans as there is a greater opportunity for self-employed borrowers to falsify or overstate their level of income and ability to service indebtedness. This risk is mitigated by the Bank's policy to limit the amount of one-to-four family residential mortgage loans to 80% of the appraised value of the property or the sale price, whichever is less. The Bank believes that its willingness to make such loans is an aspect of its commitment to be a community-oriented bank. The Bank originated \$2.4 million and \$0.9 million of these first mortgage loans during 2007 and 2006, respectively. The Bank did not originate any of these loans during 2005. The Bank also extended \$43.0 million in home equity lines of credit during 2007 without verification of the borrower's level of income.

The Bank's fixed-rate residential mortgage loans typically are originated for terms of 15 and 30 years and are competitively priced based on market conditions and the Bank's cost of funds. The Bank did not originate or purchase any 15-year fixed-rate residential mortgages in 2007. The Bank originated and purchased \$0.4 million and \$0.1 million of 15-year fixed-rate residential mortgage loans in 2006 and 2005, respectively. The Bank originated \$0.5 million of 30-year fixed-rate mortgages in 2007. The Bank did not originate or purchase any 30-year fixed rate residential mortgages in 2006 and 2005. These loans have been retained to provide flexibility in the management of the Company's interest rate sensitivity position. At December 31, 2007, \$70.8 million, or 41.9%, of the Bank's residential mortgage loans consisted of fixed rate loans.

The Bank offers ARM loans with adjustment periods of one, three, five, seven or ten years. Interest rates on ARM loans currently offered by the Bank are adjusted at the beginning of each adjustment period based upon a fixed spread above the average yield on United States treasury securities, adjusted to the U.S. Treasury constant maturity index as published weekly by the Federal Reserve Board. From time to time, the Bank may originate ARM loans at an initial rate lower than the U.S. Treasury constant maturity index as a result of a discount on the spread for the initial adjustment period. ARM loans generally are subject to limitations on interest rate increases of 2% per adjustment period and an aggregate adjustment of 6% over the life of the loan. The Bank originated and purchased adjustable rate residential mortgage loans totaling \$36.8 million, \$13.5 million and \$13.1 million during 2007, 2006 and 2005, respectively. At December 31, 2007, \$98.0 million, or 58.1%, of the Bank's residential mortgage loans consisted of ARM loans.

The retention of ARM loans in the Bank's portfolio helps reduce the Bank's exposure to interest rate risks. However, in an environment of rapidly increasing interest rates, it is possible for the interest rate increase to exceed the

maximum aggregate adjustment on one-to-four family residential ARM loans and negatively affect the spread between the Bank's interest income and its cost of funds.

ARM loans generally involve credit risks different from those inherent in fixed-rate loans, primarily because if interest rates rise, the underlying payments of the borrower rise, thereby increasing the potential for default. However, this potential risk is lessened by the Bank's policy of originating one-to-four family residential ARM loans with annual and lifetime interest rate caps that limit the increase of a borrower's monthly payment.

Home equity loans are included in the Bank's portfolio of residential mortgage loans. These loans are offered as adjustable-rate home equity lines of credit on which interest only is due for an initial term of 10 years and thereafter principal and interest payments sufficient to liquidate the loan are required for the remaining term, not to exceed 30 years. These loans also may be offered as fully amortizing closed-end fixed-rate loans for terms up to 15 years. All home equity loans are made on one-to-four family residential and condominium units, which are owner-occupied, and one-to-four family mixed-use properties, and are subject to an 80% loan-to-value ratio computed on the basis of the aggregate of the first mortgage loan amount outstanding and the proposed home equity loan. They are generally granted in amounts from \$25,000 to \$300,000. The underwriting standards for home equity loans are substantially the same as those for residential mortgage loans. At December 31, 2007, home equity loans totaled \$36.1 million, or 1.34%, of gross loans.

*Construction Loans.* The Bank's construction loans primarily have been made to finance the construction of one-to-four family residential properties, multi-family residential properties and residential condominiums. The Bank also, to a limited extent, finances the construction of commercial real estate. The Bank's policies provide that construction loans may be made in amounts up to 70% of the estimated value of the developed property and only if the Bank obtains a first lien position on the underlying real estate. In addition, the Bank generally requires personal guarantees on all construction loans. Construction loans are generally made with terms of two years or less. Advances are made as construction progresses and inspection warrants, subject to continued title searches to ensure that the Bank maintains a first lien position. The Bank made advances on construction loans of \$54.2 million, \$75.1 million and \$46.4 million during 2007, 2006 and 2005, respectively. Construction loans outstanding at December 31, 2007 totaled \$119.7 million, or 4.44%, of gross loans.

Construction loans involve a greater degree of risk than other loans because, among other things, the underwriting of such loans is based on an estimated value of the developed property, which can be difficult to ascertain in light of uncertainties inherent in such estimations. In addition, construction lending entails the risk that the project may not be completed due to cost overruns or changes in market conditions.

*Small Business Administration Lending.* These loans are extended to small businesses and are guaranteed by the SBA up to a maximum of 85% of the loan balance for loans with balances of \$150,000 or less, and to a maximum of 75% of the loan balance for loans with balances greater than \$150,000. The Bank also provides term loans and lines of credit up to \$350,000 under the SBA Express Program, on which the SBA provides a 50% guaranty. The maximum amount the SBA can guarantee is \$2,000,000. All SBA loans are underwritten in accordance with SBA Standard Operating Procedures and the Bank generally obtains personal guarantees and collateral, where applicable, from SBA borrowers. Typically, SBA loans are originated at a range of \$25,000 to \$2.0 million with terms ranging from three to 25 years. SBA loans are generally offered at adjustable rates tied to the prime rate (as published in the Wall Street Journal) with adjustment periods of one to three months. The Bank generally sells the guaranteed portion of certain SBA term loans in the secondary market and retains the servicing rights on these loans, collecting a servicing fee of approximately 1%. The Bank originated \$12.8 million, \$19.9 million, and \$12.2 million of SBA loans during 2007, 2006, and 2005, respectively. At December 31, 2007, SBA loans totaled \$18.9 million, representing 0.70% of gross loans.

*Commercial Business and Other Lending.* The Bank originates other loans for business, personal, or household purposes. Total commercial business and other loans outstanding at December 31, 2007 amounted to \$110.0 million, or 4.08% of gross loans. Business loans are personally guaranteed by the owners, and may also be secured by additional collateral, including equipment and inventory. Included in commercial business loans are loans made to owners of New York City taxi medallions. These loans, which totaled \$68.2 million at December 31, 2007, are secured through liens on the taxi medallions. The Bank originates taxi medallion loans up to 75% of the value of the taxi medallion. The maximum loan size for a business loan is \$5,000,000, with a maximum term of 25 years. The Bank originated \$92.2 million, \$49.9 million, and \$12.4 million of commercial business loans during 2007, 2006, and 2005 respectively. Consumer loans generally consist of passbook loans and overdraft lines of credit. Generally, unsecured consumer loans are limited to amounts of \$5,000 or less for terms of up to five years. The Bank offers credit cards to its customers

through a third party financial institution and receives an origination fee and transactional fees for processing such accounts, but does not underwrite or finance any portion of the credit card receivables.

The underwriting standards employed by the Bank for consumer and other loans include a determination of the applicant's payment history on other debts and assessment of the applicant's ability to meet payments on all of his or her obligations. In addition to the creditworthiness of the applicant, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount. Unsecured loans tend to have higher risk, and therefore command a higher interest rate.

*Loan Approval Procedures and Authority.* The Bank's Board of Directors-approved lending policies establish loan approval requirements for its various types of loan products. The Bank's Residential Mortgage Lending Policy (which applies to all one-to-four family mortgage loans, including residential and mixed-use property) establishes authorized levels of approval. One-to-four family mortgage loans that do not exceed \$750,000 require two signatures for approval, one of which must be from the President, Executive Vice President or a Senior Vice President (collectively, Authorized Officers) and the other from a Senior Underwriter, Manager, Underwriter or Junior Underwriter in the Residential Mortgage Loan Department (collectively, Loan Officers). For one-to-four family mortgage loans from \$750,000 to \$1,000,000, three signatures are required for approval, at least two of which must be from the Authorized Officers, and the other one may be a Loan Officer. The Loan Committee, the Executive Committee or the full Board of Directors also must approve one-to-four family mortgage loans in excess of \$1,000,000. Pursuant to the Bank's Commercial Real Estate Lending Policy, all loans secured by commercial real estate and multi-family residential properties, must be approved by the President or the Executive Vice President upon the recommendation of the Commercial Loan Department Officer. Such loans in excess of \$1,000,000 also require Loan or Executive Committee or Board approval. In accordance with the Bank's Business Loan Policy, all business and SBA loans up to \$1,000,000, and commercial and industrial loans/professional mortgage loans up to \$1,500,000 must be approved by the Business Loan Committee, and ratified by the Management Loan Committee. Business and SBA loans in excess of \$1,000,000 up to \$2,000,000 must be approved by the Management Loan Committee and ratified by the Loan Committee of the Bank's Board of Directors. Commercial business and other loans require two signatures for approval, one of which must be from an Authorized Officer. The Bank's Construction Loan Policy requires that the Loan Committee or the Board of Directors of the Bank must approve all construction loans. Any loan, regardless of type, that deviates from the Bank's written loan policies must be approved by the Loan Committee or the Bank's Board of Directors.

For all loans originated by the Bank, upon receipt of a completed loan application, a credit report is ordered and certain other financial information is obtained. An appraisal of the real estate intended to secure the proposed loan is required. An independent appraiser designated and approved by the Bank currently performs such appraisals. The Bank's staff appraiser reviews the appraisals. The Bank's Board of Directors annually approves the independent appraisers used by the Bank and approves the Bank's appraisal policy. It is the Bank's policy to require borrowers to obtain title insurance and hazard insurance on all real estate first mortgage loans prior to closing. Borrowers generally are required to advance funds on a monthly basis together with each payment of principal and interest to a mortgage escrow account from which the Bank makes disbursements for items such as real estate taxes and, in some cases, hazard insurance premiums.

*Loan Concentrations.* The maximum amount of credit that the Bank can extend to any single borrower or related group of borrowers generally is limited to 15% of the Bank's unimpaired capital and surplus. Applicable law and regulations permit an additional amount of credit to be extended, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. See Regulation. However, it is currently the Bank's policy not to extend such additional credit. At December 31, 2007, the Bank had no loans in excess of the maximum dollar amount of loans to one borrower that the Bank was authorized to make. At that date, the three largest concentrations of loans to one borrower consisted of loans secured by a combination of commercial real estate and multi-family income producing properties with an aggregate principal balance of \$30.4 million, \$28.0 million and \$23.0 million for each of the three borrowers, respectively.

*Loan Servicing.* At December 31, 2007, the Bank was servicing \$32.0 million of mortgage loans and \$17.0 million of SBA loans for others. The Bank's policy is to retain the servicing rights to the mortgage and SBA loans that it sells in the secondary market. In order to increase revenue, management intends to continue this policy.

## **Asset Quality**

*Loan Collection.* When a borrower fails to make a required payment on a loan, the Bank takes a number of steps to induce the borrower to cure the delinquency and restore the loan to current status.

In the case of mortgage loans, personal contact is made with the borrower after the loan becomes 30 days delinquent. At that time, the Bank attempts to make arrangements with the borrower to either bring the loan to current status or begin making payments according to an agreed upon schedule. For the majority of delinquent loans, the borrower is able to bring the loan current within a reasonable time. When the borrower has indicated that he/she will be unable to bring the loan current, or due to other circumstances which, in management's opinion, indicate the borrower will be unable to bring the loan current within a reasonable time, or if the collateral value is deemed to have been impaired, the loan is classified as non-performing. All loans classified as non-performing, which includes all loans past due ninety days or more, are classified as non-accrual unless there is, in management's opinion, compelling evidence the borrower will bring the loan current in the immediate future. At December 31, 2007, there was one loan past due 90 days or more and still accruing interest.

Each non-performing loan is reviewed on an individual basis. Upon classifying a loan as non-performing, management reviews available information and conditions that relate to the status of the loan, including the estimated value of the loan's collateral and any legal considerations that may affect the borrower's ability to continue to make payments to the Bank. Based upon the available information, management will consider the sale of the loan or retention of the loan. If the loan is retained, the Bank may continue to work with the borrower to collect the amounts due or start foreclosure proceedings. If a foreclosure action is initiated and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan generally is sold at foreclosure or by the Bank as soon thereafter as practicable.

Once the decision to sell a loan is made, management determines what would be considered adequate consideration to be obtained when that loan is sold, based on the facts and circumstances related to that loan. Investors and brokers are then contacted to seek interest in purchasing the loan. The Bank has been successful in finding buyers for its non-performing loans offered for sale that are willing to pay what it considers to be adequate consideration. Terms of the sale include cash due upon closing of the sale, no contingencies or recourse to the Bank, servicing is released to the buyer and time is of the essence. These sales usually close within a reasonably short time period.

This strategy of selling non-performing loans was implemented during 2003. This has allowed the Bank to optimize its return by quickly converting its non-performing loans to cash, which can then be reinvested in earning assets. This strategy also allows the Bank to avoid lengthy and costly legal proceedings that may occur with non-performing loans. The Bank sold forty-five delinquent mortgage loans totaling \$33.9 million, thirty-five delinquent mortgage loans totaling \$12.2 million, and eleven delinquent mortgage loans totaling \$3.1 million during the years ended December 31, 2007, 2006 and 2005, respectively. The Bank did not record any charges to the allowance for loan losses for the non-performing loans which were sold. The Bank realized gross gains of \$332,000 and no gross losses on the sale of these mortgage loans for the year ended December 31, 2007. The Bank realized gross gains of \$169,000 and gross losses of \$14,000 on the sale of these mortgage loans for the year ended December 31, 2006. The Bank did not realize any gross gains or losses on the sale of these mortgage loans for the year ended December 31, 2005. There can be no assurances that the Bank will continue this strategy in future periods, or if continued, it will be able to find buyers to pay adequate consideration.

On mortgage loans or loan participations purchased by the Bank, for which the seller retains the servicing rights, the Bank receives monthly reports with which it monitors the loan portfolio. Based upon servicing agreements with the servicers of the loans, the Bank relies upon the servicer to contact delinquent borrowers, collect delinquent amounts and initiate foreclosure proceedings, when necessary, all in accordance with applicable laws, regulations and the terms of the servicing agreements between the Bank and its servicing agents. At December 31, 2007, the Bank held \$12.2 million of loans that were serviced by others.

In the case of commercial business or other loans, the Bank generally sends the borrower a written notice of non-payment when the loan is first past due. In the event payment is not then received, additional letters and phone calls generally are made in order to encourage the borrower to meet with a representative of the Bank to discuss the delinquency. If the loan still is not brought current and it becomes necessary for the Bank to take legal action, which typically occurs after a loan is delinquent 90 days or more, the Bank may attempt to repossess personal or business property that secures an SBA loan, commercial business loan or consumer loan.

*Delinquent Loans and Non-performing Assets.* The Bank generally discontinues accruing interest on delinquent loans when a loan is 90 days past due or foreclosure proceedings have been commenced, whichever first occurs. At that time, previously accrued but uncollected interest is reversed from income. Loans in default 90 days or more as to their maturity date but not their payments, however, continue to accrue interest as long as the borrower continues to remit monthly payments.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth information regarding all non-accrual loans and loans which are past due 90 days or more and still accruing, at the dates indicated. During the years ended December 31, 2007, 2006 and 2005, the amounts of additional interest income that would have been recorded on non-accrual loans, had they been current, totaled \$256,000, \$144,000 and \$103,000, respectively. These amounts were not included in the Bank's interest income for the respective periods.

(Dollars in thousands)	At December 31,				
	2007	2006	2005	2004	2003
<b>Non-accrual loans:</b>					
Multi-family residential	\$2,477	\$1,957	\$ 861	\$	\$
Commercial real estate	90	349			
One-to-four family mixed-use property					
One-to-four family residential	2,204	608	960	659	525
Co-operative apartment					
Construction					
<b>Total non-accrual mortgage loans</b>	<b>4,771</b>	<b>2,914</b>	<b>1,821</b>	<b>659</b>	<b>525</b>
Other non-accrual loans	369	212	101	252	157
<b>Total non-accrual loans</b>	<b>5,140</b>	<b>3,126</b>	<b>1,922</b>	<b>911</b>	<b>682</b>
Loans 90 days or more delinquent and still accruing	753		530		
<b>Total non-performing loans</b>	<b>5,893</b>	<b>3,126</b>	<b>2,452</b>	<b>911</b>	<b>682</b>
Foreclosed real estate					
Investment securities					
<b>Total non-performing assets</b>	<b>\$5,893</b>	<b>\$3,126</b>	<b>\$2,452</b>	<b>\$ 911</b>	<b>\$ 682</b>
<b>Troubled debt restructurings</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Non-performing loans to gross loans	0.22%	0.13%	0.13%	0.06%	0.05%
Non-performing assets to total assets	0.18%	0.11%	0.10%	0.04%	0.04%

*Real Estate Owned (REO).* The Bank aggressively markets any REO properties, when and if, they are acquired through foreclosure. At December 31, 2007, 2006 and 2005, the Bank did not own any such properties.

