

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2015

OR

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

For the transition period from _____ to _____

Commission File Number: 000-11486



CONNECTONE BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

52-1273725
(IRS Employer
Identification No.)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or smaller reporting company. See definition 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
(Do not check if smaller reporting company)

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

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

Common Stock, no par value:
(Title of Class)

30,084,744 shares
(Outstanding as of November 9, 2015)

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Item 1. Financial Statements

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

(in thousands, except for share data)	September 30, 2015 <u>(unaudited)</u>	December 31, 2014 <u></u>
ASSETS		
Cash and due from banks	\$ 30,100	\$ 31,813
Interest-bearing deposits with banks	128,421	95,034
Cash and cash equivalents	158,521	126,847
Investment securities:		
Available-for-sale	224,214	289,532
Held-to-maturity (fair value of \$234,493 and \$231,445)	227,221	224,682
Loans held for sale	990	—
Loans receivable	2,953,381	2,538,641
Less: Allowance for loan and lease losses	21,533	14,160
Net loans receivable	2,931,848	2,524,481
Investment in restricted stock, at cost	30,362	23,535
Bank premises and equipment, net	21,523	20,653
Accrued interest receivable	11,662	11,700
Bank-owned life insurance	53,681	52,518
Other real estate owned	3,244	1,108
Goodwill	145,909	145,909
Core deposit intangibles	4,125	4,825
Other assets	24,953	22,782
Total assets	<u>\$ 3,838,253</u>	<u>\$ 3,448,572</u>
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 586,643	\$ 492,515
Interest-bearing	2,079,981	1,983,092
Total deposits	2,666,624	2,475,607
Borrowings	621,674	495,553
Subordinated debentures	55,155	5,155
Other liabilities	23,654	26,038
Total liabilities	<u>3,367,107</u>	<u>3,002,353</u>
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, \$1,000 liquidation value per share, authorized 5,000,000 shares; issued and outstanding 11,250 shares of Series B preferred stock at September 30, 2015 and December 31, 2014; total liquidation value of \$11,250 at September 30, 2015 and December 31, 2014	11,250	11,250
Common stock, no par value, authorized 50,000,000 shares; issued 32,261,541 shares at September 30, 2015 and 31,758,558 at December 31, 2014; outstanding 30,197,619 shares at September 30, 2015 and 29,694,636 at December 31, 2014	374,287	374,287
Additional paid-in capital	8,315	6,015
Retained earnings	97,321	72,398
Treasury stock, at cost (2,063,922 common shares at September 30, 2015 and December 31, 2014)	(16,717)	(16,717)
Accumulated other comprehensive loss	(3,310)	(1,014)
Total stockholders' equity	<u>471,146</u>	<u>446,219</u>
Total liabilities and stockholders' equity	<u>\$ 3,838,253</u>	<u>\$ 3,448,572</u>

See accompanying notes to unaudited consolidated financial statements.

CONNECTONE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

(in thousands, except for share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest income				
Interest and fees on loans	\$ 32,276	\$ 28,098	91,807	\$ 48,670
Interest and dividends on investment securities:				
Taxable	2,669	2,916	8,340	8,840
Tax-exempt	901	892	2,666	2,840
Dividends	297	349	797	639
Interest on federal funds sold and other short-term investments	43	88	127	88
Total interest income	36,186	32,343	103,737	61,077
Interest expense				
Deposits	3,655	2,725	9,980	5,343
Borrowings	2,804	2,072	7,060	4,914
Total interest expense	6,459	4,797	17,040	10,257
Net interest income	29,727	27,546	86,697	50,820
Provision for loan and lease losses	4,175	1,300	7,550	2,209
Net interest income after provision for loan and lease losses	25,552	26,246	79,147	48,611
Noninterest income				
Annuities and insurance commissions	77	94	210	299
Bank-owned life insurance	388	401	1,162	912
Net gains on sale of loans held for sale	63	65	276	144
Deposit, loan and other income	1,224	502	2,145	1,967
Insurance recovery	—	—	2,224	—
Net gains on sales of investment securities	2,067	111	2,793	2,100
Total noninterest income	3,819	1,173	8,810	5,422
Noninterest expenses				
Salaries and employee benefits	6,905	6,243	20,480	13,153
Occupancy and equipment	1,916	1,781	5,785	3,658
FDIC insurance	535	504	1,535	1,092
Professional and consulting	836	530	2,045	1,289
Marketing and advertising	247	209	634	276
Data processing	957	902	2,686	1,761
Merger-related expenses	—	8,784	—	10,573
Loss on extinguishment of debt	—	4,550	2,397	4,550
Amortization of core deposit intangible	217	248	700	260
Other expenses	1,688	1,649	4,643	3,028
Total noninterest expenses	13,301	25,400	40,905	39,640
Income before income tax expense	16,070	2,019	47,052	14,393
Income tax expense	5,228	253	15,309	3,851
Net income	10,842	1,766	31,743	10,542
Less: Preferred stock dividends	28	28	84	84
Net income available to common stockholders	\$ 10,814	\$ 1,738	\$ 31,659	\$ 10,458
Earnings per common share:				
Basic	\$ 0.36	\$ 0.06	1.06	\$ 0.50
Diluted	\$ 0.36	\$ 0.06	1.04	\$ 0.49
Weighted average common shares outstanding:				
Basic	30,045,818	29,636,001	29,786,374	20,819,241
Diluted	30,335,571	30,108,103	30,323,376	21,285,452
Dividend per common share	\$ 0.075	\$ 0.075	0.225	\$ 0.225

See accompanying notes to unaudited consolidated financial statements.

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

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$ 10,842	\$ 1,766	\$ 31,743	\$ 10,542
Other comprehensive (loss) income, net of tax:				
Unrealized gains and losses on securities available-for-sale:				
Unrealized holding (losses) gains on available-for-sale securities	108	(1,171)	(1,196)	5,656
Tax effect	(39)	584	485	(1,882)
Net of tax amount	69	(587)	(711)	3,774
Reclassification adjustment for realized gains arising during this period	(2,067)	(111)	(2,793)	(2,100)
Tax effect	794	42	1,091	601
Net of tax amount	(1,273)	(69)	(1,702)	(1,499)
Amortization of unrealized holding losses on securities transferred from available-for-sale to held-to-maturity	37	57	165	156
Tax effect	(15)	(24)	(67)	(67)
Net of tax amount	22	33	98	89
Unrealized losses on cash flow hedges	(855)	—	(1,153)	—
Tax effect	349	—	471	—
Net of tax amount	(506)	—	(682)	—
Pension plan:				
Actuarial gains	183	—	1,186	1,281
Tax effect	(75)	—	(485)	(523)
Net of tax amount	108	—	701	758
Total other comprehensive (loss) income	(1,580)	(623)	(2,296)	3,122
Total comprehensive income	\$ 9,262	\$ 1,143	\$ 29,447	\$ 13,664

See accompanying notes to unaudited consolidated financial statements.

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

(dollars in thousands, except for per share data)	Preferred Stock	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance as of January 1, 2014	\$ 11,250	\$ 110,056	\$ 4,986	\$ 61,914	\$ (17,078)	\$ (2,544)	\$ 168,584
Net income	—	—	—	18,565	—	—	18,565
Other comprehensive income, net of tax	—	—	—	—	—	1,530	1,530
Dividend on series B preferred stock	—	—	—	(112)	—	—	(112)
Issuance cost of common stock	—	—	—	(7)	—	—	(7)
Cash dividends declared on common stock (\$0.300 per share)	—	—	—	(7,962)	—	—	(7,962)
Exercise of 100,911 stock options	—	—	806	—	361	—	1,167
Stock issued (13,221,152 shares) and options acquired (783,732 shares) in acquisition of Legacy ConnectOne	—	264,231	—	—	—	—	264,231
Stock-based compensation expense	—	—	223	—	—	—	223
Balance as of December 31, 2014	<u>11,250</u>	<u>374,287</u>	<u>6,015</u>	<u>72,398</u>	<u>(16,717)</u>	<u>(1,014)</u>	<u>446,219</u>
Net income	—	—	—	31,743	—	—	31,743
Other comprehensive loss, net of tax	—	—	—	—	—	(2,296)	(2,296)
Dividend on series B preferred stock	—	—	—	(84)	—	—	(84)
Cash dividends declared on common stock (\$0.225 per share)	—	—	—	(6,736)	—	—	(6,736)
Exercise of stock options (340,492 shares)	—	—	1,424	—	—	—	1,424
Restricted stock and performance units grants (162,491 shares)	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	876	—	—	—	876
Balance as of September 30, 2015	<u>\$ 11,250</u>	<u>\$ 374,287</u>	<u>\$ 8,315</u>	<u>\$ 97,321</u>	<u>\$ (16,717)</u>	<u>\$ (3,310)</u>	<u>\$ 471,146</u>

See accompanying notes to unaudited consolidated financial statements.

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

(in thousands)	Nine months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 31,743	\$ 10,542
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premiums and accretion of discounts on investment securities, net	1,442	1,966
Depreciation and amortization	2,420	1,717
Provision for loan losses	7,550	2,209
Stock-based compensation	876	51
Gains on sales of investment securities, net	(2,793)	(2,100)
Net loss on sale of other real estate owned	112	23
Loans originated for resale	(18,004)	(7,316)
Proceeds from sale of loans held for sale	17,290	6,730
Gains on sale of loans held for sale	(276)	(144)
Decrease in accrued interest receivable	38	296
Increase in cash surrender value of bank-owned life insurance	(1,163)	(912)
(Increase) decrease in other assets	(3,324)	1,128
Increase (decrease) in other liabilities	294	(3,791)
Net cash provided by operating activities	36,205	10,399
Cash flows from investing activities:		
Investment securities available-for-sale:		
Purchases	(34,796)	(31,550)
Sales	44,397	66,738
Maturities, calls and principal repayments	53,542	20,951
Investment securities held-to-maturity:		
Purchases	(17,531)	(8,310)
Maturities and principal repayments	14,702	6,235
Net (purchases) redemptions of restricted investment in bank stocks	(6,827)	4,710
Net increase in loans	(417,291)	(167,314)
Purchases of premises and equipment	(2,590)	(2,199)
Cash acquired in acquisition of Legacy ConnectOne	—	70,318
Proceeds from sale of other real estate owned	126	1,562
Net cash (used in) provided by investing activities	(366,268)	(38,859)
Cash flows from financing activities:		
Net increase in deposits	191,017	75,821
Increase in subordinated debt	50,000	—
Advances of FHLB borrowings	625,000	11,590
Repayments of FHLB borrowings	(482,879)	—
Net decrease in repurchase agreements	(16,000)	—
Cash dividends on preferred stock	(84)	(84)
Cash dividends paid on common stock	(6,741)	(4,681)
Issuance cost of common stock	—	(7)
Tax benefit of options exercised	—	357
Proceeds from exercise of stock options	1,424	785
Net cash provided (used in) by financing activities	361,737	83,781
Net change in cash and cash equivalents	31,674	55,321
Cash and cash equivalents at beginning of period	126,847	82,692
Cash and cash equivalents at end of period	\$ 158,521	\$ 138,013
Supplemental disclosures of cash flow information:		
Cash payments for:		
Interest paid on deposits and borrowings	\$ 15,940	\$ 10,222
Income taxes	17,045	4,653
Supplemental disclosures of non-cash investing activities:		
Transfer of loans to other real estate owned	2,374	—
Dividends declared, not paid	(5)	1,063

See accompanying notes to unaudited consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1. Nature of Operations and Principles of Consolidation

The consolidated financial statements of ConnectOne Bancorp, Inc. (the “Parent Corporation”) are prepared on an accrual basis and include the accounts of the Parent Corporation and its wholly-owned subsidiary, ConnectOne Bank (the “Bank” and, collectively with the Parent Corporation and the Parent Corporation’s other direct and indirect subsidiaries, the “Company”). All significant intercompany accounts and transactions have been eliminated from the accompanying consolidated financial statements.

The Bank is a community-based, full-service New Jersey-chartered commercial bank that was founded in 2005. The Bank operates from its headquarters located at 301 Sylvan Avenue in the Borough of Englewood Cliffs, Bergen County, New Jersey and through its twenty-one other banking offices. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from business operations. There are no significant concentrations of loans to any one industry or client. However, the clients’ ability to repay their loans is dependent on the cash flows, real estate and general economic conditions in the area.

The following unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, and, accordingly, do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2015, or for any other interim period. The Company’s 2014 Annual Report on Form 10-K, should be read in conjunction with these financial statements.

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

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”). Some items in the prior year financial statements were reclassified to conform to current presentation. Reclassifications had no effect on prior year net income or stockholders’ equity.

Note 2. New Authoritative Accounting Guidance

ASU No. 2015-03, “Interest—Imputation of Interest (Subtopic 835-30) Simplifying the Presentation of Debt Issuance Costs” requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in the ASU No. 2015-03. ASU No. 2015-03 will be effective for reporting periods (including interim periods) beginning after December 15, 2015. ASU No. 2015-03 became effective for the Company on January 1, 2015 and did not have a significant impact on its consolidated financial statements.

Note 3. Business Combinations

On January 20, 2014, the Parent Corporation entered into an Agreement and Plan of Merger (the “Merger Agreement”) with ConnectOne Bancorp, Inc., a New Jersey Company (“Legacy ConnectOne”). Effective July 1, 2014 (the “Effective Time”), the Parent Corporation completed the merger contemplated by the Merger Agreement (the “Merger”) with Legacy ConnectOne. At closing, Legacy ConnectOne merged with and into the Parent Corporation, with the Parent Corporation as the surviving Company. Also at closing, the Parent Corporation changed its name from “Center Bancorp, Inc.” to “ConnectOne Bancorp, Inc.” and changed its NASDAQ trading symbol to “CNOB” from “CNBC.”