*Environmental Concerns Relating to Loans.* The Bank currently obtains environmental reports in connection with the underwriting of commercial real estate loans, and typically obtains environmental reports in connection with the underwriting of multi-family loans. For all other loans, the Bank obtains environmental reports only if the nature of the current or, to the extent known to the Bank, prior use of the property securing the loan indicates a potential environmental risk. However, the Bank may not be aware of such uses or risks in any particular case, and, accordingly, there is no assurance that real estate acquired by the Bank in foreclosure is free from environmental contamination or that, if any such contamination or other violation exists, the Bank will not have any liability therefor.

#### Allowance for Loan Losses

The Bank has established and maintains on its books an allowance for loan losses that is designed to provide a reserve against estimated losses inherent in the Bank's overall loan portfolio. The allowance is established through a provision for loan losses based on management's evaluation of the risk inherent in the various components of its loan portfolio and other factors, including historical loan loss experience (which is updated at least annually), changes in the composition and volume of the portfolio, collection policies and experience, trends in the volume of non-accrual loans and regional and national economic conditions. The determination of the amount of the allowance for loan losses includes estimates that are susceptible to significant changes due to changes in appraisal values of collateral, national and regional economic conditions and other factors. Management reviews the Bank's loan portfolio by separate categories with similar risk and collateral characteristics. Impaired loans are segregated and reviewed separately. All non-performing loans are classified impaired. Impaired loans secured by collateral are reviewed based on their collateral and the estimated time to recover the Bank's investment in the loan, and the estimate of the recovery

## Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

anticipated. Specific reserves allocated to impaired loans were \$605,000 and \$316,000 at December 31, 2007 and 2006, respectively. For non-collateralized impaired loans, management estimates any recoveries that are anticipated for each loan. Specific reserves are allocated to impaired loans based on this review. In connection with the determination of the allowance, the market value of collateral ordinarily is evaluated by the Bank's staff appraiser; however, the Bank may from time to time obtain independent appraisals for significant properties. Current year charge-offs, charge-off trends, new loan production and current balance by particular loan categories are also taken into account in determining the appropriate amount of

allowance. The Board of Directors reviews and approves the adequacy of the allowance for loan losses on a quarterly basis.

In assessing the adequacy of the allowance, management also reviews the Bank's loan portfolio by separate categories which have similar risk and collateral characteristics; e.g. multi-family residential, commercial real estate, one-to-four family mixed-use property, one-to-four family residential, co-operative apartment, construction, SBA, commercial business, taxi medallion and consumer loans. General provisions are established against performing loans in the Bank's portfolio in amounts deemed prudent from time to time based on the Bank's qualitative analysis of the factors, including the historical loss experience and regional economic conditions. During the five-year period ended December 31, 2007, the Bank incurred total net charge-offs of \$701,000. This reflects a significant improvement over the loss experience of the 1990s. In addition, while the regional economy had slowed by the fourth quarter of 2007, the regional economy has improved since 2001, including significant increases in real estate values. The Bank's underwriting standards generally require a loan-to-value ratio of 75% at a time the loan is originated. Since real estate values have increased significantly since 2001, the loan-to-value ratios for loans originated in prior years have declined below the original 75% level. The rate at which mortgagors have been defaulting on their loans has declined, as the mortgagor's equity in the property has increased. The Bank has not been affected by the recent increase in defaults of sub-prime mortgages as the Bank does not originate, or hold in portfolio, sub-prime mortgages. As a result, the Bank has not incurred losses on mortgage loans in recent years. As a result of these improvements, and despite the increase in the loan portfolio and shift to loans with greater risk, the Bank has not considered it necessary to provide a provision for loan losses during any of the years in the five-year period ended December 31, 2007. Management has concluded, and the Board of Directors has concurred, that, during this time period, the allowance was sufficient to absorb losses inherent in the loan portfolio.

The Bank's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS and the FDIC, which can require the establishment of additional general allowances or specific loss allowances or require charge-offs. Such authorities may require the Bank to make additional provisions to the allowance based on their judgments about information available to them at the time of their examination. An OTS policy statement provides guidance for OTS examiners in determining whether the levels of general valuation allowances for savings institutions are adequate. The policy statement requires that if a savings institution's general valuation allowance policies and procedures are deemed to be inadequate, recommendations for correcting deficiencies, including any examiner concerns regarding the level of the allowance, should be noted in the report of examination. Additional supervisory action may also be taken based on the magnitude of the observed shortcomings in the allowance process, including the materiality of any error in the reported amount of the allowance.

Management of the Bank believes that the current allowance for loan losses is adequate in light of current economic conditions, the composition of its loan portfolio and other available information and the Board of Directors concurs in this belief. Due to the acquisition of Atlantic Liberty in 2006, the allowance for loan losses was increased by Atlantic Liberty's allowance of \$753,000. The Bank however did not record any additional provision for loan losses for the years ended December 31, 2007, 2006 and 2005. At December 31, 2007, the total allowance for loan losses was \$6.6 million, representing 112.57% of each of non-performing loans and non-performing assets, compared to 225.72% for both of these ratios at December 31, 2006. The Bank continues to monitor and, as necessary, modify the level of its allowance for loan losses in order to maintain the allowance at a level which management considers adequate to provide for probable loan losses based on available information.

Many factors may require additions to the allowance for loan losses in future periods beyond those currently revealed. These factors include future adverse changes in economic conditions, changes in interest rates and changes in the financial capacity of individual borrowers (any of which may affect the ability of borrowers to make repayments on loans), changes in the real estate market within the Bank's lending area and the value of collateral, or a review and evaluation of the Bank's loan portfolio in the future. The determination of the amount of the allowance for loan losses includes estimates that are susceptible to significant changes due to changes in appraised values of collateral, national and regional economic conditions, interest rates and other factors. In addition, the Bank's increased emphasis on multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans can be expected to increase the overall level of credit risk inherent in the Bank's loan portfolio. The greater risk associated with these loans, as well as construction loans and business loans, could require the Bank to increase its provisions for loan losses and to maintain an allowance for loan losses as a percentage of total loans that is in excess of the allowance currently maintained by the Bank. Provisions for loan losses are charged against net income. See "Lending Activities" and "Asset Quality".

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth changes in, and the balance of, the Bank's allowance for loan losses.

<i>(Dollars in thousands)</i>	At and for the years ended December 31,				
	2007	2006	2005	2004	2003
Balance at beginning of year	\$ 7,057	\$ 6,385	\$ 6,533	\$ 6,553	\$ 6,581
Acquisition of Atlantic Liberty		753			
Provision for loan losses					
Loans charged-off:					
Multi-family residential					
Commercial real estate					
One-to-four family mixed-use property					
One-to-four family residential					
Co-operative apartment					
Construction					
SBA	(470)	(57)	(144)	(28)	(111)
Commercial business and other loans	(2)	(36)	(20)		(44)
Total loans charged-off	(472)	(93)	(164)	(28)	(155)
Recoveries:					
Mortgage loans	29	2	3	3	125
SBA, commercial business and other loans	19	10	13	5	2
Total recoveries	48	12	16	8	127
Net charge-offs	(424)	(81)	(148)	(20)	(28)
Balance at end of year	\$ 6,633	\$ 7,057	\$ 6,385	\$ 6,533	\$ 6,553
Ratio of net charge-offs during the year to average loans outstanding during the year	0.02%	0.00%	0.01%	0.00%	0.00%
Ratio of allowance for loan losses to gross loans at end of the year	0.25%	0.30%	0.34%	0.43%	0.51%
Ratio of allowance for loan losses to non-performing loans at the end of the year	112.57%	225.72%	260.39%	717.29%	960.86%
Ratio of allowance for loan losses to non-performing assets at the end of the year	112.57%	225.72%	260.39%	717.29%	960.86%



Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth the Bank's allocation of its allowance for loan losses to the total amount of loans in each of the categories listed at the dates indicated. The numbers contained in the Amount column indicate the allowance for loan losses allocated for each particular loan category. The numbers contained in the column entitled Percentage of Loans in Category to Total Loans indicate the total amount of loans in each particular category as a percentage of the Bank's loan portfolio.

At December 31,										
Loan Category	2007		2006		2005		2004		2003	
	Amount	Percent of Loans in Category to Total loans	Amount	Percent of Loans in Category to Total loans	Amount	Percent of Loans in Category to Total loans	Amount	Percent of Loans in Category to Total loans	Amount	Percent of Loans in Category to Total loans
<i>(Dollars in thousands)</i>										
<b>Mortgage Loans:</b>										
Multi-family residential	\$ 1,644	35.79%	\$ 1,122	37.52%	\$ 1,216	41.92%	\$ 1,010	42.61%	\$ 1,251	42.53%
Commercial real estate	933	23.23	668	22.38	1,272	21.23	1,715	22.00	2,740	22.79
One-to-four family mixed-use property	1,223	25.49	661	25.33	1,544	25.42	1,494	21.92	803	17.76
One-to-four family residential	251	6.01	80	6.98	524	7.17	718	10.00	684	14.01
Co-operative apartment	15	0.26	10	0.35	161	0.11	207	0.21	127	0.29
Construction	1,172	4.44	851	4.50	64	2.63	55	2.07	56	1.85
<b>Gross mortgage loans</b>	<b>5,238</b>	<b>95.22</b>	<b>3,392</b>	<b>97.06</b>	<b>4,781</b>	<b>98.48</b>	<b>5,199</b>	<b>98.81</b>	<b>5,661</b>	<b>99.23</b>
<b>Small Business</b>										
Administration loans	373	0.70	1,895	0.75	964	0.49	663	0.37	553	0.39
Commercial business and other loans	1,022	4.08	1,770	2.19	640	1.03	671	0.82	339	0.38
<b>Total loans</b>	<b>\$ 6,633</b>	<b>100.00%</b>	<b>\$ 7,057</b>	<b>100.00%</b>	<b>\$ 6,385</b>	<b>100.00%</b>	<b>\$ 6,533</b>	<b>100.00%</b>	<b>\$ 6,553</b>	<b>100.00%</b>

## Investment Activities

*General.* The investment policy of the Company, which is approved by the Board of Directors, is designed primarily to manage the interest rate sensitivity of its overall assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement the Bank's lending activities and to provide and maintain liquidity. In establishing its investment strategies, the Company considers its business and growth strategies, the economic environment, its interest rate risk exposure, its interest rate sensitivity gap position, the types of securities to be held, and other factors. See Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Management Strategy in Item 7 of this Annual Report.

Federally chartered savings institutions have authority to invest in various types of assets, including U.S. government obligations, securities of various federal agencies, mortgage-backed and mortgage-related securities, certain certificates of deposit of insured banks and savings institutions, certain bankers acceptances, reverse repurchase agreements, loans of federal funds, and, subject to certain limits, corporate securities, commercial paper and mutual funds. The Company primarily invests in mortgage-backed securities, U. S. government obligations, and mutual funds which purchase these same instruments.

The Investment Committee of the Bank and the Company meets quarterly to monitor investment transactions and to establish investment strategy. The Board of Directors reviews the investment policy on an annual basis and investment activity on a monthly basis.

The Company classifies its investment securities as available for sale. Unrealized gains and losses (other than unrealized losses considered other than temporary) for available-for-sale securities are excluded from earnings and included in Accumulated Other Comprehensive Income (a separate component of equity), net of taxes. At December 31, 2007, the Company had \$440.1 million in securities available for sale which represented 13.1% of total assets. These securities had an aggregate market value at December 31, 2007 that was approximately 1.9 times the amount of the Company's equity at that date. The cumulative balance of unrealized net gains on securities available for sale was \$16,000, net of taxes, at December 31, 2007. As a result of the magnitude of the Company's holdings of securities available for sale, changes in interest rates could produce significant changes in the value of such securities and could produce significant fluctuations in the equity of the Company. See Note 4 of Notes to Consolidated Financial Statements, included in Item 8 of this Annual Report. The Company may from time to time sell securities and realize a loss if the proceeds of such sale may be reinvested in loans or other assets offering more attractive yields.

At December 31, 2007, there was one issuer's security, excluding government agencies or government sponsored agencies, that either alone, or together with any investments in the securities of any affiliate(s) of such issuer, exceeded 10% of the Company's equity. This security is a collateralized mortgage obligation issued by Residential Asset Securitization Trust 2006-A4IP, and is a senior fixed-rate pass-through whose credit enhancement is the securities subordinated to this security. The Company's amortized cost of this security as of December 31, 2007 was \$24.7 million, and the fair value of the security was \$24.4 million. The Company does not consider this investment to be other-than-temporarily impaired as of December 31, 2007.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The table below sets forth certain information regarding the amortized cost and market values of the Company's securities portfolio, interest bearing deposits and federal funds sold, at the dates indicated. Securities available for sale are recorded at market value. See Note 4 of Notes to Consolidated Financial Statements, included in Item 8 of this Annual Report.

	At December 31,					
	2007		2006		2005	
	Amortized Cost	Market Value	Amortized Cost	Market Value	Amortized Cost	Market Value
<i>(In thousands)</i>						
<b>Securities available for sale</b>						
Bonds and other debt securities:						
U.S. government and agencies	\$ 4,406	\$ 4,406	\$ 15,016	\$ 15,004	\$ 10,942	\$ 10,911
Corporate debentures	2,643	2,643				
Total bonds and other debt securities	7,049	7,049	15,016	15,004	10,942	10,911
Mutual funds	21,752	21,752	21,224	20,645	20,296	19,767
Equity securities:						
Common stock	1,838	1,838	619	619	619	619
Preferred stock	46,732	46,732	5,685	5,468	5,493	5,270
Total equity securities	48,570	48,570	6,304	6,087	6,112	5,889
Mortgage-backed securities:						
FNMA	123,121	122,770	135,458	131,192	152,412	147,802
REMIC and CMO	182,609	182,730	100,165	98,652	91,369	89,561
FHLMC	45,511	45,566	53,440	51,733	57,470	55,735
GNMA	11,464	11,663	7,199	7,274	7,789	8,096
Total mortgage-backed securities	362,705	362,729	296,262	288,851	309,040	301,194
Total securities available for sale	440,076	440,100	338,806	330,587	346,390	337,761
<b>Interest-bearing deposits and Federal funds sold</b>						
	5,758	5,758	4,670	4,670	4,396	4,396
Total	\$ 445,834	\$ 445,858	\$ 343,476	\$ 335,257	\$ 350,786	\$ 342,157

*Mortgage-backed securities.* At December 31, 2007, the Company had \$362.7 million invested in mortgage-backed securities, of which \$13.5 million was invested in adjustable-rate mortgage-backed securities. The mortgage loans underlying these adjustable-rate securities generally are subject to limitations on annual and lifetime interest rate increases. The Company anticipates that investments in mortgage-backed securities may continue to be used in the future to supplement mortgage-lending activities. Mortgage-backed securities are more liquid than individual mortgage loans and may be used more easily to collateralize obligations of the Bank.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth the Company's mortgage-backed securities purchases, sales and principal repayments for the years indicated:

	For the years ended December 31,		
	2007	2006	2005
	<i>(In thousands)</i>		
Balance at beginning of year	\$ 288,851	\$ 301,194	\$ 395,629
Acquired with Atlantic Liberty		30,844	
Purchases of mortgage-backed securities	117,408	43,897	29,627
Amortization of unearned premium, net of accretion of unearned discount	(193)	(560)	(1,219)
Net change in unrealized gains (losses) on mortgage-backed securities available for sale	1,695	435	(6,285)
Net realized gains recorded on mortgage-backed securities carried at fair value	2,685		
Net change in interest due on securities carried at fair value	515		
Sales of mortgage-backed securities		(36,220)	(28,643)
Principal repayments received on mortgage-backed securities	(48,232)	(50,739)	(87,915)
Net increase (decrease) in mortgage-backed securities	73,878	(12,343)	(94,435)
Balance at end of year	\$ 362,729	\$ 288,851	\$ 301,194

While mortgage-backed securities carry a reduced credit risk as compared to whole loans, such securities remain subject to the risk that a fluctuating interest rate environment, along with other factors such as the geographic distribution of the underlying mortgage loans, may alter the prepayment rate of such mortgage loans and so affect both the prepayment speed and value of such securities. The Company does not own any derivative instruments that are extremely sensitive to changes in interest rates.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The table below sets forth certain information regarding the amortized cost, fair value, annualized weighted average yields and maturities of the Company's debt and equity securities at December 31, 2007. The stratification of balances is based on stated maturities. Equity securities are shown as immediately maturing, except for preferred stocks with stated redemption dates, which are shown in the period they are scheduled to be redeemed. Assumptions for repayments and prepayments are not reflected for mortgage-backed securities. The Company carries these investments at their fair value in the consolidated financial statements.

	One year or Less	One to Five Years	Five to Ten Years	More than Ten Years	Total Securities					
	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield	Average Remaining Years to Maturity	Amortized Cost	Estimated Fair Value	Weighted Average Yield

(Dollars in thousands)

**Securities  
available for sale**

Bonds and other  
debt securities:

U.S. government and agencies	\$	%	\$ 4,406	4.15%	\$	% 5.16	\$ 4,406	\$ 4,406	4.15%
---------------------------------	----	---	----------	-------	----	--------	----------	----------	-------

Corporate debentures			2,643	5.39		4.63	2,643	2,643	5.39
-------------------------	--	--	-------	------	--	------	-------	-------	------

Total bonds and  
other debt  
securities

			7,049	4.61		4.96	7,049	7,049	4.61
--	--	--	-------	------	--	------	-------	-------	------

Mutual funds	21,752	4.99				N/A	21,752	21,752	4.99
--------------	--------	------	--	--	--	-----	--------	--------	------

Equity securities:

Common stock					1,838	7.03	N/A	1,838	1,838	7.03
--------------	--	--	--	--	-------	------	-----	-------	-------	------

Preferred stock			4,753	5.78	41,979	7.18	N/A	46,732	46,732	7.04
-----------------	--	--	-------	------	--------	------	-----	--------	--------	------

Total equity  
securities

			4,753	5.78	43,817	7.17	N/A	48,570	48,570	7.04
--	--	--	-------	------	--------	------	-----	--------	--------	------

Mortgage-backed  
securities:

FNMA		4,114	5.01	8,318	5.33	110,689	5.08	16.38	123,121	122,770	5.09
------	--	-------	------	-------	------	---------	------	-------	---------	---------	------

		153	3.99	27,465	4.53	154,991	5.60	23.54	182,609	182,730	5.44
--	--	-----	------	--------	------	---------	------	-------	---------	---------	------

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

<b>REMIC and CMO</b>												
FHLMC		8,403	4.03		502	5.95	36,606	4.77	13.40	45,511	45,566	4.65
GNMA							11,464	5.81	27.55	11,464	11,663	5.81
<hr/>												
Total mortgage-backed securities		12,670	4.35		36,285	4.73	313,750	5.33	19.96	362,705	362,729	5.23
<hr/>												
<b>Interest-bearing deposits</b>												
	5,758	2.80							N/A	5,758	5,758	2.80
<hr/>												
Total securities	\$ 27,510	4.53%	\$ 12,670	4.35%	\$ 48,087	4.82%	\$ 357,567	5.55%	19.68	\$ 445,834	\$ 445,858	5.38%
<hr/>												

## Sources of Funds

*General.* Deposits, FHLB-NY borrowings, repurchase agreements, principal and interest payments on loans, mortgage-backed and other securities, and proceeds from sales of loans and securities are the Company's primary sources of funds for lending, investing and other general purposes.

*Deposits.* The Bank offers a variety of deposit accounts having a range of interest rates and terms. The Bank's deposits principally consist of savings accounts, money market accounts, demand accounts, NOW accounts and certificates of deposit. The Bank has a relatively stable retail deposit base drawn from its market area through its fourteen full service offices. The Bank seeks to retain existing depositor relationships by offering quality service and competitive interest rates, while keeping deposit growth within reasonable limits. It is management's intention to balance its goal to maintain competitive interest rates on deposits while seeking to manage its cost of funds to finance its strategies.

In November, 2006, the Bank launched [iGObanking.com](http://iGObanking.com)<sup>®</sup>, an internet branch, offering savings accounts and certificates of deposit. This allows the Bank to compete on a national scale without the geographical constraints of physical locations. Since the number of U.S. households with accounts at Web-only banks has grown more than tenfold in the past six years, our strategy was to join the market place by creating a branch that offers clients the simplicity and flexibility of a virtual online bank, which is a division of a stable, traditional bank that was established in 1929. At December 31, 2007, total deposits for the internet branch were \$133.0 million.

In 2007, the Bank formed a new wholly owned subsidiary, Flushing Commercial Bank, a New York State chartered commercial bank, for the limited purpose of accepting municipal deposits and state funds in the State of New York. The commercial bank offers a full range of deposit products to municipalities and the State of New York, similar to the products currently being offered by the Bank. To date the operations of Flushing Commercial Bank have not been material.

The Bank's core deposits, consisting of savings accounts, NOW accounts, money market accounts, and non-interest bearing demand accounts, are typically more stable and lower costing than other sources of funding. However, the flow of deposits into a particular type of account is influenced significantly by general economic conditions, changes in prevailing money market and other interest rates, and competition. The Bank has seen an increase in its deposits in each of the past three years. While the nation's economy continued to expand in 2006 and 2007, the economy began to show signs of slowing growth in late 2007. The Bank saw an increase in its deposits during 2007 of \$258.6 million. The Federal Reserve's Federal Open Market Committee (FOMC) began increasing short-term interest rates in the second half of 2004, and continued increasing short-term rates through June 2006. The FOMC held the short-term interest rates through September 2007, and then lowered short-term interest rates 100 basis through December 2007. The Bank responded by increasing interest rates paid on savings, money market and certificate of deposit accounts during 2005 and 2006. The Bank held rates through most of 2007, before being able to lower rates near the end of 2007. This resulted in new deposits being obtained at rates that were higher than the weighted average cost of existing deposits. The cost of deposits increased to 4.31% in the fourth quarter of 2007 from 3.97% in the fourth quarter of 2006 and 2.95% in the fourth quarter of 2005. While we are unable to predict the direction of future interest rate changes, if interest rates rise during 2008, the result could be continued increases in the Company's cost of deposits, which could reduce the Company's net interest margin. Similarly, if interest rates decline in 2008, the Company could see a decline in its cost of deposits, which could increase the Company's net interest margin.

Included in deposits are certificates of deposit with a balance of \$100,000 or more totaling \$318.5 million, \$298.9 million and \$255.3 million at December 31, 2007, 2006 and 2005, respectively.

The Bank utilizes brokered deposits as an additional funding source. Brokered deposits are marketed through national brokerage firms to their customers in \$1,000 increments. The Bank maintains only one account for the total deposit amount, while the detailed records of owners are maintained by the brokerage firms. The Depository Trust Company is used as the clearing house, maintaining each deposit under the name of CEDE & Co. The deposits are transferable just like a stock or bond investment and the customer can open the account with only a phone call, just like buying a stock or bond. This provides a large deposit for the Bank at a lower operating cost since the Bank only has one account to maintain versus several accounts with multiple interest and maturity checks. The Bank seeks to obtain brokered deposits primarily when the interest rate on these deposits is below the prevailing interest rate in its market.

Unlike non-brokered deposits, where the deposit amount can be withdrawn with a penalty for any reason, including increasing interest rates, a brokered deposit can only be withdrawn in the event of the death, or court declared mental incompetence, of the depositor. This allows the Bank to better manage the maturity of its deposits. Currently, the

rates offered by the Bank for brokered deposits are comparable to that offered for retail certificates of deposit of similar size and maturity.

The Bank also offers access to \$50 million per customer in FDIC insurance coverage through a Certificate of Deposit Account Registry Service ( CDARS® ). CDARS® is a deposit placement service. The Bank belongs to a network which arranges for placement of funds into certificate of deposit accounts issued by other member banks of the network in increments of less than \$100,000 to ensure that both principal and interest are eligible for full FDIC deposit insurance. This allows the Bank to accept deposits in excess of \$100,000 from a depositor, and place the deposits through the network to other member banks to provide full FDIC deposit insurance coverage. The Bank may receive deposits from other member banks in exchange for the deposits the Bank places into the network. The Bank may also obtain deposits from other network member banks without placing deposits into the network, or place deposits with other member banks without receiving deposits from other member banks. Depositors are allowed to withdraw funds, with a penalty, from these accounts at one or more of the member banks that hold the deposits.

Brokered deposits and funds obtained through the CDARS® network are classified as brokered deposits for financial reporting purposes. At December 31, 2007, the Bank has \$201.7 million classified as brokered deposits, with \$16.5 million obtained through the CDARS® network and \$185.2 million obtained through brokers.



Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth the distribution of the Bank's deposit accounts at the dates indicated and the weighted average nominal interest rates on each category of deposits presented.

At December 31,									
2007			2006			2005			
Amount	Percent of Total Deposits	Weighted Average Nominal Rate	Amount	Percent of Total Deposits	Weighted Average Nominal Rate	Amount	Percent of Total Deposits	Weighted Average Nominal Rate	
<i>(Dollars in thousands)</i>									
Savings accounts	\$ 354,746	17.51%	2.82%	\$ 262,980	14.91%	1.70%	\$ 273,753	18.66%	1.45%
NOW accounts	70,817	3.50	2.16	47,181	2.67	0.44	42,029	2.87	0.50
Demand accounts	69,299	3.42		80,061	4.54		58,678	4.00	
Mortgagors' escrow deposits	22,492	1.11	0.23	19,755	1.12	0.22	19,423	1.32	0.21
<b>Total</b>	<b>517,354</b>	<b>25.54</b>	<b>2.24</b>	<b>409,977</b>	<b>23.24</b>	<b>1.15</b>	<b>393,883</b>	<b>26.85</b>	<b>1.07</b>
Money market accounts	340,694	16.82	3.18	251,197	14.24	4.06	175,247	11.94	2.47
Certificate of deposit accounts with original maturities of:									
Less than 6 Months (2)	6,090	0.30	4.32	2,704	0.15	0.66	2,684	0.18	0.74
6 to less than 12 Months (3)	303,894	15.00	5.07	166,622	9.44	4.91	66,965	4.56	3.20
12 to less than 30 Months (4)	421,568	20.82	4.82	441,616	25.03	4.65	412,527	28.11	3.50
30 to less than 48 Months (5)	58,424	2.88	4.07	65,698	3.72	3.74	59,623	4.06	3.41
48 to less than 72 Months (6)	326,184	16.11	4.69	368,000	20.87	4.66	292,380	19.94	4.52
72 Months or more	51,239	2.53	4.79	58,336	3.31	4.92	63,978	4.36	4.95
<b>Total certificate of deposit accounts</b>	<b>1,167,399</b>	<b>57.64</b>	<b>4.81</b>	<b>1,102,976</b>	<b>62.52</b>	<b>4.64</b>	<b>898,157</b>	<b>61.21</b>	<b>3.90</b>
<b>Total deposits (1)</b>	<b>\$ 2,025,447</b>	<b>100.00%</b>	<b>3.88%</b>	<b>\$ 1,764,150</b>	<b>100.00%</b>	<b>3.75%</b>	<b>\$ 1,467,287</b>	<b>100.00%</b>	<b>2.97%</b>

(1) Included in the above balances are IRA and Keogh deposits totaling \$173.2 million, \$177.0 million and \$170.9 million at December 31, 2007, 2006 and 2005, respectively.

(2) Includes brokered deposits of \$3.0 million at December 31, 2007.

(3) Includes brokered deposits of \$3.2 million at December 31, 2007.

(4) Includes brokered deposits of \$21.7 million at December 31, 2007.

(5) Includes brokered deposits of \$69.7 million, \$46.4 million and \$11.5 million at December 31, 2007, 2006 and 2005, respectively.

(6) Includes brokered deposits of \$104.1 million, \$98.5 million and \$19.8 million at December 31, 2007, 2006 and 2005, respectively.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table presents by various rate categories, the amount of time deposit accounts outstanding at the dates indicated, and the years to maturity of the certificate accounts outstanding at December 31, 2007.

	At December 31,			At December 31, 2007			
	2007	2006	2005	Within One Year	One to Three Years	Thereafter	Total
<i>(In thousands)</i>							
<b>Interest rate:</b>							
1.99% or less	\$ 9,931	\$ 49,953	\$ 70,762	\$ 8,773	\$ 1,158	\$ 9	\$ 9,931
2.00% to 2.99%	5,009	9,630	20,044	2,297	2,703	9	5,009
3.00% to 3.99% (1)	94,249	114,487	336,757	55,070	33,244	5,935	94,249
4.00% to 4.99% (2)	399,921	382,060	379,327	228,778	126,910	44,233	399,921
5.00% to 5.99% (3)	657,558	542,524	83,925	420,317	167,225	70,016	657,558
6.00% to 6.99% (4)	94	302	3,007	94			94
7.00% to 7.99%	637	4,020	4,335	637			637
<b>Total</b>	<b>\$ 1,167,399</b>	<b>\$ 1,102,976</b>	<b>\$ 898,157</b>	<b>\$ 715,966</b>	<b>\$ 331,240</b>	<b>\$ 120,193</b>	<b>\$ 1,167,399</b>

- (1) Includes brokered deposits of \$0.3 million at December 31, 2007.
- (2) Includes brokered deposits of \$65.0 million, \$51.0 million and \$31.3 million at December 31, 2007, 2006 and 2005, respectively.
- (3) Includes brokered deposits of \$136.3 million and \$93.9 million at December 31, 2007 and 2006, respectively.
- (4) Includes brokered deposits of \$0.1 million at December 31, 2007.

The following table presents by remaining maturity categories the amount of certificate of deposit accounts with balances of \$100,000 or more at December 31, 2007 and their annualized weighted average interest rates.

	Amount	Weighted Average Rate
<i>(Dollars in thousands)</i>		
<b>Maturity Period:</b>		
Three months or less	\$ 127,668	5.07%
Over three through six months	41,594	4.86
Over six through 12 months	72,906	4.84
Over 12 months	76,297	4.81
<b>Total</b>	<b>\$ 318,465</b>	<b>4.93%</b>

The above table does not include brokered deposits of \$201.7 million with a weighted average rate of 4.96%.

The following table presents the deposit activity, including mortgagors escrow deposits, of the Bank for the periods indicated.

For the year ended December 31,		
2007	2006	2005

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

	<i>(In thousands)</i>		
Net deposits	\$ 183,280	\$ 133,240	\$ 139,833
Acquired with Atlantic Liberty		106,766	
Amortization of premiums, net	855	464	
Interest on deposits	77,162	56,393	34,657
	<u>          </u>	<u>          </u>	<u>          </u>
Net increase in deposits	\$ 261,297	\$ 296,863	\$ 174,490
	<u>          </u>	<u>          </u>	<u>          </u>

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth the distribution of the Bank's average deposit accounts for the years indicated, the percentage of total deposit portfolio, and the average interest cost of each deposit category presented. Average balances for all years shown are derived from daily balances.

	For the years ended December 31,								
	2007			2006			2005		
	Average Balance	Percent of Total Deposits	Average Cost	Average Balance	Percent of Total Deposits	Average Cost	Average Balance	Percent of Total Deposits	Average Cost
	<i>(Dollars in thousands)</i>								
Savings accounts	\$ 310,457	16.09%	2.44%	\$ 265,421	16.23%	1.52%	\$ 241,121	17.98%	0.92%
NOW accounts	57,915	3.00	1.58	43,052	2.63	0.47	43,133	3.22	0.50
Demand accounts	65,508	3.40		60,991	3.73		52,017	3.88	
Mortgagors escrow deposits	32,403	1.68	0.23	29,275	1.79	0.22	27,337	2.04	0.21
<b>Total</b>	<b>466,283</b>	<b>24.17</b>	<b>1.84</b>	<b>398,739</b>	<b>24.38</b>	<b>1.08</b>	<b>363,608</b>	<b>27.12</b>	<b>0.69</b>
Money market accounts	294,402	15.26	4.22	235,642	14.41	3.74	228,818	17.06	2.27
Certificate of deposit accounts	1,168,620	60.57	4.88	1,001,438	61.21	4.37	748,747	55.82	3.60
<b>Total deposits</b>	<b>\$ 1,929,305</b>	<b>100.00%</b>	<b>4.04%</b>	<b>\$ 1,635,819</b>	<b>100.00%</b>	<b>3.48%</b>	<b>\$ 1,341,173</b>	<b>100.00%</b>	<b>2.58%</b>

*Borrowings.* Although deposits are the Bank's primary source of funds, the Bank also uses borrowings as an alternative and cost effective source of funds for lending, investing and other general purposes. The Bank is a member of, and is eligible to obtain advances from, the FHLB-NY. Such advances generally are secured by a blanket lien against the Bank's mortgage portfolio and the Bank's investment in the stock of the FHLB-NY. In addition, the Bank may pledge mortgage-backed securities to obtain advances from the FHLB-NY. See Regulation Federal Home Loan Bank System. The maximum amount that the FHLB-NY will advance for purposes other than for meeting withdrawals fluctuates from time to time in accordance with the policies of the FHLB-NY. The Bank also enters into repurchase agreements with broker-dealers and the FHLB-NY. These agreements are recorded as financing transactions and the obligations to repurchase are reflected as a liability in the Company's consolidated financial statements. In addition, the Holding Company issued junior subordinated debentures with a total par of \$61.8 million in June and July 2007. These junior subordinated debentures are carried at fair value in the consolidated statement of financial position. The average cost of borrowed funds was 4.97%, 4.73% and 4.33% for the years ended December 31, 2007, 2006 and 2005, respectively. The average balances of borrowed funds were \$897.8 million, \$715.3 million and \$683.0 million for the same years, respectively.

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

The following table sets forth certain information regarding the Company's borrowed funds at or for the periods ended on the dates indicated.