Pursuant to the Merger Agreement, holders of Legacy ConnectOne common stock, no par value per share (the “Legacy ConnectOne Common Stock”), received 2.6 shares of common stock of the Parent Corporation, no par value per share (the “Company Common Stock”), for each share of Legacy ConnectOne Common Stock held immediately prior to the effective time of the Merger, with cash to be paid in lieu of fractional shares. Each outstanding share of Company Common Stock remained outstanding and was unaffected by the Merger. Each option granted by Legacy ConnectOne to purchase shares of Legacy ConnectOne Common Stock was converted into an option to purchase Company Common Stock on the same terms and conditions as were applicable prior to the Merger (taking into account any acceleration or vesting by reason of the consummation of the Merger and its related transactions), subject to adjustment of the exercise price and the number of shares of Company Common Stock issuable upon exercise of such option based on the 2.6 exchange ratio.

Immediately following the Merger, Union Center National Bank, a bank organized pursuant to the laws of the United States, and a wholly owned subsidiary of the Parent Corporation (“UNCB”), merged (the “Bank Merger”) with and into ConnectOne Bank, a New Jersey state-chartered commercial bank and a wholly owned subsidiary of Legacy ConnectOne, with ConnectOne Bank as the surviving entity (the “Bank”). The Bank now conducts business only in the name of and under the brand of ConnectOne.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 3. Business Combinations – (continued)

The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting. The assets and liabilities, both tangible and intangible, were recorded at their fair values as of July 1, 2014 based on management's best estimate using the information available as of the Merger date. The application of the acquisition method of accounting resulted in the recognition of goodwill of \$129,105,000 and a core deposit intangible of \$5,308,000. As of July 1, 2014, Legacy ConnectOne had assets with a carrying value of approximately \$1.5 billion, including loans with a carrying value of approximately \$1.2 billion, and deposits with a carrying value of approximately \$1.1 billion. The table below summarizes the amounts recognized as of the Merger date for each major class of assets acquired and liabilities assumed, the estimated fair value adjustments and the amounts recorded in the Company's financial statements at fair value at the Merger date (in thousands):

Consideration paid through Parent Corporation common stock issued to Legacy ConnectOne shareholders and fair value of stock options acceleration was:

	<u>Legacy ConnectOne carrying value</u>	<u>Fair value adjustments</u>	<u>\$ 264,231</u> <u>As recorded at acquisition</u>
Cash and cash equivalents	\$ 70,318	\$ —	\$ 70,318
Investment securities	28,436	16 (a)	28,452
Restricted stock	13,646	—	13,646
Loans held for sale	190	—	190
Loans	1,304,600	(5,316) (b)	1,299,284
Bank owned life insurance	15,481	—	15,481
Premises and equipment	7,380	(905) (c)	6,475
Accrued interest receivable	4,470	—	4,470
Core deposit and other intangibles	—	5,308 (d)	5,308
Other real estate owned	2,455	—	2,455
Other assets	10,636	3,650 (e)	14,286
Deposits	(1,049,666)	(1,676) (f)	(1,051,342)
FHLB borrowings	(262,046)	(1,324) (g)	(263,370)
Other liabilities	(10,527)	—	(10,527)
Total identifiable net assets	<u>\$ 135,373</u>	<u>\$ (247)</u>	<u>\$ 135,126</u>
Goodwill recorded in the Merger			<u>\$ 129,105</u>

The following provides an explanation of certain fair value adjustments presented in the above table:

- a) Represents the fair value adjustment on investment securities held to maturity.
- b) Represents the elimination of Legacy ConnectOne's allowance for loan and lease losses, deferred fees, deferred costs and an adjustment of the amortized cost of loans to estimated fair value, which includes an interest rate mark and credit mark.
- c) Represent an adjustment to reflect the fair value of above-market rent on leased premises. The above-market rent adjustment will be amortized on a straight-line basis over the remaining term of the respective leases.
- d) Represents intangible assets recorded to reflect the fair value of core deposits. The core deposit asset was recorded as an identifiable intangible asset and will be amortized on an accelerated basis over the estimated average life of the deposit base.
- e) Consist primarily of adjustments in net deferred tax assets resulting from the fair value adjustments related to acquired assets, liabilities assumed and identifiable intangibles recorded.
- f) Represents fair value adjustment on time deposits as the weighted average interest rates of time deposits assumed exceeded the costs of similar funding available in the market at the time of the Merger, as well as the elimination of fees paid on brokered time deposits.
- g) Represents the fair value adjustment on FHLB borrowings as the weighted average interest rate of FHLB borrowings assumed exceeded the cost of similar funding available in the market at the time of the Merger.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 3. Business Combinations – (continued)

Except for collateral dependent loans with deteriorated credit quality, the fair values for loans acquired from Legacy ConnectOne were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted by estimated future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. For collateral dependent loans with deteriorated credit quality, fair value was estimated by analyzing the value of the underlying collateral, assuming the fair values of the loans were derived from the eventual sale of the collateral. These values were discounted using market derived rates of returns, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral. There was no carryover of Legacy ConnectOne allowance for loan and lease losses associated with the loans that were acquired, as the loans were initially recorded at fair value on the date of the Merger.

The acquired loan portfolio subject to purchased credit impairment accounting guidance (ASC 310-30) as of July 1, 2014 was comprised of collateral dependent loans with deteriorated credit quality as follows (in thousands):

	ASC 310-30 Loans
Contractual principal and accrued interest at acquisition	\$ 23,284
Principal not expected to be collected (non-accretable discount)	(6,942)
Expected cash flows at acquisition	16,342
Interest component of expected cash flows (accretable discount)	(5,013)
Fair value of acquired loans	\$ 11,329

The core deposit intangible asset recognized is being amortized over its estimated useful life of approximately 10 years utilizing the accelerated method. Other intangibles consist of below market rents, which are amortized over the remaining life of each lease using the straight-line method.

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

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

Direct acquisition and integration costs of the Merger were expensed as incurred and totaled \$12.4 million for the full year 2014. These items were recorded as merger-related expenses on the statement of operations.

Note 4. Earnings per Common Share

Basic earnings per common share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding. Diluted EPS includes any additional common shares as if all potentially dilutive common shares were issued (e.g., stock options). The Company's weighted average common shares outstanding for diluted EPS include the effect of stock options and restricted stock awards outstanding using the Treasury Stock Method, which are not included in the calculation of basic EPS.