	At or for the years ended December 31,		
	2007	2006	2005
<i>(Dollars in thousands)</i>			
<b>Securities Sold with the Agreement to Repurchase</b>			
Average balance outstanding	\$ 229,544	\$ 207,955	\$ 210,174
Maximum amount outstanding at any month end during the period	272,693	238,900	213,900
Balance outstanding at the end of period	222,824	223,900	178,900
Weighted average interest rate during the period	5.04%	4.70%	4.25%
Weighted average interest rate at end of period	4.71	4.91	4.43
<b>FHLB-NY Advances</b>			
Average balance outstanding	\$ 625,035	\$ 486,750	\$ 452,246
Maximum amount outstanding at any month end during the period	788,499	587,894	524,198
Balance outstanding at the end of period	788,499	587,894	490,191
Weighted average interest rate during the period	4.77%	4.56%	4.23%
Weighted average interest rate at end of period	4.70	4.63	4.40
<b>Other Borrowings</b>			
Average balance outstanding	\$ 43,242	\$ 20,619	\$ 20,619
Maximum amount outstanding at any month end during the period	63,651	20,619	20,619
Balance outstanding at the end of period	61,228	20,619	20,619
Weighted average interest rate during the period	7.43%	9.00%	7.21%
Weighted average interest rate at end of period	7.03	9.02	7.80
<b>Total Borrowings</b>			
Average balance outstanding	\$ 897,821	\$ 715,324	\$ 683,039
Maximum amount outstanding at any month end during the period	1,075,705	832,413	758,717
Balance outstanding at the end of period	1,072,551	832,413	689,710
Weighted average interest rate during the period	4.97%	4.73%	4.33%
Weighted average interest rate at end of period	4.83	4.81	4.51
<b>Subsidiary Activities</b>			

At December 31, 2007, the Holding Company had four wholly owned subsidiaries: the Bank and the Trusts. In addition, the Bank had four wholly owned subsidiaries: Flushing Commercial Bank (FCB), FSB Properties, Inc. (Properties), Flushing Preferred Funding Corporation (FPFC), and Flushing Service Corporation.

(a) FCB was formed in 2007 for the limited purpose of accepting municipal deposits and state funds, including certain court ordered funds from New York State Courts, in the State of New York.

(b) Properties was formed in 1976 under the Bank's New York State leeway investment authority. The original purpose of Properties was to engage in joint venture real estate equity investments. The Bank discontinued these activities in 1986. The last joint venture in which Properties was a partner was dissolved in 1989. The last remaining property acquired by the dissolution of these joint ventures was disposed of in 1998.

(c) FPFC was formed in 1997 as a real estate investment trust for the purpose of acquiring, holding and managing real estate mortgage assets. FPFC also provides an additional vehicle for access by the Company to the capital markets for future opportunities.

(d) Flushing Service Corporation was formed in 1998 to market insurance products and mutual funds.

## Personnel

At December 31, 2007, the Bank had 269 full-time employees and 56 part-time employees. None of the Bank's employees are represented by a collective bargaining unit, and the Bank considers its relationship with its employees to be good. At the present time, the Holding Company only employs certain officers of the Bank. These employees do not receive any extra compensation as officers of the Holding Company.

## Omnibus Incentive Plan

The 2005 Omnibus Incentive Plan ( Omnibus Plan ) became effective on May 17, 2005 after adoption by the Board of Directors and approval by the stockholders. The Omnibus Plan authorizes the Compensation Committee to grant a variety of equity compensation awards as well as long-term and annual cash incentive awards, all of which can be structured so as to comply with Section 162(m) of the Internal Revenue Code. As of December 31, 2007, there are 189,774 shares available under the full value award plan and 153,188 shares under the non-full value plan. The Company has applied the shares previously authorized by stockholders under the 1996 Stock Option Incentive Plan and the 1996 Restricted Stock Incentive Plan for use under the non-full value and full value plans, respectively, for future awards under the Omnibus Plan. All grants and awards under the 1996 Stock Option Incentive Plan and 1996 Restricted Stock Incentive Plan prior to the effective date of the Omnibus Plan remain outstanding as issued. The Company will continue to maintain separate pools of available shares for full value as opposed to non-full value awards, except that shares can be moved from the non-full value pool to the full value pool on a 3-for-1 basis. In April 2007 the Company removed 399,999 shares from the non-full value pool and moved those shares to the full value pool on a 3-for-1 basis resulting in 133,333 shares being added to the full value pool. The exercise price per share of a stock option grant may not be less than the fair market value of the common stock of the Company on the date of grant, and may not be repriced without the approval of the Company's stockholders. Options, stock appreciation rights, restricted stock, restricted stock units and other stock based awards granted under the Omnibus Plan are generally subject to a minimum vesting period of three years. The Omnibus Plan increased the annual grants to each non-employee director to 3,600 restricted stock units, while eliminating grants of stock options for non-employee directors. Prior to the approval of the 2005 Omnibus Plan non-employee directors were annually granted 1,687 restricted stock unit awards and 14,850 stock options. This change provided an expense benefit in 2006, as we began expensing stock options grants as required by SFAS No. 123 R, Share-Based Compensation.

For additional information concerning this plan, see Note 9 of Notes to Consolidated Financial Statements in Item 8 of this Annual Report.

## FEDERAL, STATE AND LOCAL TAXATION

The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Company.

### Federal Taxation

*General.* The Company reports its income using a calendar year and the accrual method of accounting. The Company is subject to the federal tax laws and regulations which apply to corporations generally, as well as, since the enactment of the Small Business Job Protection Act of 1996 (the Act ), those governing the Bank's deductions for bad debts, described below.

*Bad Debt Reserves.* Prior to the enactment of the Act, which was signed into law on August 20, 1996, savings institutions which met certain definitional tests primarily relating to their assets and the nature of their business ( qualifying thrifts ), such as the Bank, were allowed deductions for bad debts under methods more favorable than those granted to other taxpayers. Qualifying thrifts could compute deductions for bad debts using either the specific charge off method of Section 166 of the Internal Revenue Code (the Code ) or the reserve method of Section 593 of the Code. Section 1616(a) of the Act repealed the Section 593 reserve method of accounting for bad debts by qualifying thrifts, effective for taxable years beginning after 1995. Qualifying thrifts that are treated as large banks, such as the Bank, are required to use the specific charge off method, pursuant to which the amount of any debt may be deducted only as it actually becomes wholly or partially worthless.

*Distributions.* To the extent that the Bank makes non-dividend distributions to stockholders that are considered to result in distributions from its pre-1988 reserves or the supplemental reserve for losses on loans ( excess distributions ), then an amount based on the amount distributed will be included in the Bank's taxable income. Non-dividend distributions include distributions in excess of the Bank's current and post-1951 accumulated earnings and profits, as calculated for federal income tax purposes, distributions in redemption of stock and distributions in partial or complete liquidation. The amount of additional taxable income resulting from an excess distribution is an amount that when reduced by the tax attributable to the income is equal to the amount of the excess distribution. Thus, slightly more

than one and one-half times the amount of the excess distribution made would be includable in gross income for federal income tax purposes, assuming a 35% federal corporate income tax rate. See Regulation Restrictions on Dividends and Capital Distributions for limits on the payment of dividends by the Bank. The Bank does not intend to pay dividends or make non-dividend distributions described above that would result in a recapture of any portion of its pre-1988 bad debt reserves.

*Corporate Alternative Minimum Tax.* The Code imposes an alternative minimum tax on corporations equal to the excess, if any, of 20% of alternative minimum taxable income ( AMTI ) over a corporation's regular federal income tax liability. AMTI is equal to taxable income with certain adjustments. Generally, only 90% of AMTI can be offset by net operating loss carrybacks and carryforwards.

## State and Local Taxation

*New York State and New York City Taxation.* The Company is subject to the New York State Franchise Tax on Banking Corporations in an annual amount equal to the greater of (1) 7.1% (7.5% for 2006 and 2005) of entire net income allocable to New York State during the taxable year or (2) the applicable alternative minimum tax. The alternative minimum tax is generally the greater of (a) 0.01% of the value of assets allocable to New York State with certain modifications, (b) 3% of alternative entire net income allocable to New York State or (c) \$250. Entire net income is similar to federal taxable income, subject to certain modifications, including that net operating losses arising during any taxable year prior to January 1, 2001 cannot be carried back or carried forward, and net operating losses arising during any taxable year beginning on or after January 1, 2001 cannot be carried back. Alternative entire net income is equal to entire net income without certain deductions which are allowable in the calculation of entire net income. The Company also is subject to a similarly calculated New York City tax of 9% on income allocated to New York City (although net operating losses cannot be carried back or carried forward regardless of when they arise) and similar alternative taxes. In addition, the Company is subject to a tax surcharge at a rate of 17% of the New York State Franchise Tax that is attributable to business activity carried on within the Metropolitan Commuter Transportation District.

Notwithstanding the repeal of the federal income tax provisions permitting bad debt deductions under the reserve method, New York State has enacted legislation maintaining the preferential treatment of additional loss reserves for qualifying real property and non-qualifying loans of qualifying thrifts for both New York State and New York City tax purposes. Calculation of the amount of additions to reserves for qualifying real property loans is limited to the larger of the amount derived by the percentage of taxable income method or the experience method. For these purposes, the applicable percentage to calculate the bad debt deduction under the percentage of taxable income method is 32% of taxable income, reduced by additions to reserves for non-qualifying loans, except that the amount of the addition to the reserve cannot exceed the amount necessary to increase the balance of the reserve for losses on qualifying real property loans at the close of the taxable year to 6% of the balance of the qualifying real property loans outstanding at the end of the taxable year. Under the experience method, the maximum addition to a loan reserve generally equals the amount necessary to increase the balance of the bad debt reserve at the close of the taxable year to the greater of (1) the amount that bears the same ratio to loans outstanding at the close of the taxable year as the total net bad debts sustained during the current and five preceding taxable years bears to the sum of the loans outstanding at the close of those six years, or (2) the balance of the bad debt reserve at the close of the base year, or, if the amount of loans outstanding has declined since the base year, the amount which bears the same ratio to the amount of loans outstanding at the close of the taxable year as the balance of the reserve at the close of the base year. For these purposes, the base year is the last taxable year beginning before 1988. The amount of additions to reserves for non-qualifying loans is computed under the experience method. In no event may the additions to reserves for qualifying real property loans be greater than the larger of the amount determined under the experience method or the amount which, when added to the additions to reserves for non-qualifying loans, equal the amount by which 12% of the total deposits or withdrawable accounts of depositors of the Bank at the close of the taxable year exceeds the sum of the Bank's surplus, undivided profits and reserves at the beginning of such year.

*Delaware State Taxation.* As a Delaware holding company not earning income in Delaware, the Company is exempt from Delaware corporate income tax but is required to file an annual report with and pay an annual franchise tax to the State of Delaware.

## REGULATION

### General

The Holding Company is registered with the OTS as a savings and loan holding company and is subject to OTS regulations, examinations, supervision and reporting requirements. In addition, the OTS has enforcement authority over the Company and any non-savings institution subsidiaries it may form or acquire. Among other things, this authority

permits the OTS to restrict or prohibit activities that it determines may pose a serious risk to the Bank. As a publicly owned company, the Company is required to file certain reports with the Securities and Exchange Commission ( SEC ) under federal securities laws. The Bank is a member of the FHLB System. The Bank is subject to extensive regulation by the OTS, as its chartering agency, and the FDIC, as the insurer of the Bank's deposits. The Bank is also subject to certain regulations promulgated by the other federal agencies. The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other savings institutions. The Bank is subject to periodic examinations by the OTS and the FDIC to examine whether the Bank is in compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily to ensure the safe and sound operation of the Bank for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of an adequate allowance for possible loan losses for regulatory purposes. Any change in such regulation, whether by the OTS, the FDIC, other federal agencies or the United States Congress, could have a material adverse impact on the Company, the Bank and their operations.

The activities of federal savings institutions are governed primarily by the Home Owners' Loan Act, as amended ( HOLA ) and, in certain respects, the Federal Deposit Insurance Act ( FDIA ). Most regulatory functions relating to deposit insurance and to the administration of conservatorships and receiverships of insured institutions are exercised by the FDIC. The Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ), among other things, requires that federal banking regulators intervene promptly when a depository institution experiences financial difficulties, mandated the establishment of a risk-based deposit insurance assessment system, and required imposition of numerous additional safety and soundness operational standards and restrictions. FDICIA and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ( FIRREA ) each contain provisions affecting numerous aspects of the operations and regulations of federal savings banks, and these laws empower the OTS and the FDIC, among other agencies, to promulgate regulations implementing their provisions.

Set forth below is a brief description of certain laws and regulations which relate to the regulation of the Bank and the Company. The description does not purport to be a comprehensive description of applicable laws, rules and regulations and is qualified in its entirety by reference to applicable laws, rules and regulations.

### **Holding Company Regulation**

The Company is a unitary savings and loan holding company within the meaning of the HOLA. As such, the Company is required to register with the OTS and is subject to OTS regulations, examinations, supervision and reporting requirements. In addition, the OTS has enforcement authority over the Company and any non-savings institution subsidiaries it may form or acquire. Among other things, this authority permits the OTS to restrict or prohibit activities that it determines may pose a serious risk to the Bank. See Restrictions on Dividends and Capital Distributions.

HOLA prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from (1) acquiring another savings institution or holding company thereof, without prior written approval of the OTS; (2) acquiring or retaining, with certain exceptions, more than 5% of a non-subsidiary savings institution, a non-subsidiary holding company, or a non-subsidiary company engaged in activities other than those permitted by HOLA; or (3) acquiring or retaining control of a depository institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the OTS will consider the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the insurance funds, the convenience and needs of the community, and the impact of any competitive factors that may be involved.

As a unitary savings and loan holding company, the Company currently is not restricted as to the types of business activities in which it may engage, provided that the Bank continues to meet the qualified thrift lender ( QTL ) test. See Qualified Thrift Lender Test. Upon any non-supervisory acquisition by the Company of another savings association or savings bank, the Company would become a multiple savings and loan holding company (if the acquired institution is held as a separate subsidiary) and would be subject to extensive limitations on the types of business activities in which it could engage. HOLA limits the activities of a multiple savings and loan holding company and its non-insured institution subsidiaries primarily to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the OTS, and activities authorized by OTS regulation.

The OTS is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (1) emergency acquisitions authorized by the FDIC and (2) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. Under New York law, reciprocal interstate acquisitions are





authorized for savings and loan holding companies and savings institutions. Certain states do not authorize interstate acquisitions under any circumstances; however, federal law authorizing acquisitions in supervisory cases preempts such state law.

Federal law generally provides that no person acting directly or indirectly or through or in concert with one or more other persons, may acquire control, as that term is defined in OTS regulations, of a federally insured savings institution without giving at least 60 days' written notice to the OTS and providing the OTS an opportunity to disapprove the proposed acquisition. Such acquisitions of control may be disapproved if it is determined, among other things, that (1) the acquisition would substantially lessen competition; (2) the financial condition of the acquiring person might jeopardize the financial stability of the savings institution or prejudice the interests of its depositors; or (3) the competency, experience or integrity of the acquiring person or the proposed management personnel indicates that it would not be in the interest of the depositors or the public to permit the acquisition of control by such person.

### **Investment Powers**

The Bank is subject to comprehensive regulation governing its investments and activities. Among other things, the Bank may invest in (1) residential mortgage loans, mortgage-backed securities, education loans and credit card loans in an unlimited amount, (2) non-residential real estate loans up to 400% of total capital, (3) commercial business loans up to 20% of total assets (however, amounts over 10% of total assets must be used only for small business loans) and (4) in general, consumer loans and highly rated commercial paper and corporate debt securities in the aggregate up to 35% of total assets. In addition, the Bank may invest up to 3% of its total assets in service corporations, an unlimited percentage of its assets in operating subsidiaries (which may only engage in activities permissible for the Bank itself) and under certain conditions may invest in finance subsidiaries. Other than investments in service corporations, operating subsidiaries, finance subsidiaries and certain government-sponsored enterprises, such as FHLMC and FNMA, the Bank generally is not permitted to make equity investments. See General Investment Activities. A service corporation in which the Bank may invest is permitted to engage in activities that a federal savings bank may conduct directly, other than taking deposits, as well as certain activities pre-approved by the OTS, which include providing certain support services for the institution; originating, investing in, selling, purchasing, servicing or otherwise dealing with specified types of loans and participations (principally loans that the parent institution could make); specified real estate activities, including limited real estate development; securities brokerage services; certain insurance brokerage activities; and other specified investments and services.

### **Real Estate Lending Standards**

FDICIA requires each federal banking agency to adopt uniform regulations prescribing standards for extensions of credit which are either (1) secured by real estate, or (2) made for the purpose of financing the construction of improvements on real estate. In prescribing these standards, the banking agencies must consider the risk posed to the deposit insurance funds by real estate loans, the need for safe and sound operation of insured depository institutions and the availability of credit. The OTS and the other federal banking agencies adopted uniform regulations, effective March 19, 1993. The OTS regulation requires each savings association to establish and maintain written internal real estate lending standards consistent with safe and sound banking practices and appropriate to the size of the institution and the nature and scope of its real estate lending activities. The policy must also be consistent with accompanying OTS guidelines, which include maximum loan-to-value ratios for the following types of real estate loans: raw land (65%), land development (75%), nonresidential construction (80%), improved property (85%) and one-to-four family residential construction (85%). Owner-occupied one-to-four family mortgage loans and home equity loans do not have maximum loan-to-value ratio limits, but owner-occupied one-to-four family mortgage loans with a loan-to-value ratio at origination of 90% or greater are to be backed by private mortgage insurance or readily marketable collateral. Institutions are also permitted to make a limited amount of loans that do not conform to the proposed loan-to-value limitations so long as such exceptions are appropriately reviewed and justified. The guidelines also list a number of lending situations in which exceptions to the loan-to-value standard are justified.

### **Loans-to-One Borrower Limits**

The Bank generally is subject to the same loans-to-one borrower limits that apply to national banks. With certain exceptions, total loans and extensions of credit outstanding at one time to one borrower (including certain related entities of the borrower) may not exceed, for loans not fully secured, 15% of the Bank's unimpaired capital and unimpaired surplus, plus, for loans fully secured by readily marketable collateral, an additional 10% of the Bank's unimpaired capital and unimpaired surplus. At December 31, 2007, the largest amount the Bank could lend to one borrower was approximately \$36.2 million, and at that date, the Bank's largest aggregate amount of loans-to-one borrower was \$30.4 million, all of which were performing according to their terms. See General Lending Activities.

## Insurance of Accounts

The deposits of the Bank are insured up to \$100,000 per depositor, excluding retirement accounts, which are insured up to \$250,000 per depositor, (as defined by federal law and regulations) by the FDIC. All of the Bank's deposits are presently insured by the FDIC under the Deposit Insurance Fund ( DIF ). Previously, the majority of the Bank's deposits were insured by the Bank Insurance Fund ( BIF ), and the remainder by the Savings Association Insurance Fund ( SAIF ). As insurer, the FDIC is authorized to conduct examinations of, and to require reporting by, insured institutions. It also may prohibit any insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the insurance fund. The FDIC also has the authority to initiate enforcement actions where the OTS has failed or declined to take such action after receiving a request to do so from the FDIC.

On February 8, 2006, as part of the Deficit Reduction Act of 2005, the Federal Deposit Insurance Reform Act of 2005 ( Deposit Act ) was enacted. The Deposit Act required the FDIC to merge the BIF and SAIF into a new insurance fund, the DIF, no later than July 1, 2006. The funds were merged on March 31, 2006. The FDIC was also required to propose regulations to implement the Deposit Act's provisions. These regulations have been finalized and became effective January 1, 2007. Other major provisions of the Deposit Act include: (1) maintaining basic deposit insurance coverage at \$100,000, and increasing deposit insurance coverage to \$250,000 for certain retirement accounts, with increases for inflation each five years beginning in 2011, (2) giving the FDIC flexibility to manage the insurance fund by setting the designated reserve ratio between 1.15% and 1.50% (thereby eliminating the 1.25% trigger), (3) requiring all banks to be assessed premiums, (4) providing a one-time assessment credit of \$4.7 billion to banks and savings institutions in existence on December 31, 1996, that capitalized the FDIC in the 1990s to offset future premiums under a new risk-based assessment system, and (5) imposing a cap on the growth of the insurance fund by requiring a premium dividend to institutions when certain levels of the DIF are exceeded.

The FDIC utilizes a risk-based deposit insurance assessment system. Through December 31, 2006, under this system, the FDIC assigned each institution to one of three capital categories well capitalized, adequately capitalized and undercapitalized which are defined in the same manner as the regulations establishing the prompt corrective action system under Section 38 of FDIA, as discussed below. These three categories were then divided into three subcategories which reflect varying levels of supervisory concern. The matrix so created resulted in nine assessment risk classifications. Effective January 1, 2007, the FDIC revised their risk-based deposit insurance assessment system, and placed institutions into four risk categories based upon supervisory and capital evaluations. Risk Category 1 is further subdivided based upon supervisory ratings and other risk measures to differentiate risk. At December 31, 2007, the Bank's annual assessment rate was 0.05%. This assessment rate for 2008 has not yet been determined. The Bank was provided a one-time assessment credit of \$1.1 million, which is being used to offset the FDIC assessment. During 2007, the Bank utilized \$1.0 million of this credit to offset the FDIC assessment. The Bank's assessment rate in effect from time to time will depend upon the risk category to which it is assigned. In addition, the FDIC is authorized to increase federal deposit insurance assessment rates to the extent necessary to protect the fund under current law. Any increase in deposit insurance assessment rates, as a result of a change in the category or subcategory to which the Bank is assigned or the exercise of the FDIC's authority to increase assessment rates generally, could have an adverse effect on the earnings of the Bank.

Under the FDIA, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

On September 30, 1996, as part of an omnibus appropriations bill, the Deposit Insurance Funds Act of 1996 (the Funds Act ) was enacted. The Funds Act required BIF institutions, beginning January 1, 1997, to pay a portion of the interest due on the Finance Corporation ( FICO ) bonds issued in connection with the savings and loan association crisis in the late 1980s, and required BIF institutions to pay their full pro rata share of the FICO payments starting the earlier of January 1, 2000 or the date at which no savings institution continues to exist. The Bank was required, as of January 1, 2000, to pay its full pro rata share of the FICO payments. The FICO assessment rate is subject to change. The Bank paid \$224,000, \$191,000 and \$179,000 for its share of the interest due on FICO bonds in 2007, 2006 and 2005, respectively.

## Qualified Thrift Lender Test

Institutions regulated by the OTS are required to meet a QTL test to avoid certain restrictions on their operations. FDICIA and applicable OTS regulations require such institutions to maintain at least 65% of their portfolio assets (total assets less intangibles, properties used to conduct the institution's business and liquid assets not exceeding 20% of total assets) in qualified thrift investments on a monthly average basis in nine of every 12 months. Qualified thrift investments constitute primarily residential mortgage loans and related investments, including certain mortgage-backed and mortgage-related securities. A savings institution that fails the QTL test must either convert to a bank charter

or, in general, it will be prohibited from: (1) making an investment or engaging in any new activity not permissible for a national bank, (2) paying dividends not permissible under national bank regulations and (3) establishing any new branch office in a location not permissible for a national bank in the institution's home state. One year following the institution's failure to meet the QTL test, any holding company parent of the institution must register and be subject to supervision as a bank holding company. In addition, beginning three years after the institution failed the QTL test, the institution would be prohibited from retaining any investment or engaging in any activity not permissible for a national bank. At December 31, 2007 the Bank had maintained more than 65% of its portfolio assets in qualified thrift investments in at least nine of the preceding 12 months. Accordingly, on that date, the Bank had met the QTL test.

Under the Economic Growth and Paperwork Reduction Act of 1996 ( Regulatory Paperwork Reduction Act ), Congress modified and expanded investment authority under the QTL test. The Regulatory Paperwork Reduction Act amendments permit federal thrifts to invest in, sell, or otherwise deal in education and credit card loans without limitation and raised from 10% to 20% of total assets the aggregate amount of commercial, corporate, business, or agricultural loans or investments that may be made by a thrift, subject to a requirement that amounts in excess of 10% of total assets be used only for small business loans. In addition, the Regulatory Paperwork Reduction Act defines qualified thrift investment to include, without limit, education, small business, and credit card loans; and removes the 10% limit on personal, family, or household loans for purposes of the QTL test. The legislation also provides that a thrift meets the QTL test if it qualifies as a domestic building and loan association under the Code.

### **Transactions with Affiliates**

Transactions between the Bank and any related party or affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate is generally any company or entity which controls, is controlled by or is under common control with the Bank, including the Company, the Trust, the Bank's subsidiaries, and any other qualifying subsidiary of the Bank or the Company that may be formed or acquired in the future. Generally, Sections 23A and 23B: (1) limit the extent to which the Bank or its subsidiaries may engage in covered transactions with any one affiliate to an amount equal to 10% of the Bank's capital stock and surplus, and impose an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (2) require that all such transactions be on terms substantially the same, or at least as favorable, to the Bank or subsidiary as those provided to a non-affiliate. The term covered transaction includes the making of loans, purchase of assets, issuance of a guarantee and other similar types of transactions. Each loan or extension of credit to an affiliate by the Bank must be secured by collateral with a market value ranging from 100% to 130% (depending on the type of collateral) of the amount of credit extended. In addition, the Bank may not: (1) loan or otherwise extend credit to an affiliate, except to any affiliate which engages only in activities which are permissible for bank holding companies under Section 4(c) of the Bank Company Act, or (2) purchase or invest in any stocks, bonds, debentures, notes or similar obligations of any affiliates, except subsidiaries of the Bank.

In addition, the Bank is subject to Regulation O promulgated under Sections 22(g) and 22(h) of the Federal Reserve Act. Regulation O requires that loans by the Bank to a director, executive officer or to a holder of more than 10% of the Common Stock, and to certain affiliated interests of any such insider, may not, in the aggregate, exceed the Bank's loans-to-one borrower limit. Loans to insiders and their related interests must also be made on terms substantially the same as offered, and follow credit underwriting procedures that are not less stringent than those applied, in comparable transactions to other persons. Prior Board approval is required for certain loans. In addition, the aggregate amount of extensions of credit by the Bank to all insiders cannot exceed the institution's unimpaired capital and unimpaired surplus. These laws place additional restrictions on loans to executive officers of the Bank.

The Bank is in compliance with these regulations.

### **Restrictions on Dividends and Capital Distributions**

The Bank is subject to OTS limitations on capital distributions, which include cash dividends, stock redemptions or repurchases, cash-out mergers, interest payments on certain convertible debt and some other distributions charged to the Bank's capital account. In general, the applicable regulation permits specified levels of capital distributions by a savings institution that meets at least its minimum capital requirements, so long as the OTS is provided with at least 30 days advance notice and has no objection to the distribution.

Under OTS capital distribution regulations, an institution is not required to file an application with, or to provide a notice to, the OTS if neither the institution nor the proposed capital distribution meets any of the criteria for any such application or notice as provided below. An institution will be required to file an application with the OTS if the institution is not eligible for expedited treatment by the OTS; if the total amount of all its capital distributions for the applicable calendar year exceeds the net income for that year to date plus the retained net income (net income less capital distributions) for the preceding two years; if it would not be at least adequately capitalized following the distribution; or if its proposed capital distribution would violate a prohibition contained in any applicable statute, regulation, or



agreement between the association and the OTS. By contrast, only notice to the OTS is required for an institution that is not required to file an application as provided in the preceding sentence, if it would not be well capitalized following the distribution; if the association's proposed capital distribution would reduce the amount of or retire any part of its common or preferred stock or retire any part of debt instruments such as notes or debentures included in capital under OTS regulations; or if the association is a subsidiary of a savings and loan holding company. The Bank is a subsidiary of a savings and loan holding company and, therefore, is subject to the 30-day advance notice requirement. As of December 31, 2007, the Bank had \$29.0 million in retained earnings available to distribute to the Holding Company in the form of cash dividends.

### **Federal Home Loan Bank System**

In connection with converting to a federal charter, the Bank became a member of the FHLB-NY, which is one of 12 regional FHLBs governed and regulated by the Federal Housing Finance Board. Each FHLB serves as a source of liquidity for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by its Board of Directors.

As a member, the Bank is mandated to purchase and maintain membership stock in the FHLB-NY based on the asset size of the Bank. In addition, for all borrowing activity, the Bank is required to purchase shares of FHLB-NY non-marketable capital stock at par. Pursuant to this requirement, at December 31, 2007, the Bank was required to maintain \$42.7 million of FHLB-NY stock. The Bank was in compliance with this requirement at that time.

### **Assessments**

Savings institutions are required by OTS regulations to pay assessments to the OTS to fund the operations of the OTS. The general assessment, paid on a semi-annual basis, as determined from time to time by the Director of the OTS, is computed upon the savings institution's total assets, including consolidated subsidiaries, as reported in the institution's latest quarterly thrift financial report. Based on the average balance of the Bank's total assets for the year ended December 31, 2007, the Bank's OTS assessments were \$498,000 for that period.

### **Branching**

OTS regulations permit federally chartered savings institutions to branch nationwide to the extent allowed by federal statute. This permits federal savings associations to geographically diversify their loan portfolios and lines of business. The OTS authority preempts any state law purporting to regulate branching by federal savings institutions.

### **Community Reinvestment**

Under the Community Reinvestment Act (CRA), as implemented by OTS regulations, the Bank has an obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods located in the community. 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 OTS, in connection with its examination of a savings institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by the institution. The methodology used by the OTS for determining an institution's compliance with the CRA focuses on three tests: (a) a lending test, to evaluate the institution's record of making loans in its service areas; (b) an investment test, to evaluate the institution's record of investing in community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and (c) a service test, to evaluate the range of the institution's services and the delivery of services through its branches, ATMs, and other offices. The Bank received a CRA rating of Satisfactory in its most recent completed CRA examination, which was completed as of March 5, 2007. Institutions that receive less than a satisfactory rating may face difficulties in securing approval for new activities or acquisitions. The CRA requires all institutions to make public disclosure of their CRA ratings.

### **Brokered Deposits**

The FDIC has promulgated regulations implementing the FDICIA limitations on brokered deposits. Under the regulations, well-capitalized institutions are not subject to brokered deposit limitations, while adequately capitalized institutions are able to accept, renew or roll over brokered deposits only with a waiver from the FDIC and subject to restrictions on the interest rate which can be paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits and may not solicit deposits by offering an effective yield that exceeds by more than 75 basis points the prevailing effective yields on insured deposits of comparable maturity in the institution's normal market area or in the market area in which such deposits are being solicited. Pursuant to the regulation, the Bank, as a well-



capitalized institution, may accept brokered deposits. At December 31, 2007, the Bank had \$201.7 million in brokered deposit accounts.

### Capital Requirements

*General.* The Bank is required to maintain minimum levels of regulatory capital. Since FIRREA, capital requirements established by the OTS generally must be no less stringent than the capital requirements applicable to national banks. The OTS also is authorized to impose capital requirements in excess of these standards on a case-by-case basis.

Any institution that fails any of its applicable capital requirements is subject to possible enforcement actions by the OTS or the FDIC. Such actions could include a capital directive, a cease and desist order, civil money penalties, the establishment of restrictions on the institution's operations and the appointment of a conservator or receiver. The OTS capital regulation provides that such actions, through enforcement proceedings or otherwise, could require one or more of a variety of corrective actions. See Prompt Corrective Action.

The OTS capital regulations create three capital requirements: a tangible capital requirement, a leverage and core capital requirement and a risk-based capital requirement. At December 31, 2007, the Bank's capital levels exceeded applicable OTS capital requirements. The three OTS capital requirements are described below.

*Tangible Capital Requirement.* Under current OTS regulations, each savings institution must maintain tangible capital equal to at least 1.50% of its adjusted total assets (as defined by regulation). Tangible capital generally includes common stockholders' equity and retained income, and certain non-cumulative perpetual preferred stock and related income. In addition, all intangible assets, other than a limited amount of purchased mortgage servicing rights, must be deducted from tangible capital. Tangible capital also excludes adjustments to accumulated other comprehensive income recorded for postretirement benefits. At December 31, 2007, the Bank had \$13.9 million in goodwill and \$2.8 million in a core deposit intangible which were classified as intangible assets, and no purchased mortgage servicing rights. At that date, the Bank's tangible capital ratio was 7.27%.

In calculating adjusted total assets, adjustments are made to total assets to give effect to the exclusion of certain assets from capital and to appropriately account for the investments in and assets of both includable and non-includable subsidiaries.

*Leverage and Core Capital Requirement.* The current OTS requirement for leverage and core capital (commonly referred to as core capital) ranges between 3% and 5% of adjusted total assets. Savings institutions that receive the highest supervisory rating for safety and soundness are required to maintain a minimum core capital ratio of 3%, while the capital floor for all other savings institutions generally ranges from 4% to 5%, as determined by the OTS on a case by case basis. Core capital includes common stockholders' equity (including retained income), non-cumulative perpetual preferred stock and related surplus. At December 31, 2007, the Bank's core capital ratio was 7.27%.

OTS regulations limit the amount of servicing assets, together with purchased credit card receivables, includable in core capital to 100% of such capital, subject to limitations on fair value. At December 31, 2007, the Bank had \$294,000 in capitalized servicing rights and no purchased credit card receivables.

*Risk-Based Requirement.* The risk-based capital standard adopted by the OTS requires savings institutions to maintain a minimum ratio of total capital to risk-weighted assets of 8%. Total capital consists of core capital, defined above, and supplementary capital but excludes the effect of recognizing deferred taxes based upon future income after one year. Supplementary capital consists of certain capital instruments that do not qualify as core capital, and general valuation loan and lease loss allowances up to a maximum of 1.25% of risk-weighted assets. Supplementary capital may be used to satisfy the risk-based requirement only in an amount equal to the amount of core capital. In determining the risk-based capital ratios, total assets, including certain off-balance sheet items, are multiplied by a risk weight based on the risks inherent in the type of assets. The risk weights assigned by the OTS for significant categories of assets are (1) 0% for cash and securities issued by the federal government or unconditionally backed by the full faith and credit of the federal government; (2) 20% for securities (other than equity securities) issued by federal government sponsored agencies and mortgage-backed securities issued by, or fully guaranteed as to principal and interest by, the FNMA or the FHLMC, except for those classes with residual characteristics or stripped mortgage-related securities; (3) 50% for prudently underwritten permanent one-to-four family first lien mortgage loans and certain qualifying multi-family mortgage loans not more than 90 days delinquent and having a loan-to-value ratio of not more than 80% at origination unless insured to such ratio by an insurer approved by the FNMA or the FHLMC; and (4) 100% for all other loans and investments, including consumer loans, home equity loans, commercial loans, and one-to-four family residential real estate loans more than 90 days delinquent, and all repossessed assets or assets more than 90 days past due. At December 31, 2007, the Bank's risk-based capital ratio was 11.20%. Risk-based capital excludes the effect of recognizing deferred taxes based upon future income after one year.



## Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

Flushing Commercial Bank is required to maintain minimum levels of regulatory capital, which are similar to those of the Bank. At December 31, 2007, Flushing Commercial Bank exceeded its regulatory capital requirements.

### **Federal Reserve System**

The Federal Reserve Board requires all depository institutions to maintain reserves against their transaction accounts (primarily NOW and checking accounts) and non-personal time deposits. At December 31, 2007, the Bank was in compliance with these requirements.