Earnings per common share have been computed as follows:

(in thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$ 10,842	\$ 1,766	\$ 31,743	\$ 10,542
Less: preferred stock dividends	(28)	(28)	(84)	(84)
Net income available to common stockholders	\$ 10,814	\$ 1,738	31,659	10,458
Basic weighted average common shares outstanding	30,046	29,636	29,786	20,819
Plus: effect of dilutive options and awards	290	472	537	466
Diluted weighted average common shares outstanding	30,336	30,108	30,323	21,285
Earnings per common share:				
Basic	\$ 0.36	\$ 0.06	\$ 1.06	\$ 0.50
Diluted	0.36	0.06	1.04	0.49

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 5. Investment Securities

The Company's investment securities are classified as available-for-sale and held-to-maturity at September 30, 2015 and December 31, 2014. Investment securities available-for-sale are reported at fair value with unrealized gains or losses included in equity, net of tax. Accordingly, the carrying value of such securities reflects their fair value as of September 30, 2015. Fair value is based upon either quoted market prices, or in certain cases where there is limited activity in the market for a particular instrument, assumptions are made to determine their fair value. See Note 8 of the Notes to Consolidated Financial Statements for a further discussion.

Transfers of debt securities from the available-for-sale category to the held-to-maturity category are made at fair value at the date of transfer. The unrealized holding gain or loss at the date of transfer remains in accumulated other comprehensive income and in the carrying value of the held-to-maturity investment security. Premiums or discounts on investment securities are amortized or accreted using the effective interest method over the life of the security as an adjustment of yield. Unrealized holding gains or losses that remain in accumulated other comprehensive income are amortized or accreted over the remaining life of the security as an adjustment of yield, offsetting the related amortization of the premium or accretion of the discount.

The following tables present information related to the Company's investment securities at September 30, 2015 and December 31, 2014.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2015				
(in thousands)				
<u>Investment securities available-for-sale</u>				
Federal agency obligations	\$ 30,474	\$ 438	\$ (7)	\$ 30,905
Residential mortgage pass-through securities	46,943	1,162	(14)	48,091
Commercial mortgage pass-through securities	2,996	59	—	3,055
Obligations of U.S. states and political subdivisions	8,191	191	—	8,382
Trust preferred securities	16,087	385	(150)	16,322
Corporate bonds and notes	76,049	2,418	(81)	78,386
Asset-backed securities	21,403	2	(275)	21,130
Certificates of deposit	1,896	27	(3)	1,920
Equity securities	376	—	(38)	338
Other securities	15,715	67	(97)	15,685
Total	<u>\$ 220,130</u>	<u>\$ 4,749</u>	<u>\$ (665)</u>	<u>\$ 224,214</u>
<u>Investment securities held-to-maturity</u>				
U.S. Treasury and agency securities	\$ 28,419	\$ 1,328	\$ —	\$ 29,747
Federal agency obligations	35,519	642	(47)	36,114
Residential mortgage-backed securities	4,240	19	(1)	4,258
Commercial mortgage-backed securities	4,150	97	—	4,247
Obligations of U.S. states and political subdivisions	118,877	4,470	(46)	123,301
Corporate bonds and notes	36,016	888	(78)	36,826
Total	<u>\$ 227,221</u>	<u>\$ 7,444</u>	<u>\$ (172)</u>	<u>\$ 234,493</u>
Total investment securities	<u>\$ 447,351</u>	<u>\$ 12,193</u>	<u>\$ (837)</u>	<u>\$ 458,707</u>

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Note 5. Investment Securities – (continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2014				
(in thousands)				
<u>Investment securities available-for-sale</u>				
Federal agency obligations	\$ 32,650	\$ 217	\$ (50)	\$ 32,817
Residential mortgage pass-through securities	58,836	1,531	(11)	60,356
Commercial mortgage pass-through securities	3,042	4	—	3,046
Obligations of U.S. states and political subdivisions	8,201	205	—	8,406
Trust preferred securities	16,086	489	(269)	16,306
Corporate bonds and notes	119,838	5,950	(11)	125,777
Asset-backed securities	27,393	140	(31)	27,502
Certificates of deposit	2,098	27	(2)	2,123
Equity securities	376	—	(69)	307
Other securities	12,941	33	(82)	12,892
Total	<u>\$ 281,461</u>	<u>\$ 8,596</u>	<u>\$ (525)</u>	<u>\$ 289,532</u>
<u>Investment securities held-to-maturity</u>				
U.S. Treasury and agency securities	\$ 28,264	\$ 920	\$ —	\$ 29,184
Federal agency obligations	27,103	322	(28)	27,397
Residential mortgage-backed securities	5,955	28	—	5,983
Commercial mortgage-backed securities	4,266	50	—	4,316
Obligations of U.S. states and political subdivisions	120,144	4,512	(60)	124,596
Corporate bonds and notes	38,950	1,026	(7)	39,969
Total	<u>\$ 224,682</u>	<u>\$ 6,858</u>	<u>\$ (95)</u>	<u>\$ 231,445</u>
Total investment securities	<u>\$ 506,143</u>	<u>\$ 15,454</u>	<u>\$ (620)</u>	<u>\$ 520,977</u>

The following table presents information for investment securities at September 30, 2015, based on scheduled maturities. Actual maturities can be expected to differ from scheduled maturities due to prepayment or early call options of the issuer.

	September 30, 2015	
	Amortized Cost	Fair Value
(in thousands)		
<u>Investment securities available-for-sale:</u>		
Due in one year or less	\$ 16,296	\$ 16,443
Due after one year through five years	30,271	31,401
Due after five years through ten years	55,740	56,953
Due after ten years	51,793	52,248
Residential mortgage pass-through securities	46,943	48,091
Commercial mortgage pass-through securities	2,996	3,055
Equity securities	376	338
Other securities	15,715	15,685
Total	<u>\$ 220,130</u>	<u>\$ 224,214</u>
<u>Investment securities held-to-maturity:</u>		
Due in one year or less	\$ —	\$ —
Due after one year through five years	13,571	13,888
Due after five years through ten years	76,126	78,980
Due after ten years	129,134	133,120
Residential mortgage-backed securities	4,240	4,258
Commercial mortgage-backed securities	4,150	4,247
Total	<u>\$ 227,221</u>	<u>\$ 234,493</u>
Total investment securities	<u>\$ 447,351</u>	<u>\$ 458,707</u>

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Note 5. Investment Securities – (continued)

Gross gains and losses from the sales, calls and maturities of investment securities for the three-month and nine-month periods ended September 30, 2015 and 2014 were as follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Proceeds	\$ 32,125	\$ 2,303	\$ 44,397	\$ 66,738
Gross gains on sales of investment securities	2,067	111	2,793	2,122
Gross losses on sales of investment securities	—	—	—	(22)
Net gains on sales of investment securities	\$ 2,067	\$ 111	\$ 2,793	\$ 2,100
Less: tax provision on net gains	794	42	1,091	601
Total	\$ 1,273	\$ 69	\$ 1,702	\$ 1,499

The Company performs regular analysis on the securities portfolio to determine whether a decline in fair value indicates that an investment is other-than-temporarily impaired in accordance with FASB ASC 320-10. FASB ASC 320-10 requires companies to record other-than-temporary impairment (“OTTI”) charges, through earnings, if they have the intent to sell, or more likely than not will be required to sell, an impaired debt security before recovery of its amortized cost basis. If the Company intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current period credit loss, the OTTI is recognized in earnings equal to the entire difference between the investment’s amortized cost basis and its estimated fair value at the balance sheet date. If the Company does not intend to sell the security and it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current period loss, and as such, it determines that a decline in fair value is other than temporary, the OTTI is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

The Company maintains a watch list for the identification and monitoring of securities experiencing problems that require a heightened level of review. This could include credit rating downgrades.