The balances maintained to meet the reserve requirements imposed by the Federal Reserve Board may be used to satisfy liquidity requirements imposed by the OTS. Because required reserves must be maintained in the form of vault cash or a non-interest-bearing account at a Federal Reserve Bank directly or through another bank, the effect of this reserve requirement is to reduce an institution's earning assets. The amount of funds necessary to satisfy this requirement has not had a material effect on the Bank's operations.

As a creditor and financial institution, the Bank is also subject to additional regulations promulgated by the FRB, including, without limitation, regulations implementing requirements of the Truth in Savings Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act and the Truth in Lending Act.

### **Financial Reporting**

The Bank is required to submit independently audited annual reports to the FDIC and the OTS. These publicly available reports must include (a) annual financial statements prepared in accordance with generally accepted accounting principles and such other disclosure requirements as required by the FDIC or the OTS and (b) a report, signed by the Bank's chief executive officer and chief financial officer which contains statements about the adequacy of internal controls and compliance with designated laws and regulations, and attestations by independent auditors related thereto. The Bank is required to monitor the foregoing activities through an independent audit committee.

### **Standards for Safety and Soundness**

The FDIA, as amended by the FDICIA and the Riegle Community Development and Regulatory Improvement Act of 1994 (the Community Development Act), requires each federal bank regulatory agency to establish safety and soundness standards for institutions under its authority. On July 10, 1995, the federal banking agencies, including the OTS, jointly released Interagency Guidelines Establishing Standards for Safety and Soundness and published a final rule establishing deadlines for submission and review of safety and soundness compliance plans. The guidelines, among other things, require savings institutions to maintain internal controls, information systems and internal audit systems that are appropriate to the size, nature and scope of the institution's business. The guidelines also establish general standards relating to loan documentation, credit underwriting, interest rate risk exposure, asset growth, and compensation, fees and benefits. Savings institutions are required to maintain safeguards to prevent the payment of excessive compensation to an executive officer, employee, director or principal shareholder. The OTS may determine that a savings institution is not in compliance with the safety and soundness guidelines and, upon doing so, may require the institution to submit an acceptable plan to achieve compliance with the guidelines. An institution must submit an acceptable compliance plan to the OTS within 30 days of receipt or request for such a plan. Failure to submit or implement a compliance plan may subject the institution to regulatory actions. Management believes that the Bank currently meets the standards adopted in the interagency guidelines.

Additionally, under FDICIA, as amended by the Community Development Act, federal banking agencies are required to establish standards relating to asset quality and earnings that the agencies determine to be appropriate. Effective October 1, 1998, the federal banking agencies, including the OTS, adopted guidelines relating to asset quality and earnings which require insured institutions to maintain systems, consistent with their size and the nature and scope of their operations, to identify problem assets and prevent deterioration in those assets as well as to evaluate and monitor earnings and insure that earnings are sufficient to maintain adequate capital and reserves.

### **Gramm-Leach-Bliley Act**

The Gramm-Leach-Bliley Act (the Modernization Act) was signed into law on November 12, 1999. Among other things, the Modernization Act permits qualifying bank holding companies to affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or complementary thereto, as determined by the Federal Reserve Board. Subject to certain limitations, a national bank may, through a financial subsidiary, engage in similar activities. The Modernization Act also prohibits the creation or acquisition of new unitary savings and loan holding companies that are affiliated with non-banking firms, but grandfathered existing savings and loan holding companies, such as the Company. Grandfathered companies retain the existing powers available to unitary savings and loan holding companies. See Holding Company Regulation. Certain business combinations which were impermissible prior to the effective date of the Modernization Act are now possible. Management believes the



Modernization Act has led to some consolidation in the financial services industry and could lead to further consolidation, which, if completed, would likely result in an increase in the service offerings of our competitors. We cannot assure you that the Modernization Act will not result in further changes in the competitive environment in the Bank's market area or otherwise impact the Bank or the Holding Company.

In addition, the Modernization Act calls for heightened privacy protection of customer information gathered by financial institutions. The OTS has enacted regulations implementing the privacy protection provisions of the Modernization Act. Under the regulations, each financial institution is to (1) adopt procedures to protect customers' non-public personal information, (2) disclose its privacy policy, including identifying to customers others with whom it shares non-public personal information, at the time of establishing the customer relationship and annually thereafter, and (3) provide its customers with the ability to opt-out of having the financial institution share their personal information with affiliated third parties. The regulations became effective on November 13, 2000, with compliance voluntary prior to July 1, 2001. Management has reviewed and amended our privacy protection policy and believes we are in compliance with these regulations.

#### **USA Patriot Act**

On October 26, 2001, following the September 11, 2001 attacks, President Bush signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the Patriot Act) to enhance protections against money laundering and criminal laws against terrorist activities, and give law enforcement authorities greater investigative powers. Among other things, the Patriot Act (1) requires financial institutions that administer, maintain or manage private bank accounts or correspondent accounts for foreign persons to establish due diligence policies; (2) prohibits correspondent accounts with foreign shell banks; (3) permits sharing of information among financial institutions, regulators and law enforcement regarding persons engaged in terrorist or money laundering activities; (4) requires financial institutions to verify customer identification at account opening; (5) requires financial institutions to report suspicious activities; and (6) requires financial institutions to establish an anti-money laundering compliance program. Management believes we are in compliance with these regulations.

#### **Prompt Corrective Action**

Under Section 38 of the FDIA, as added by the FDICIA, each appropriate banking agency is required to take prompt corrective action to resolve the problems of insured depository institutions that do not meet minimum capital ratios. Such action must be accomplished at the least possible long-term cost to the appropriate deposit insurance fund.

The federal banking agencies, including the OTS, adopted substantially similar regulations to implement Section 38 of the FDIA. Under the regulations, an institution is deemed to be (1) well capitalized if it has total risk-based capital ratio of 10% or more, has a Tier 1 risk-based capital ratio of 6% or more, has a leverage capital ratio of 5% or more and is not subject to any order or final capital directive to meet and maintain a specific capital level for any capital measure, (2) adequately capitalized if it has a total risk-based capital ratio of 8% or more, a Tier 1 risk-based capital ratio of 4% or more and a leverage capital ratio of 4% or more (3% under certain circumstances) and does not meet the definition of well capitalized, (3) undercapitalized if it has a total risk-based capital ratio that is less than 8%, a Tier 1 risk-based capital ratio that is less than 4% or a leverage capital ratio that is less than 4% (3% under certain circumstances), (4) significantly undercapitalized if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 3% or a leverage capital ratio that is less than 3%, and (5) critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2%. Section 38 of the FDIA and the regulations promulgated thereunder also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution or an undercapitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized). At December 31, 2007, the Bank met the criteria to be considered a well capitalized institution.

#### **Federal Securities Laws**

The Company's Common Stock is registered with the SEC under Section 12(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act). The Company is subject to the information and reporting requirements, regulations governing proxy solicitations, insider trading restrictions and other requirements applicable to companies whose stock is registered under the Exchange Act.

*Sarbanes-Oxley Act of 2002.* The Sarbanes-Oxley Act of 2002 (the 2002 Act), enacted on July 30, 2002, aims to increase the reliability of financial information by, among other things, (1) heightening accountability of Chief Executive Officers and Chief Financial Officers to issue accurate financial statements, (2) increasing the authority and independence of corporate audit committees, (3) creating a new regulatory entity to oversee the activities of accountants

that audit public companies, (4) prohibiting activities and relationships that may compromise the independence of auditors, (5) increasing required financial statement disclosures, and (6) providing tough new penalties for issuing noncompliant financial statements and for other violations related to securities laws.

In furtherance of the 2002 Act, the SEC has issued rules. Compliance with these rules, and the related corporate governance rules adopted by NASDAQ with the approval of the SEC, has, and will continue to, increase costs to the Company, including, but not limited to, fees to our independent accountants, consultants, legal fees and Board service fees, and may require additions to staff. To date, compliance with the 2002 Act has not had a material effect on the Company results of operations. We cannot assure you that compliance with the 2002 Act and its regulations will not have a material effect on the business or operations of the Company in the future.

## **AVAILABLE INFORMATION**

We make available free of charge on or through our web site at [www.flushingsavings.com](http://www.flushingsavings.com) our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

### **Item 1A. Risk Factors.**

In addition to the other information contained in this Annual Report, the following factors and other considerations should be considered carefully in evaluating the Holding Company, the Bank and their business.

#### **Changes in Interest Rates May Significantly Impact the Company's Financial Condition and Results of Operations**

Like most financial institutions, the Company's results of operations depend to a large degree on its net interest income. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets, a significant increase in market interest rates could adversely affect net interest income. Conversely, a significant decrease in market interest rates could result in increased net interest income. As a general matter, the Company seeks to manage its business to limit its overall exposure to interest rate fluctuations. However, fluctuations in market interest rates are neither predictable nor controllable and may have a material adverse impact on the operations and financial condition of the Company. Additionally, in a rising interest rate environment, a borrower's ability to repay adjustable rate mortgages can be negatively affected as payments increase at repricing dates.

Prevailing interest rates also affect the extent to which borrowers repay and refinance loans. In a declining interest rate environment, the number of loan prepayments and loan refinancings may increase, as well as prepayments of mortgage-backed securities. Call provisions associated with the Company's investment in U.S. government agency and corporate securities may also adversely affect yield in a declining interest rate environment. Such prepayments and calls may adversely affect the yield of the Company's loan portfolio and mortgage-backed and other securities as the Company reinvests the prepaid funds in a lower interest rate environment. However, the Company typically receives additional loan fees when existing loans are refinanced, which partially offset the reduced yield on the Company's loan portfolio resulting from prepayments. In periods of low interest rates, the Company's level of core deposits also may decline if depositors seek higher-yielding instruments or other investments not offered by the Company, which in turn may increase the Company's cost of funds and decrease its net interest margin to the extent alternative funding sources are utilized. An increasing interest rate environment would tend to extend the average lives of lower yielding fixed rate mortgages and mortgage-backed securities, which could adversely affect net interest income. In addition, depositors tend to open longer term, higher costing certificate of deposit accounts which could adversely affect the Bank's net interest income if rates were to subsequently decline. Additionally, adjustable rate mortgage loans and mortgage-backed securities generally contain interim and lifetime caps that limit the amount the interest rate can increase or decrease at repricing dates. Significant increases in prevailing interest rates may significantly affect demand for loans and the value of bank collateral. See Local Economic Conditions.

#### **The Bank's Lending Activities Involve Risks that May Be Exacerbated Depending on the Mix of Loan Types**

Multi-family residential, commercial real estate and one-to-four family mixed use property mortgage loans and commercial business loans (the increased origination of which is part of management's strategy), and construction loans, are generally viewed as exposing the lender to a greater risk of loss than fully underwritten one-to-four family residential mortgage loans and typically involve higher principal amounts per loan. Repayment of multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans generally is dependent, in large part, upon sufficient income from the property to cover operating expenses and debt service. Repayment of commercial business loans is contingent on the successful operation of the related business. Repayment of construction loans is contingent upon the successful completion and operation of the project. Changes in local economic conditions and



government regulations, which are outside the control of the borrower or lender, also could affect the value of the security for the loan or the future cash flow of the affected properties.

In addition, the Bank, from time-to-time, originates one-to-four family residential mortgage loans without verifying the borrower's level of income. These loans involve a higher degree of risk as compared to the Bank's other fully underwritten one-to-four family residential mortgage loans. These risks are mitigated by the Bank's policy to generally limit the amount of one-to-four family residential mortgage loans to 80% of the appraised value or sale price, whichever is less, as well as charging a higher interest rate than when the borrower's income is verified. These loans are not as readily saleable in the secondary market as the Bank's other fully underwritten loans, either as whole loans or when pooled or securitized.

There can be no assurance that the Bank will be able to successfully implement its business strategies with respect to these higher-yielding loans. In assessing the future earnings prospects of the Bank, investors should consider, among other things, the Bank's level of origination of one-to-four family residential mortgage loans (including loans originated without verifying the borrower's income), the Bank's emphasis on multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans, and commercial business and construction loans, and the greater risks associated with such loans. See "Business Lending Activities" in Item 1 of this Annual Report.

### **The Markets in Which the Bank Operates Are Highly Competitive**

The Bank faces intense and increasing competition both in making loans and in attracting deposits. The Bank's market area has a high density of financial institutions, many of which have greater financial resources, name recognition and market presence than the Bank, and all of which are competitors of the Bank to varying degrees. Particularly intense competition exists for deposits and in all of the lending activities emphasized by the Bank. The Bank's competition for loans comes principally from commercial banks, other savings banks, savings and loan associations, mortgage banking companies, insurance companies, finance companies and credit unions. Management anticipates that competition for mortgage loans will continue to increase in the future. The Bank's most direct competition for deposits historically has come from other savings banks, commercial banks, savings and loan associations and credit unions. In addition, the Bank faces competition for deposits from products offered by brokerage firms, insurance companies and other financial intermediaries, such as money market and other mutual funds and annuities. Consolidation in the banking industry and the lifting of interstate banking and branching restrictions have made it more difficult for smaller, community-oriented banks, such as the Bank, to compete effectively with large, national, regional and super-regional banking institutions. In November, 2006, the Bank launched an internet branch, [iGObanking.com](http://iGObanking.com)<sup>®</sup> a division of Flushing Savings Bank, to provide the Bank access to markets outside its geographic locations. The internet banking arena also has many larger financial institutions which have greater financial resources, name recognition and market presence than the Bank.

Notwithstanding the intense competition, the Bank has been successful in increasing its loan portfolios and deposit base. However, no assurances can be given that the Bank will be able to continue to increase its loan portfolios and deposit base, as contemplated by management's current business strategy.

### **The Company's Results of Operations May Be Adversely Affected by Changes in National and/or Local Economic Conditions**

The Company's operating results are affected by national and local economic and competitive conditions, including changes in market interest rates, the strength of the local economy, government policies and actions of regulatory authorities. During 2007, the nation's economy was generally considered to be expanding, although the expansion had slowed by the fourth quarter of 2007. World events, particularly the "War on Terror" and the level of oil prices, continued to have an effect on the economy. The housing market in the United States saw a significant slowdown during 2007, and foreclosures of single family homes rose from the level seen in the past five years. These economic conditions can result in borrowers defaulting on their loans, or withdrawing their funds on deposit at the Bank to meet their financial obligations. While we have not seen a significant increase in delinquent loans, and have seen an increase in deposits, we cannot predict the effect of these economic conditions on the Company's financial condition or operating results.

A decline in the local economy, national economy or metropolitan area real estate market could adversely affect the financial condition and results of operations of the Company, including through decreased demand for loans or increased competition for good loans, increased non-performing loans and loan losses and resulting additional provisions for loan losses and for losses on real estate owned. Although management of the Bank believes that the current allowance for loan losses is adequate in light of current economic conditions, many factors could require additions to the allowance for loan losses in future periods above those currently maintained. These factors include: (1) adverse changes in economic conditions and changes in interest rates that may affect the ability of borrowers to make payments on loans, (2) changes in the financial capacity of individual borrowers, (3) changes in the local real estate market and the value of the Bank's loan collateral, and (4) future review and evaluation of the Bank's loan portfolio, internally or by regulators.



The amount of the allowance for loan losses at any time represents good faith estimates that are susceptible to significant changes due to changes in appraisal values of collateral, national and regional economic conditions, prevailing interest rates and other factors. See Business General Allowance for Loan Losses in Item 1 of this Annual Report.

#### **Changes in Laws and Regulations Could Adversely Affect the Company's Business**

From time to time, legislation is enacted or regulations are promulgated that have the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks and other financial institutions are frequently made in Congress, in the New York legislature and before various bank regulatory agencies. No prediction can be made as to the likelihood of any major changes or the impact such changes might have on the Bank or the Company. For a discussion of regulations affecting the Company, see Business Regulation and Business Federal, State and Local Taxation in Item 1 of this Annual Report.

#### **Certain Anti-Takeover Provisions May Increase the Costs to or Discourage an Acquiror**

On September 5, 2006, the Board of Directors of the Holding Company renewed the Company's Stockholder Rights Plan, (the Rights Plan), which was originally adopted on and had been in place since September 17, 1996 and had been scheduled to expire on September 30, 2006. The Rights Plan was designed to preserve long-term values and protect stockholders against inadequate offers and other unfair tactics to acquire control of the Holding Company. Under the Rights Plan, each stockholder of record at the close of business on September 30, 2006 received a dividend distribution of one right to purchase from the Holding Company one one-hundredth of a share of Series A junior participating preferred stock at a price of \$65. The rights will become exercisable only if a person or group acquires 15% or more of the Holding Company's common stock or commences a tender or exchange offer which, if consummated, would result in that person or group owning at least 15% of the Common Stock (the acquiring person or group). In such case, all stockholders other than the acquiring person or group will be entitled to purchase, by paying the \$65 exercise price, Common Stock (or a common stock equivalent) with a value of twice the exercise price. In addition, at any time after such event, and prior to the acquisition by any person or group of 50% or more of the Common Stock, the Board of Directors may, at its option, require each outstanding right (other than rights held by the acquiring person or group) to be exchanged for one share of Common Stock (or one common stock equivalent). If a person or group becomes an acquiring person and the Holding Company is acquired in a merger or other business combination or sells more than 50% of its assets or earning power, each right will entitle all other holders to purchase, by payment of \$65 exercise price, common stock of the acquiring company with a value of twice the exercise price. The renewed rights plan expires on September 30, 2016.

The Rights Plan, as well as certain provisions of the Holding Company's certificate of incorporation and bylaws, the Bank's federal stock charter and bylaws, certain federal regulations and provisions of Delaware corporation law, and certain provisions of remuneration plans and agreements applicable to employees and officers of the Bank may have anti-takeover effects by discouraging potential proxy contests and other takeover attempts, particularly those which have not been negotiated with the Board of Directors. The Rights Plan and those other provisions, as well as applicable regulatory restrictions, may also prevent or inhibit the acquisition of a controlling position in the Common Stock and may prevent or inhibit takeover attempts that certain stockholders may deem to be in their or other stockholders' interest or in the interest of the Holding Company, or in which stockholders may receive a substantial premium for their shares over then current market prices. The Rights Plan and those other provisions may also increase the cost of, and thus discourage, any such future acquisition or attempted acquisition, and would render the removal of the current Board of Directors or management of the Holding Company more difficult.

#### **The Bank May Not Be Able To Successfully Implement Its New Commercial Business Banking Initiative**

The Bank's strategy includes a transition to a more commercial-like banking institution. The Bank has developed a complement of deposit, loan and cash management products to support this initiative, and intends to expand these product offerings. A business banking unit has been established to build relationships in order to obtain lower-costing deposits, generate fee income, and originate commercial business loans. The success of this initiative is dependent on developing additional product offerings, and building relationships to obtain the deposits and loans. There can be no assurance that the Bank will be able to successfully implement its business strategy with respect to this initiative.

#### **Item 1B. Unresolved Staff Comments.**

None.



Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

**Item 2. Properties.**

The Bank conducts its business through fourteen full-service branch offices and its internet branch, iGObanking.com®. The Company's executive offices are located in Lake Success, in Nassau County, NY.

Office	Leased or Owned	Date Leased or Acquired	Lease Expiration Date	Net Book Value at December 31, 2007
Corporate Headquarters 1979 Marcus Avenue, Suite E140 Lake Success, N.Y. 11042	Leased	2004	3/31/2015	\$ 1,065,607
Main Office Branch 144-51 Northern Boulevard Flushing, N.Y. 11354	Owned	1972	N/A	1,772,768
Broadway Branch 159-18 Northern Boulevard Flushing, N.Y. 11358	Owned	1962	N/A	738,503
Auburndale Branch 188-08 Hollis Court Boulevard Flushing, N.Y. 11358	Owned	1991	N/A	662,692
Springfield Branch 61-54 Springfield Boulevard Bayside, N.Y. 11364	Leased	1991	11/30/2016	63,414
Bay Ridge Branch 7102 Third Avenue Brooklyn, N.Y. 11209	Owned	1991	N/A	292,618
Irving Place Branch 33 Irving Place New York, N.Y. 10003	Leased	1991	11/30/2011	257,357
New Hyde Park Branch (1) 661 Hillside Avenue New Hyde Park, N.Y. 11040	Leased	1971	12/31/2011	1,381,669
Kissena Branch 44-43 Kissena Boulevard Flushing, N.Y. 11355	Leased	2000	4/30/2010	181,050
Bell Boulevard Branch (2) 42-11 Bell Boulevard Bayside, N.Y. 11361	Leased	2005	11/30/2020	2,822,559
Astoria Branch 31-16 30th Avenue Astoria, N.Y. 11102	Leased	2003	10/31/2013	561,919
Montague Street Branch 186 Montague Street Brooklyn, N.Y. 11201	Owned	2006	N/A	6,341,838
Avenue J Branch 1402 Avenue J Brooklyn, N.Y. 11230	Owned	2006	N/A	2,946,784
Forest Hills Branch 107-11 Continental Avenue Forest Hills, N.Y. 11375	Leased	2006	9/30/2021	2,213,241
Roosevelt Avenue Branch 136-41 Roosevelt Avenue Flushing, N.Y. 11354	Leased	2006	5/31/2021	2,634,181
Total premises and equipment, net				\$ 23,936,200

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

- (1) Includes offices of Flushing Commercial Bank
- (2) Includes offices of iGObanking.com®

---

The Holding Company neither owns nor leases any property but instead uses the premises and equipment of the Bank.

40

---

**Item 3. Legal Proceedings.**

The Bank is involved in various legal actions arising in the ordinary course of its business which, in the aggregate, involve amounts which are believed by management to be immaterial to the financial condition, results of operations and cash flows of the Bank.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

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

Flushing Financial Corporation Common Stock is traded on the NASDAQ Global Select Market<sup>®</sup> under the symbol FFIC. As of December 31, 2007, the Company had approximately 807 shareholders of record, not including the number of persons or entities holding stock in nominee or street name through various brokers and banks. The Company's stock closed at \$16.05 on December 31, 2007. The following table shows the high and low sales price of the Common Stock during the periods indicated. Such prices do not necessarily reflect retail markups, markdowns, or commissions. See Note 11 of Notes to Consolidated Financial Statements in Item 8 of this Annual Report for dividend restrictions.

	2007			2006		
	High	Low	Dividend	High	Low	Dividend
First Quarter	\$ 17.77	\$ 15.30	\$ 0.12	\$ 17.55	\$ 14.87	\$ 0.11
Second Quarter	17.20	15.51	0.12	17.96	16.09	0.11
Third Quarter	18.68	14.41	0.12	17.97	16.30	0.11
Fourth Quarter	17.88	14.88	0.12	18.79	16.68	0.11

The following table sets forth information regarding the shares of common stock repurchased by the Company during the quarter ended December 31, 2007.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
October 1 to October 31, 2007		\$		362,050
November 1 to November 30, 2007				362,050
December 1 to December 31, 2007				362,050
Total		\$		

The current common stock repurchase program was approved by the Company's Board of Directors on August 17, 2004. This repurchase program authorized the repurchase of 1,000,000 common shares. The repurchase program does not have an expiration date or a maximum dollar amount that may be paid to repurchase the common shares. Stock repurchases under this program will be made from time to time, on the open market or in privately negotiated transactions, at the discretion of the management of the Company.

**Stock Performance Graph**

The following graph shows a comparison of cumulative total stockholder return on the Company's common stock since December 31, 2002 with the cumulative total returns of a broad equity market index as well as two published industry indices. The broad equity market index chosen was the Nasdaq Composite. The published industry indices chosen were the SNL Thrift Index and SNL Mid-Atlantic Thrift Index. The SNL Mid-Atlantic Thrift Index has been included in the Company's Stock Performance Graph because the Company believes it provides valuable comparative information reflecting the Company's geographic peer group. The SNL Thrift Index has been included in the Stock Performance Graph because it uses a broader group of thrifts and therefore more closely reflects the Company's size. The Company believes that both geographic area and size are important factors in analyzing the Company's performance against its peers. The graph below reflects historical performance only, which is not indicative of possible future performance of the common stock.

The total return assumes \$100 invested on December 31, 2002 and all dividends reinvested through the end of the Company's fiscal year ended December 31, 2007. The performance graph above is based upon closing prices on the trading date specified.

<i>Index</i>	<i>Period Ending</i>					
	<b>12/31/02</b>	<b>12/31/03</b>	<b>12/31/04</b>	<b>12/31/05</b>	<b>12/31/06</b>	<b>12/31/07</b>
Flushing Financial Corporation	100.00	170.73	190.90	151.66	170.66	165.32
NASDAQ Composite	100.00	150.01	162.89	165.13	180.85	198.60
SNL Thrift Index	100.00	141.57	157.73	163.29	190.35	114.19
SNL Mid-Atlantic Thrift Index	100.00	157.96	162.75	158.69	185.05	152.35

**Item 6. Selected Financial Data.**

At or for the years ended December 31,

2007 2006 2005 2004 2003

*(Dollars in thousands, except per share data)***Selected Financial Condition Data**

Total assets	\$ 3,354,519	\$ 2,836,521	\$ 2,353,208	\$ 2,058,044	\$ 1,910,751
Loans, net	2,702,118	2,324,748	1,881,876	1,516,507	1,269,521
Securities available for sale	440,100	330,587	337,761	435,745	535,709
Deposits	2,025,447	1,764,150	1,467,287	1,292,797	1,169,909
Borrowed funds	1,072,551	832,413	689,710	584,736	578,142
Stockholders' equity	233,654	218,415	176,467	160,653	146,762
Book value per share (1)(2)	\$ 10.96	\$ 10.34	\$ 9.07	\$ 8.35	\$ 7.61

**Selected Operating Data**

Interest and dividend income	\$ 193,562	\$ 158,384	\$ 132,439	\$ 118,724	\$ 112,339
Interest expense	122,624	90,680	64,229	52,233	52,176

Net interest income	70,938	67,704	68,210	66,491	60,163
Provision for loan losses					

Net interest income after provision for loan losses	70,938	67,704	68,210	66,491	60,163
---	--------	--------	--------	--------	--------

## Non-interest income:

Net gains (losses) on sales of securities and loans	700	813	(45)	206	329
Other-than-temporary impairment charge on securities	(4,710)				
Net gain from fair value adjustments	2,685				
Other income	11,578	8,982	6,692	5,737	5,956

Total non-interest income	10,253	9,795	6,647	5,943	6,285
Non-interest expense	50,076	42,742	36,264	35,389	31,226

Income before income tax provision	31,115	34,757	38,593	37,045	35,222
Income tax provision	10,930	13,118	15,051	14,396	13,544

Net income	\$ 20,185	\$ 21,639	\$ 23,542	\$ 22,649	\$ 21,678
------------	-----------	-----------	-----------	-----------	-----------

Basic earnings per share (2)	\$ 1.03	\$ 1.16	\$ 1.34	\$ 1.30	\$ 1.27
Diluted earnings per share (2)	\$ 1.02	\$ 1.14	\$ 1.31	\$ 1.25	\$ 1.22
Dividends declared per share (2)	\$ 0.48	\$ 0.44	\$ 0.40	\$ 0.35	\$ 0.28
Dividend payout ratio	46.6%	37.9%	29.9%	26.9%	22.0%

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

At or for the years ended December 31,	2007	2006	2005	2004	2003
<b>Selected Financial Ratios and Other Data</b>					
Performance ratios:					
Return on average assets	0.66%	0.84%	1.07%	1.13%	1.21%
Return on average equity	9.15	11.14	14.27	14.97	15.93
Average equity to average assets	7.19	7.58	7.47	7.56	7.57
Equity to total assets	6.97	7.70	7.50	7.81	7.68
Interest rate spread	2.23	2.54	3.03	3.30	3.37
Net interest margin	2.44	2.78	3.24	3.49	3.56
Non-interest expense to average assets	1.63	1.67	1.64	1.77	1.74
Efficiency ratio	60.20	55.21	48.03	48.79	47.00
Average interest-earning assets to average interest-bearing liabilities	1.05x	1.06x	1.07x	1.07x	1.06x
Regulatory capital ratios: (3)					
Tangible capital	7.27%	6.91%	7.14%	7.89%	8.00%
Core capital	7.27	6.91	7.14	7.89	8.00
Total risk-based capital	11.20	10.99	12.12	14.01	15.12
Asset quality ratios:					
Non-performing loans to gross loans (4)	0.22%	0.13%	0.13%	0.06%	0.05%
Non-performing assets to total assets (5)	0.18	0.11	0.10	0.04	0.04
Net charge-offs to average loans	0.02		0.01		
Allowance for loan losses to gross loans	0.25	0.30	0.34	0.43	0.51
Allowance for loan losses to total non-performing assets (5)	112.57	225.72	260.39	717.29	960.86
Allowance for loan losses to total non-performing loans (4)	112.57	225.72	260.39	717.29	960.86
Full-service customer facilities	14	12	9	10	11

- (1) Calculated by dividing stockholders' equity of \$233.7 million and \$218.4 million at December 31, 2007 and 2006, respectively, by 21,321,564 and 21,131,274 shares outstanding at December 31, 2007 and 2006, respectively.
- (2) The shares held in the Company's Employee Benefit Trust are not included in shares outstanding for purposes of calculating earnings per share. Unvested restricted stock and unvested restricted stock unit awards are not included in basic earnings per share calculations, but are included in diluted earnings per share calculations.
- (3) The Bank exceeded all minimum regulatory capital requirements during the periods presented.
- (4) Non-performing loans consist of non-accrual loans and loans delinquent 90 days or more that are still accruing.
- (5) Non-performing assets consist of non-performing loans, real estate owned and non-performing investment securities.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**General**

Flushing Financial Corporation ( Holding Company ), a Delaware corporation, is the parent holding company for Flushing Savings Bank, FSB ( Bank ), a federally chartered stock savings bank. The Bank was organized in 1929 as a New York State chartered mutual savings bank. In 1994, the Bank converted to a federally chartered mutual savings bank and changed its name from Flushing Savings Bank to Flushing Savings Bank, FSB. The Bank converted to a federally chartered stock savings bank in 1995. As a federal savings bank, the Bank's primary regulator is the Office of Thrift Supervision ( OTS ). The Bank's deposits are insured to the maximum allowable amount by the Federal Deposit Insurance Corporation ( FDIC ). The Bank owns four subsidiaries: Flushing Commercial Bank, Flushing Preferred Funding Corporation, Flushing Service Corporation, and FSB Properties Inc.

The Holding Company also owns three special purpose business trusts, Flushing Financial Capital Trust II, Flushing Financial Capital Trust III, and Flushing Financial Capital Trust IV (the Trusts ). The Trusts were formed during 2007, with each issuing \$20.0 million of floating rate capital securities. The Trusts invested the proceeds from the sale of the capital securities, and the issuance of their common stock, in \$61.8 million of junior subordinated debentures issued by the Holding Company. The Holding Company had owned Flushing Financial Capital Trust I ( Trust I ), which was formed in 2002. Trust I issued \$20.0 million of floating rate capital securities, and invested the proceeds from the sale of the capital securities, and the issuance of its common stock, in \$20.6 million of junior subordinated debentures issued by the Holding Company. The Holding Company redeemed the junior subordinated debentures issued to Trust I in July 2007. As a result, Trust I redeemed its outstanding capital securities and common stock, and was liquidated in July 2007. Prior to 2004, Trust I was included in the consolidated financial statements of the Company. Effective January 1, 2004, in accordance with the requirements of FASB Interpretation No. 46R, Trust I was deconsolidated. The Trusts are not included in the consolidated financial statements of the Company in accordance with the requirements of FASB Interpretation No. 46R.

The following discussion of financial condition and results of operations includes the collective results of the Holding Company and the Bank (collectively, the Company ), but reflects principally the Bank's activities. Management views the Company as operating as a single unit, a community savings bank. Therefore, segment information is not provided.

On June 30, 2006, the Company acquired all of the outstanding common stock of Atlantic Liberty Financial Corporation ( Atlantic Liberty ), the parent holding company for Atlantic Liberty Savings, F.A., based in Brooklyn, New York. The aggregate purchase price was \$42.5 million, which consisted of \$14.7 million of cash, common stock valued at \$26.6 million, and \$1.3 million assigned to the fair value of Atlantic Liberty's outstanding stock options. Under the terms of the Agreement and Plan of Merger, dated December 20, 2005, Atlantic Liberty's shareholders received \$24.00 in cash, 1.43 Holding Company shares per Atlantic Liberty share owned, or a combination thereof, subject to aggregate allocation to all Atlantic Liberty's shareholders of 65% stock / 35% cash. In connection with the merger, the Company issued 1.6 million shares of common stock, the value of which was determined based on the closing price of the Company's common stock on the announcement date of December 21, 2005, and two days prior to and after the announcement date. The Company acquired two branches in prime areas of Brooklyn, New York, with \$186.9 million in assets, \$116.2 million in net loans and assumed \$106.8 million in deposits.

On November 27, 2006, the Bank launched a new internet branch, iGObanking.com®, a division of Flushing Savings Bank, FSB. iGObanking.com® provides the Bank access to markets outside its geographic locations.

During 2007, the Bank formed a wholly owned subsidiary, Flushing Commercial Bank, for the limited purpose of accepting municipal deposits and state funds in the State of New York. The commercial bank offers a full range of deposit products to municipalities and New York State, similar to the products currently being offered by the Bank, but will not make loans. To date, the operations of Flushing Commercial Bank have not been material.

**Overview**

The Bank's principal business is attracting retail deposits from the general public and investing those deposits together with funds generated from ongoing operations and borrowings, primarily in (1) originations and purchases of one-to-four family (focusing on mixed-use properties - properties that contain both residential dwelling units and commercial units), multi-family residential and commercial real estate mortgage loans; (2) construction loans, primarily for multi-family residential properties; (3) Small Business Administration ( SBA ) loans and other small business loans; (4) mortgage loan surrogates such as mortgage-backed securities; and (5) U.S. government securities, corporate fixed-income securities and other marketable securities. The Bank also originates certain other consumer loans.