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

The following table presents detailed information for each single issuer trust preferred security held by the Company at September 30, 2015, of which all but one has at least one rating below investment grade (in thousands):

Issuer	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Lowest Credit Rating Assigned
Countrywide Capital IV	\$ 1,771	\$ 1,804	\$ 33	BB+
Countrywide Capital V	2,747	2,829	82	BB+
Countrywide Capital V	250	257	7	BB+
Nationsbank Cap Trust III	1,576	1,426	(150)	BB+
Morgan Stanley Cap Trust IV	2,500	2,537	37	BB
Morgan Stanley Cap Trust IV	1,743	1,775	32	BB
Goldman Sachs	1,000	1,149	149	BB
Stifel Financial	4,500	4,545	45	BBB-
Total	\$ 16,087	\$ 16,322	\$ 235	

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Note 5. Investment Securities – (continued)

Temporarily Impaired Investments

The Company does not believe that the unrealized losses, for all securities, which were comprised of 57 and 54 investment securities as of September 30, 2015 and December 31, 2014, respectively, represent an other-than-temporary impairment. The gross unrealized losses associated with U.S. Treasury and agency securities, federal agency obligations, mortgage-backed securities, corporate bonds, tax- exempt securities, asset-backed securities, trust preferred securities, mutual funds and equity securities are not considered to be other than temporary because these unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer.

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

The decline in value is related to a change in interest rates and subsequent change in credit spreads required for these issues affecting market price. All issues are performing and are expected to continue to perform in accordance with their respective contractual terms and conditions. Short to intermediate average durations and in certain cases monthly principal payments should reduce further market value exposure to increases in rates.

The Company evaluates all securities with unrealized losses quarterly to determine whether the loss is other than temporary. Unrealized losses in the corporate debt securities category consist primarily of senior unsecured corporate debt securities issued by large financial institutions, insurance companies and other corporate issuers. Single issuer corporate trust preferred securities are also included, and in the case of one holding the market valuation loss is largely based upon the floating rate coupon and corresponding market valuation. Neither that trust preferred issuer, nor any other corporate issuers, have defaulted on interest payments. The unrealized loss in equity securities consists of losses on other bank equities. The decline in fair value is due in large part to the lack of an active trading market for these securities, changes in market credit spreads and rating agency downgrades. Management concluded that these securities were not other-than-temporarily impaired at September 30, 2015.

In determining that the securities giving rise to the previously mentioned unrealized losses were not other than temporary, the Company evaluated the factors cited above, which the Company considers when assessing whether a security is other-than-temporarily impaired. In making these evaluations the Company must exercise considerable judgment. Accordingly, there can be no assurance that the actual results will not differ from the Company's judgments and that such differences may not require the future recognition of other-than-temporary impairment charges that could have a material effect on the Company's financial position and results of operations. In addition, the value of, and the realization of any loss on, an investment security is subject to numerous risks as cited above.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 5. Investment Securities – (continued)

The following tables indicate gross unrealized losses not recognized in income and fair value, aggregated by investment category and the length of time individual securities have been in a continuous unrealized loss position at September 30, 2015 and December 31, 2014:

	September 30, 2015					
	Total		Less than 12 Months		12 Months or Longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
<u>Investment securities available-for-sale:</u>						
Federal agency obligation	\$ 3,743	\$ (7)	\$ 3,478	\$ (5)	\$ 265	\$ (2)
Residential mortgage pass-through securities	2,283	(14)	2,162	(13)	121	(1)
Trust preferred securities	1,426	(150)	—	—	1,426	(150)
Corporate bonds and notes	8,389	(81)	6,437	(58)	1,952	(23)
Asset-backed securities	19,628	(275)	18,359	(235)	1,269	(40)
Certificates of deposit	220	(3)	220	(3)	—	—
Equity securities	338	(38)	—	—	338	(38)
Other securities	5,597	(97)	—	—	5,597	(97)
Total	<u>\$ 41,624</u>	<u>\$ (665)</u>	<u>\$ 30,656</u>	<u>\$ (314)</u>	<u>\$ 10,968</u>	<u>\$ (351)</u>
<u>Investment securities held-to-maturity:</u>						
Federal agency obligation	\$ 5,443	\$ (47)	\$ 4,614	\$ (47)	\$ 829	\$ —
Residential mortgage pass-through securities	438	(1)	391	(1)	47	—
Obligations of U.S. states and political subdivisions	7,313	(46)	7,313	(46)	—	—
Corporate bonds and notes	2,670	(78)	2,670	(78)	—	—
Total	<u>\$ 15,864</u>	<u>\$ (172)</u>	<u>\$ 14,988</u>	<u>\$ (172)</u>	<u>\$ 876</u>	<u>\$ —</u>
Total temporarily impaired securities	<u>\$ 57,488</u>	<u>\$ (837)</u>	<u>\$ 45,644</u>	<u>\$ (486)</u>	<u>\$ 11,844</u>	<u>\$ (351)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 5. Investment Securities – (continued)

	December 31, 2014					
	Total		Less than 12 Months		12 Months or Longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
<u>Investment securities available-for-sale:</u>						
Federal agency obligation	\$ 6,755	\$ (50)	\$ 2,770	\$ (9)	\$ 3,985	\$ (41)
Residential mortgage pass-through securities	5,694	(11)	5,694	(11)	—	—
Trust preferred securities	1,307	(269)	—	—	1,307	(269)
Corporate bonds and notes	1,961	(11)	1,961	(11)	—	—
Asset-backed securities	9,773	(31)	9,773	(31)	—	—
Certificates of deposit	369	(2)	369	(2)	—	—
Equity securities	307	(69)	—	—	307	(69)
Other securities	5,417	(82)	1,978	(21)	3,439	(61)
Total	<u>\$ 31,583</u>	<u>\$ (525)</u>	<u>\$ 22,545</u>	<u>\$ (85)</u>	<u>\$ 9,038</u>	<u>\$ (440)</u>
<u>Investment securities held-to-maturity:</u>						
Federal agency obligation	\$ 3,228	\$ (28)	\$ 3,228	\$ (28)	\$ —	\$ —
Obligations of U.S. states and political subdivisions	8,341	(60)	1,401	(3)	6,940	(57)
Corporate bonds and notes	993	(7)	993	(7)	—	—
Total	<u>\$ 12,562</u>	<u>\$ (95)</u>	<u>\$ 5,622</u>	<u>\$ (38)</u>	<u>\$ 6,940</u>	<u>\$ (57)</u>
Total temporarily impaired securities	<u>\$ 44,145</u>	<u>\$ (620)</u>	<u>\$ 28,167</u>	<u>\$ (123)</u>	<u>\$ 15,978</u>	<u>\$ (497)</u>

Investment securities having a carrying value of approximately \$142.8 million and \$224.7 million at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits, borrowings, Federal Reserve Discount Window and Federal Home Loan Bank advances and for other purposes required or permitted by law.

As of September 30, 2015 and December 31, 2014, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

Note 6 - Derivatives

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

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

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Note 6 – Derivatives – (continued)

Summary information about the interest rate swaps designated as cash flow hedges as of September 30, 2015 and 2014 and December 31, 2014 is presented in the following table.

(dollars in thousands)	September 30, 2015	December 31, 2014	September 30, 2014
Notional amount	\$ 75,000	\$ 50,000	\$ —
Weighted average pay rates	1.56%	1.58%	—%
Weighted average receive rates	0.30%	0.24%	—%
Weighted average maturity	4.1 years	4.4 years	—
Fair value	\$ (1,105)	\$ 48	\$ —

Interest expense recorded on these swap transactions totaled approximately \$165 thousand and \$528 thousand for the three and nine months ended September 30, 2015, respectively. There were no related expenses during the nine months ended September 30, 2014.

Cash Flow Hedge

The following table presents the net gains (losses), recorded in other comprehensive income and the Consolidated Statements of Income relating to the cash flow derivative instruments for the nine months ended September 30, 2015:

(in thousands)	2015		
	Amount of loss recognized in OCI (Effective Portion)	Amount of loss reclassified from OCI to interest income	Amount of loss recognized in other Non-interest income (Ineffective Portion)
Interest rate contracts	\$ (1,153)	\$ —	\$ —

There were no net gains (losses) recorded in accumulated other comprehensive income or in the Consolidated Statement of Income relating to cash flow derivative instruments for the nine months ended September 30, 2014.

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Note 7. Loans and the Allowance for Loan and Lease Losses

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

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

Interest income on commercial, commercial real estate, commercial construction and residential loans are discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to nonaccrual status in accordance with the Company's policy, typically after 90 days of non-payment.

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

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

Allowance for Loan and Lease Losses

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

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings ("TDRs") and classified as impaired. As part of the evaluation of impaired loans, the Company individually reviews for impairment all non-homogeneous loans internally classified as substandard or below. Generally, smaller impaired non-homogeneous loans and impaired homogeneous loans are collectively evaluated for impairment.

The Bank has defined its population of impaired loans to include all loans on nonaccrual status; all troubled debt restructuring loans; and all loans (above an established dollar threshold of \$250,000) internally classified as "Special Mention" or below that require a specific reserve.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

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

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

Purchased Credit-Impaired Loans

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

Such purchased credit impaired loans are accounted for individually. The Company estimates the amount and timing of expected cash flows for each loan and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan (accrutable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (nonaccrutable difference).

Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Composition of Loan Portfolio

The following table sets forth the composition of the Company's loan portfolio, including net deferred loan fees, at September 30, 2015 and December 31, 2014:

	September 30, 2015	December 31, 2014
	(in thousands)	
Commercial	\$ 569,605	\$ 499,816
Commercial real estate	1,873,714	1,634,510
Commercial construction	283,623	167,359
Residential real estate	225,158	234,967
Consumer	3,569	2,879
Gross loans	2,955,669	2,539,531
Net deferred loan fees	(2,288)	(890)
Total loans receivable	<u>\$ 2,953,381</u>	<u>\$ 2,538,641</u>

At September 30, 2015 and December 31, 2014, loan balances of approximately \$1.6 billion and \$1.0 billion, respectively, were pledged to secure borrowings from the Federal Home Loan Bank of New York.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

Purchased Credit-Impaired Loans

The Company holds purchased loans for which there was, at their acquisition date, evidence of deterioration of credit quality since their origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans is as follows at September 30, 2015 and December 31, 2014.

	September 30, 2015	December 31, 2014
	(in thousands)	
Commercial	\$ 7,046	\$ 7,199
Commercial real estate	1,799	1,816
Residential real estate	323	806
Total carrying amount	<u>\$ 9,168</u>	<u>\$ 9,821</u>

For those purchased loans disclosed above, the Company did not increase the allowance for loan and lease losses for the nine months ended September 30, 2015.

The accretable yield, or income expected to be collected, on the purchased loans disclosed above for the nine months ended September 30, 2015 is as follows (in thousands):

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2015
Beginning balance	\$ 5,013	\$ 4,678	\$ 4,805
New loans purchased	—	—	—
Accretion of income	(76)	(53)	(180)
Reclassifications from nonaccretable difference	—	—	—
Disposals	—	—	—
Ending balance	<u>\$ 4,937</u>	<u>\$ 4,625</u>	<u>\$ 4,625</u>

The following table presents information about the recorded investment in loan receivables on nonaccrual status by segment at September 30, 2015 and December 31, 2014:

Loans Receivable on Nonaccrual Status

	September 30, 2015	December 31, 2014
	(in thousands)	
Commercial	\$ 5,051	\$ 616
Commercial real estate	3,467	8,197
Commercial construction	1,479	—
Residential real estate	2,891	2,796
Total loans receivable on nonaccrual status	<u>\$ 12,888</u>	<u>\$ 11,609</u>

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogenous loans that are collectively evaluated for impairment and individually classified impaired loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

The Company continuously monitors the credit quality of its loans receivable. In addition to its internal staff, the Company utilizes the services of a third party loan review firm to rate the credit quality of its loans receivable. Credit quality is monitored by reviewing certain credit quality indicators. Assets classified “Pass” are deemed to possess average to superior credit quality, requiring no more than normal attention. Assets classified as “Special Mention” have generally acceptable credit quality yet possess higher risk characteristics/circumstances than satisfactory assets. Such conditions include strained liquidity, slow pay, stale financial statements, or other conditions that require more stringent attention from the lending staff. These conditions, if not corrected, may weaken the loan quality or inadequately protect the Company’s credit position at some future date. Assets are classified “Substandard” if the asset has a well-defined weakness that requires management’s attention to a greater degree than for loans classified special mention. Such weakness, if left uncorrected, could possibly result in the compromised ability of the loan to perform to contractual requirements. An asset is classified as “Doubtful” if it is inadequately protected by the net worth and/or paying capacity of the obligor or of the collateral, if any, that secures the obligation. Assets classified as doubtful include assets for which there is a “distinct possibility” that a degree of loss will occur if the inadequacies are not corrected. The following table presents information, excluding net deferred loan fees, about the Company’s loan credit quality at September 30, 2015 and December 31, 2014:

	September 30, 2015				
	Pass	Special Mention	Substandard	Doubtful	Total
	(in thousands)				
Commercial	\$ 476,142	\$ 80,516	\$ 12,696	\$ 251	\$ 569,605
Commercial real estate	1,827,412	25,189	21,113	—	1,873,714
Commercial construction	282,144	—	1,479	—	283,623
Residential real estate	222,370	—	2,788	—	225,158
Consumer	3,482	—	87	—	3,569
Total loans	\$ 2,811,550	\$ 105,705	\$ 38,163	\$ 251	\$ 2,955,669
	December 31, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
	(in thousands)				
Commercial	\$ 481,638	\$ 3,686	\$ 14,203	\$ 289	\$ 499,816
Commercial real estate	1,596,606	14,140	23,764	—	1,634,510
Commercial construction	165,880	1,479	—	—	167,359
Residential real estate	230,772	—	4,195	—	234,967
Consumer	2,778	—	101	—	2,879
Total loans	\$ 2,477,674	\$ 19,305	\$ 42,263	\$ 289	\$ 2,539,531

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

The following table provides an analysis of the impaired loans, by loan segment, at September 30, 2015 and December 31, 2014:

	September 30, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
(in thousands)			
<u>No related allowance recorded</u>			
Commercial	\$ 690	735	
Commercial real estate	4,830	5,233	
Commercial construction	1,479	1,479	
Residential real estate	3,164	3,518	
Consumer	95	87	
Total	<u>\$ 10,258</u>	<u>11,052</u>	
<u>With an allowance recorded</u>			
Commercial	\$ 79,724	\$ 79,494	\$ 3,001
<u>Total</u>			
Commercial	\$ 80,414	\$ 80,229	\$ 3,001
Commercial real estate	4,830	5,233	—
Commercial construction	1,479	1,479	—
Residential real estate	3,164	3,518	—
Consumer	95	87	—
Total	<u>\$ 89,982</u>	<u>\$ 90,546</u>	<u>\$ 3,001</u>
December 31, 2014			
	Recorded Investment	Unpaid Principal Balance	Related Allowance
(in thousands)			
<u>No related allowance recorded</u>			
Commercial	\$ 481	\$ 527	
Commercial real estate	5,890	6,587	
Residential real estate	3,072	3,407	
Consumer	109	101	
Total	<u>\$ 9,552</u>	<u>\$ 10,622</u>	
<u>With an allowance recorded</u>			
Commercial	\$ 387	\$ 390	\$ 111
Commercial real estate	3,520	3,520	151
Total	<u>\$ 3,907</u>	<u>\$ 3,910</u>	<u>\$ 262</u>
<u>Total</u>			
Commercial	\$ 868	\$ 917	\$ 111
Commercial real estate	9,410	10,107	151
Residential real estate	3,072	3,407	—
Consumer	109	101	—
Total	<u>\$ 13,459</u>	<u>\$ 14,532</u>	<u>\$ 262</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

The following table provides an analysis related to the average recorded investment and interest income recognized on impaired loans by segment as of and for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	<u>Three Months Ended September 30,</u>				<u>Nine Months Ended September 30,</u>			
	<u>2015</u>		<u>2014</u>		<u>2015</u>		<u>2014</u>	
	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<u>Impaired loans with no related allowance recorded:</u>								
Commercial	\$ 712	\$ —	\$ 897	\$ —	\$ 707	\$ —	\$ 778	\$ 30
Commercial real estate	4,869	15	5,046	31	4,905	46	5,313	74
Commercial construction	1,479	—	—	—	1,479	—	—	31
Residential real estate	3,221	7	1,975	—	3,251	12	2,044	5
Consumer	100	1	106	2	102	4	106	—
Total	\$ 10,381	23	\$ 8,024	33	\$ 10,444	62	\$ 8,241	\$ 140

Impaired loans with an allowance recorded:

Commercial	\$ 79,732	\$ 722	\$ —	\$ —	\$ 45,747	\$ 1,206	\$ —	\$ —
Commercial real estate	—	—	3,600	37	—	—	3,600	122
Total	\$ 79,732	\$ 722	\$ 3,600	\$ 37	\$ 45,747	\$ 1,206	\$ 3,600	\$ 122

Total impaired loans:

Commercial	\$ 80,444	\$ 712	\$ 897	\$ —	\$ 46,454	\$ 1,206	\$ 778	\$ 30
Commercial real estate	4,869	15	8,646	68	4,905	46	8,913	196
Commercial construction	1,479	—	—	—	1,479	—	—	—
Residential mortgage	3,221	7	1,975	—	3,251	12	2,044	31
Consumer	100	1	106	2	102	4	106	5
Total	\$ 90,113	\$ 745	\$ 11,624	\$ 70	\$ 56,191	\$ 1,268	\$ 11,841	\$ 262

Included in impaired loans at September 30, 2015, December 31, 2014 and September 30, 2014 are loans that are deemed troubled debt restructurings. The recorded investment in loans include accrued interest receivable and other capitalized costs such as real estate taxes paid on behalf of the borrower and loan origination fees, net, when applicable. Cash basis interest and interest income recognized on accrual basis approximate each other.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

The following table provides an analysis of the aging of the recorded investment of loans, excluding net deferred loan fees that are past due at September 30, 2015 and December 31, 2014 by segment:

Aging Analysis

September 30, 2015							
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable 90 Days or Greater Past Due and Accruing
(in thousands)							
Commercial	\$ —	\$ 9,726	\$ 5,020	\$ 14,746	\$ 554,859	\$ 569,605	\$ —
Commercial real estate	782	1,365	3,232	5,379	1,868,335	1,873,714	—
Commercial construction	—	—	1,479	1,479	282,144	283,623	—
Residential real estate	922	1,308	3,244	5,474	219,684	225,158	268
Consumer	—	—	—	—	3,569	3,569	—
Total	<u>\$ 1,704</u>	<u>\$ 12,399</u>	<u>\$ 12,975</u>	<u>\$ 27,078</u>	<u>\$ 2,928,591</u>	<u>\$ 2,955,669</u>	<u>\$ 268</u>

Aging Analysis

December 31, 2014							
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable 90 Days or Greater Past Due and Accruing
(in thousands)							
Commercial	\$ 6,060	\$ —	\$ 662	\$ 6,722	\$ 493,094	\$ 499,816	\$ 45
Commercial real estate	4,937	638	5,961	11,535	1,622,975	1,634,510	609
Commercial construction	—	—	—	—	167,359	167,359	—
Residential real estate	1,821	210	3,200	5,231	229,736	234,967	557
Consumer	30	1	—	31	2,848	2,879	—
Total	<u>\$ 12,848</u>	<u>\$ 849</u>	<u>\$ 9,823</u>	<u>\$ 23,520</u>	<u>\$ 2,516,011</u>	<u>\$ 2,539,531</u>	<u>\$ 1,211</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