The Company's results of operations depend primarily on net interest income, which is the difference between the income earned on its interest-earning assets and the cost of its interest-bearing liabilities. Net interest income is the result of the Company's interest rate margin, which is the difference between the average yield earned on interest-earning assets and the average cost of interest-bearing liabilities, adjusted for the difference in the average balance of interest-earning assets as compared to the average balance of interest-bearing liabilities. The Company also generates non-interest income from loan fees, service charges on deposit accounts, mortgage servicing fees, and other fees, income earned on Bank Owned Life Insurance ( BOLI ), dividends on Federal Home Bank of New York ( FHLB-NY ) stock and net gains and losses on sales of securities and loans. The Company's operating expenses consist principally of employee compensation and benefits, occupancy and equipment costs, other general and administrative expenses and income tax expense. The Company's results of operations also can be significantly affected by its periodic provision for loan losses and specific provision for losses on real estate owned. However, the Company has not recorded a provision since 1999.

*Management Strategy.* Management's strategy is to continue the Bank's focus as an institution serving consumers, businesses, and governmental units in its local markets. In furtherance of this objective, the Company intends to: (1) continue its emphasis on the origination of multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans, (2) transition from a traditional thrift to a more commercial-like banking institution, (3) increase its commitment to the multi-cultural marketplace, with a particular focus on the Asian community in Queens, (4) maintain asset quality, (5) manage deposit growth and maintain a low cost of funds, utilizing the internet to grow deposits, (6) cross sell to lending and deposit customers, (7) actively pursue deposits from local area government units, (8) manage interest rate risk, (9) explore new business opportunities, and (10) manage capital. There can be no assurance that the Company will be able to effectively implement this strategy. The Company's strategy is subject to change by the Board of Directors.

Multi-Family Residential, Commercial Real Estate and One-to-Four Family Lending. In recent years, the Company has emphasized the origination of higher-yielding multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans. The Company expects to continue this emphasis on higher-yielding mortgage loan products.

The following table shows loan originations and purchases during 2007, and loan balances as of December 31, 2007.

	Loan Originations and Purchases	Loan Balances December 31, 2007	Percent of Gross Loans
<i>(Dollars in thousands)</i>			
Multi-family residential	\$ 231,342	\$ 964,455	35.79%
Commercial real estate	168,342	625,843	23.23
One-to-four family mixed-use property	159,331	686,921	25.49
One-to-four family residential	36,397	161,666	6.01
Co-operative apartment	828	7,070	0.26
Construction	54,151	119,745	4.44
Small Business Administration	12,840	18,922	0.70
Taxi Medallion	50,434	68,249	2.53
Commercial Business and Other	43,759	41,797	1.55
<b>Total</b>	<b>\$ 757,424</b>	<b>\$ 2,694,668</b>	<b>100.00%</b>

The Company's increased emphasis on multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans has increased the overall level of credit risk inherent in the Company's loan portfolio. The greater risk associated with multi-family, commercial real estate and one-to-four family mixed-use property mortgage loans could require the Company to increase its provisions for loan losses and to maintain an allowance for loan losses as a percentage of total loans in excess of the allowance currently maintained by the Company. To date, the Company has not experienced significant losses in its multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loan portfolios, and has determined that, at this time, additional provisions are not required.

Transition to a More Commercial-like Banking Institution. The Bank established a business banking unit during 2006 staffed with a team of experienced commercial bankers. The Bank has developed a complement of deposit, loan and cash management products to



support this initiative, and expanded these

product offerings during 2007. The business banking unit is responsible for building business relationships in order to obtain lower-costing deposits, generate fee income, and originate commercial business loans. Building these business relationships could provide the Bank with a lower-costing source of funds and higher-yielding adjustable-rate loans, which would help the Bank manage its interest-rate risk. Commercial business loans are generally viewed as having a higher risk than real estate loans, and could require the Bank to maintain an allowance for loan losses as a percentage of total loans in excess of the allowance currently maintained by the Company. To date, the Company has not experienced significant losses in its commercial business loan portfolio, and has determined that, at this time, additional provisions are not required.

Increase its Commitment to the Multi-Cultural Marketplace, with a Particular Focus on the Asian Community in Queens. The Bank serves many diverse communities in the metropolitan area. Branches are staffed with employees from their local neighborhoods who speak over 35 different languages, enabling residents of these neighborhoods to speak to our banking specialists in the language they are familiar with and the customs they are used to. The Bank is active in many community organizations. During 2006, the Bank established an Asian Advisory Board to help broaden the Bank's link to the community by providing guidance and fostering awareness of the Bank's active role in the local community.

Maintain Asset Quality. By adherence to its strict underwriting standards the Bank has been able to minimize net losses from impaired loans with net charge-offs of \$424,000 and \$81,000 for the years ended December 31, 2007 and 2006, respectively. The Company has maintained the strength of its loan portfolio, as evidenced by the Company's ratio of its allowance for loan losses to non-performing loans of 112.57% and 225.72% at December 31, 2007 and 2006, respectively. The Company seeks to maintain its loans in performing status through, among other things, strict collection efforts, and consistently monitoring non-performing assets in an effort to return them to performing status. To this end, management reviews the quality of loans and reports to the Loan Committee of the Board of Directors of the Bank on a monthly basis. The Company has sold and may continue to sell delinquent mortgage loans. The Bank sold forty-five delinquent mortgage loans totaling \$33.9 million and thirty-five delinquent mortgage loans totaling \$12.2 million during the years ended December 31, 2007 and 2006, respectively. The terms of these loan sales included cash due upon closing of the sale, no contingencies or recourse to the Bank, servicing is released to the buyer and time is of the essence. The Bank realized gross gains of \$332,000 and no gross losses on the sale of these loans in 2007. The Bank realized gross gains of \$169,000 and gross losses of \$14,000 on the sale of these loans in 2006. There can be no assurances that the Bank will continue this strategy in future periods, or if continued, we will be able to find buyers to pay adequate consideration. Non-performing assets amounted to \$5.9 million and \$3.1 million at December 31, 2007 and 2006, respectively. Non-performing assets as a percentage of total assets were 0.18% and 0.11% at December 31, 2007 and 2006, respectively.

Manage Deposit Growth and Maintain Low Cost of Funds, Utilizing the Internet to Grow Deposits. The Company has a relatively stable retail deposit base drawn from its market area through its full-service offices. Although the Company seeks to retain existing deposits and maintain depositor relationships by offering quality service and competitive interest rates to its customers, the Company also seeks to keep deposit growth within reasonable limits and its strategic plan. In November 2006, the Bank launched an internet branch, [iGObanking.com](http://iGObanking.com), a division of Flushing Savings Bank, to compete for deposits from sources outside the geographic footprint of its full-service offices. During 2007, the Bank formed a wholly owned subsidiary, Flushing Commercial Bank, a New York State chartered commercial bank, for the limited purpose of accepting municipal deposits and state funds, including certain court ordered funds from New York State Courts, in the State of New York as an additional source of deposits. The Company also obtains deposits through brokers and the CDARS® network. Management intends to balance its goal to maintain competitive interest rates on deposits while seeking to manage its overall cost of funds to finance its strategies. The Company generally relies on its deposit base as its principal source of funding. In creating [iGObanking.com](http://iGObanking.com), the Bank's strategy is to reduce our reliance on wholesale borrowings. In addition, the Bank is a member of the FHLB-NY, which provides it with a source of borrowing. The Bank also utilizes reverse purchase agreements, established with other financial institutions. These borrowings help the Company fund asset growth and increase net interest income. During 2007, the Company realized an increase in due to depositors of \$258.6 million and an increase in borrowed funds of \$240.1 million.

Cross Sell to Lending and Deposit Customers. A significant portion of the Bank's lending and deposit customers do not have both their loans and deposits with the Bank. The Bank intends to focus on obtaining additional deposits from its lending customers, and originating additional loans to its deposit customers. Product offerings were expanded in 2006 and 2007, and are expected to be further expanded in 2008 to accommodate perceived customer demands. In addition, specific employees have been identified who have been assigned

responsibilities of generating these additional deposits and loans by coordinating efforts between lending and deposit gathering departments.

Actively Pursue Deposits From Local Area Governmental Units. During 2007, the Bank formed a wholly owned subsidiary, Flushing Commercial Bank, a New York State chartered commercial bank, for the limited purpose of accepting municipal deposits and state funds, including certain court ordered funds from New York State Courts, in the State of New York. The commercial bank offers a full range of deposit products to municipalities and New York State, similar to the products currently being offered by the Bank, but does not make loans. To date, the operations of Flushing Commercial Bank have not been material.

Manage Interest Rate Risk. The Company seeks to manage its interest rate risk by actively reviewing the repricing and maturities of its interest rate sensitive assets and liabilities. The mix of loans originated by the Company (fixed or ARM) is determined in large part by borrowers' preferences and prevailing market conditions. The Company seeks to manage the interest rate risk of the loan portfolio by actively managing its security portfolio and borrowings. By adjusting the mix of fixed and adjustable rate securities, as well as the maturities of the securities, the Company has the ability to manage the combined interest rate sensitivity of its assets. See - Interest Rate Sensitivity Analysis. Additionally, the Company seeks to balance the interest rate sensitivity of its assets by managing the maturities of its liabilities. During 2007 the Bank extended the maturity of borrowings as they matured, and focused on attracting longer-term certificates of deposit and brokered deposits. In addition, management's expectation is that the new deposits generated from our internet branch, [iGObanking.com](http://iGObanking.com), will help to lessen our long standing dependency on wholesale borrowings.

Explore New Business Opportunities. The Company has in the past increased growth through acquisitions of financial institutions and branches of other financial institutions, and will continue to pursue growth through acquisitions that are, or are expected to be within a reasonable time frame, accretive to earnings, as well as evaluating the feasibility of opening additional branches. The Company has in the past opened new branches. In 2006, the Company completed the acquisition of Atlantic Liberty Savings and opened a branch in Bayside, Queens. Two branches were also opened in Queens in the first quarter of 2007. We plan to continue to seek and review potential acquisition opportunities that complement our current business, are consistent with our strategy to build a bank that is focused on the unique personal and small business banking needs of the multi-ethnic communities we serve, and will be accretive to earnings.

Manage Capital. The Bank faces several minimum capital requirements imposed by the OTS. These requirements limit the dividends the Bank is allowed to pay to the Holding Company, and can limit the annual growth of the Bank. As part of the strategy to find ways to best utilize its available capital, during 2007, the Holding Company continued its stock repurchase programs by repurchasing 38,000 shares of its common stock. At December 31, 2007, 362,050 shares remain to be repurchased under the current stock repurchase program. The Company had no shares held in treasury and had 21,321,564 shares outstanding at December 31, 2007.

*Trends and Contingencies.* The Company's operating results are significantly affected by national and local economic and competitive conditions, including changes in market interest rates, the strength of the local economy, government policies and actions of regulatory authorities. As short-term interest rates rose during the first half of 2006 and remained at those levels throughout most of 2007, we remained strategically focused on the origination of multi-family residential, commercial real estate and one-to-four family mixed-use property mortgage loans. As a result of this strategy, we were able to continue to achieve a higher yield on our mortgage portfolio than we would have otherwise experienced. We also established a business banking unit during the second half of 2006, and launched an internet branch in November 2006.

Prevailing interest rates affect the extent to which borrowers repay and refinance loans. In a declining interest rate environment, the number of loan prepayments and loan refinancings tends to increase, as do prepayments of mortgage-backed securities. Call provisions associated with the Company's investment in U.S. government agency and corporate securities may also adversely affect yield in a declining interest rate environment. Such prepayments and calls may adversely affect the yield of the Company's loan portfolio and mortgage-backed and other securities as the Company reinvests the prepaid funds in a lower interest rate environment. However, the Company typically receives additional loan fees when existing loans are refinanced, which partially offsets the reduced yield on the Company's loan portfolio resulting from prepayments. In periods of low interest rates, the Company's level of core deposits also may decline if depositors seek higher-yielding instruments or other investments not offered by the Company, which in turn may increase the Company's cost of funds and decrease its net interest margin to the extent alternative funding sources are utilized. By contrast, an increasing interest rate environment would tend to extend the average lives of lower yielding fixed rate mortgages and mortgage-backed securities, which could adversely affect net interest income. In addition, depositors tend to open longer term, higher costing certificate of deposit accounts which could adversely affect the

Bank's net interest income if rates were to subsequently decline. Additionally, adjustable rate residential mortgage loans and mortgage-backed securities generally contain interim and lifetime caps that limit the amount the interest rate can increase at re-pricing dates.

During the first half of 2006, the Federal Reserve's Federal Open Market Committee ( FOMC ) increased short term interest rates through their meeting in June, while longer-term interest rates remained relatively stable. As a result, the yield curve flattened to the point where there was little difference between the rate on overnight funds and the rate on ten year bonds. During the second half of 2006 and through September 2007, the FOMC maintained the overnight rate, while longer term rates declined, resulting in an inverted yield curve. As a result, the Company's net interest margin declined as the spread between the rate the Company received on loans originated narrowed compared to the rate paid on new deposits. During the fourth quarter of 2007, the FOMC lowered the overnight interest rate by 100 basis points, and the treasury yield curve returned to a more normal slope by the end of 2007. Since demand remained strong for our higher-yielding loan products, we grew our loan portfolio \$377.4 million in 2007. We funded this growth with principal payments received on our securities portfolio, deposit growth, and borrowings. At December 31, 2007, we had loans in process of \$201.0 million.

The Bank also entered into several leveraged transactions in the second half of 2007. During September, the Bank purchased \$78.0 million of mortgage-backed securities and \$26.1 million of other securities in a series of transactions financed with borrowings. During the fourth quarter of 2007, the Bank purchased \$34.1 million of mortgage backed-securities and \$22.2 million of other securities in a series of transactions financed with borrowings. The spread, on a tax adjusted basis, between the securities purchased and the borrowings incurred is approximately 200 basis points. While these transactions reduce net interest margin, they increase net interest income.

During the year ended December 31, 2007, certificates of deposit increased \$64.4 million, while lower-costing core deposits increased \$194.1 million. To fund the strong demand for our loan products, the growth in deposits was augmented by an increase in borrowed funds. The total increase in borrowed funds during 2007 was \$240.1 million, including the borrowings incurred to fund the leverage transactions discussed above. The cost of funds rose to 4.54% in the fourth quarter of 2007 from 4.26% in the fourth quarter of 2006.

As a result of the growth in our higher-yielding loan portfolio, the yield on our total interest-earning assets increased 17 basis points during 2007 as compared to 2006. However, primarily as a result of the interest rate increases by the FOMC during 2005 and the first half of 2006, the cost of our total interest-bearing liabilities increased 48 basis points. This resulted in a decrease in our interest rate spread of 31 basis points to 2.23% for 2007 as compared to 2.54% for 2006. The net interest margin decreased 34 basis points to 2.44% for 2007 as compared to 2.78% for 2006. The net interest margin declined to 2.31% in the fourth quarter of 2007 as compared to 2.58% in the fourth quarter of 2006.

We are unable to predict the direction of future interest rate changes. However, the FOMC has reduced short-term interest rates since September 2007, and the treasury yield curve has returned to a more normal slope. Approximately 43% of the Company's certificates of deposit accounts and borrowed funds reprice or mature during the next year, which could result in a decrease in the cost of our interest-bearing liabilities. Also, in a decreasing interest rate environment, mortgage loans and mortgage-backed securities with higher rates tend to prepay, which could result in a reduction in the yield on our interest-earning assets.

During 2007, the nation's economy was generally considered to be expanding, although the expansion had slowed by the fourth quarter of 2007. World events, particularly the War on Terror and the level of oil prices, continued to have an effect on the economic recovery. The housing market in the United States saw a significant slowdown during 2007, and foreclosures of single family homes rose from the level seen in the past five years. These economic conditions can result in borrowers defaulting on their loans, or withdrawing their funds on deposit at the Bank to meet their financial obligations. While we have not seen a significant increase in delinquent loans, and have seen an increase in deposits, we cannot predict the effect of these economic conditions on the Company's financial condition or operating results.

### **Interest Rate Sensitivity Analysis**

A financial institution's exposure to the risks of changing interest rates may be analyzed, in part, by examining the extent to which its assets and liabilities are interest rate sensitive and by monitoring the institution's interest rate sensitivity gap. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that time period. A gap is considered positive when the amount of interest-earning assets maturing or repricing exceeds the amount of interest-bearing liabilities maturing or repricing within the same period. A gap is considered negative when the amount of interest-bearing liabilities maturing or repricing exceeds the amount of

interest-earning assets maturing or repricing within the same period. Accordingly, a positive gap may enhance net interest income in a rising rate environment and reduce net interest income in a falling rate environment. Conversely, a negative gap may enhance net interest income in a falling rate environment and reduce net interest income in a rising rate environment.

The table below sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2007 which are anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown. Except as stated below, the amount of assets and liabilities shown that reprice or mature during a particular period was determined in accordance with the earlier of the term to repricing or the contractual terms of the asset or liability. Prepayment assumptions for mortgage loans and mortgage-backed securities are based on the Bank's experience and industry averages, which generally range from 6% to 25%, depending on the contractual rate of interest and the underlying collateral. Money Market accounts and Savings accounts were assumed to have a withdrawal or run-off rate of 10% and 17%, respectively, based on the Bank's experience. While management bases these assumptions on actual prepayments and withdrawals experienced by the Company, there is no guarantee that these trends will continue in the future.

---

Interest Rate Sensitivity Gap Analysis at December 31, 2007

---

Three Months And Less	More Than Three Months To One Year	More Than One Year To Three Years	More Than Three Years To Five Years	More Than Five Years To Ten Years	More Than Ten Years	Total
-----------------------------	---	--	--	--	------------------------	-------

*(Dollars in thousands)*

**Interest-Earning Assets**