The following table details, at the period presented, the amount of loans receivable that are evaluated individually, and collectively, for impairment (excluding net deferred loan fees), acquired, and the related portion of the allowance for loan and lease losses that are allocated to each loan portfolio segment:

	September 30, 2015						Total
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	
(in thousands)							
Allowance for loan and lease losses							
Individually evaluated for impairment	\$ 3,001	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 3,001
Collectively evaluated for impairment	4,122	10,274	2,646	1,012	4	474	18,532
Acquired with deteriorated credit quality	—	—	—	—	—	—	—
Total	<u>\$ 7,123</u>	<u>\$ 10,274</u>	<u>\$ 2,646</u>	<u>\$ 1,012</u>	<u>\$ 4</u>	<u>\$ 474</u>	<u>\$ 21,533</u>
Loans receivable							
Individually evaluated for impairment	\$ 80,414	\$ 4,830	\$ 1,479	\$ 3,164	\$ 95	\$ —	\$ 89,982
Collectively evaluated for impairment	482,145	1,867,085	282,144	221,671	3,474	—	2,856,519
Acquired with deteriorated credit quality	7,046	1,799	—	323	—	—	9,168
Total	<u>\$ 569,605</u>	<u>\$ 1,873,714</u>	<u>\$ 283,623</u>	<u>\$ 225,158</u>	<u>\$ 3,569</u>	<u>\$ —</u>	<u>\$ 2,955,669</u>

The table above includes approximately \$0.9 billion of acquired loans for the period ended September 30, 2015 reported as collectively evaluated for impairment.

The following table, at the period presented, details the amount of loans that are evaluated individually, and collectively, for impairment (excluding net deferred loan fees), acquired, and the related portion of the allowance for loan and lease losses that are allocated to each loan portfolio segment:

	December 31, 2014						Total
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	
(in thousands)							
Allowance for loan and lease losses							
Individually evaluated for impairment	\$ 111	\$ 151	\$ —	\$ —	\$ —	\$ —	\$ 262
Collectively evaluated for impairment	2,972	7,648	1,239	1,113	7	919	13,898
Acquired with deteriorated credit quality	—	—	—	—	—	—	—
Total	<u>\$ 3,083</u>	<u>\$ 7,799</u>	<u>\$ 1,239</u>	<u>\$ 1,113</u>	<u>\$ 7</u>	<u>\$ 919</u>	<u>\$ 14,160</u>
Loans receivable							
Individually evaluated for impairment	\$ 868	\$ 9,410	\$ —	\$ 3,072	\$ 109	\$ —	\$ 13,459
Collectively evaluated for impairment	491,749	1,623,284	167,359	231,089	2,770	—	2,516,251
Acquired with deteriorated credit quality	7,199	1,816	—	806	—	—	9,821
Total	<u>\$ 499,816</u>	<u>\$ 1,634,510</u>	<u>\$ 167,359</u>	<u>\$ 234,967</u>	<u>\$ 2,879</u>	<u>\$ —</u>	<u>\$ 2,539,531</u>

The table above includes approximately \$1.2 billion of acquired loans for the period ended December 31, 2014 reported as collectively evaluated for impairment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

The Company's allowance for loan and lease losses is analyzed quarterly. Many factors are considered, including growth in the portfolio, delinquencies, nonaccrual loan levels, and other factors inherent in the extension of credit. There have been no material changes to the allowance for loan and lease losses methodology as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

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

	Three Months Ended September 30, 2015						
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(in thousands)						
Balance at June 30, 2015	\$ 4,633	\$ 9,195	\$ 1,945	\$ 1,161	\$ 7	\$ 535	\$ 17,480
Charge-offs	—	(124)	—	—	—	—	(124)
Recoveries	2	—	—	—	—	—	2
Provision	<u>2,488</u>	<u>1,203</u>	<u>701</u>	<u>(149)</u>	<u>(3)</u>	<u>(61)</u>	<u>4,175</u>
Balance at September 30, 2015	<u>\$ 7,123</u>	<u>\$ 10,274</u>	<u>\$ 2,646</u>	<u>\$ 1,012</u>	<u>\$ 4</u>	<u>\$ 474</u>	<u>\$ 21,533</u>
	Three Months Ended September 30, 2014						
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(in thousands)						
Balance at June 30, 2014	\$ 2,412	\$ 5,741	\$ 504	\$ 1,011	\$ 63	\$ 1,364	\$ 10,825
Charge-offs	—	—	—	—	(18)	—	(18)
Recoveries	—	—	—	—	11	—	11
Provision	<u>336</u>	<u>1,281</u>	<u>20</u>	<u>41</u>	<u>(51)</u>	<u>(327)</u>	<u>1,300</u>
Balance at September 30, 2014	<u>\$ 2,478</u>	<u>\$ 7,022</u>	<u>\$ 524</u>	<u>\$ 1,052</u>	<u>\$ 5</u>	<u>\$ 1,037</u>	<u>\$ 12,118</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

	Nine Months Ended September 30, 2015						
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(in thousands)						
Balance at December 31, 2014	\$ 3,083	\$ 7,799	\$ 1,239	\$ 1,113	\$ 7	\$ 919	\$ 14,160
Charge-offs	(100)	(406)	—	—	(13)	—	(519)
Recoveries	12	327	—	2	1	—	342
Provision	<u>4,128</u>	<u>2,554</u>	<u>1,407</u>	<u>(103)</u>	<u>9</u>	<u>(445)</u>	<u>7,550</u>
Balance at September 30, 2015	<u>\$ 7,123</u>	<u>\$ 10,274</u>	<u>\$ 2,646</u>	<u>\$ 1,012</u>	<u>\$ 4</u>	<u>\$ 474</u>	<u>\$ 21,533</u>
	Nine Months Ended September 30, 2014						
	Commercial	Commercial real estate	Commercial construction	Residential real estate	Consumer	Unallocated	Total
	(in thousands)						
Balance at December 31, 2013	\$ 1,698	\$ 5,746	\$ 362	\$ 990	\$ 146	\$ 1,391	\$ 10,333
Charge-offs	(333)	—	—	(108)	(7)	—	(448)
Recoveries	—	—	—	11	13	—	24
Provision	<u>1,113</u>	<u>1,276</u>	<u>162</u>	<u>159</u>	<u>(147)</u>	<u>(354)</u>	<u>2,209</u>
Balance at September 30, 2014	<u>\$ 2,478</u>	<u>\$ 7,022</u>	<u>\$ 524</u>	<u>\$ 1,052</u>	<u>\$ 5</u>	<u>\$ 1,037</u>	<u>\$ 12,118</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

Trouble Debt Restructurings

At September 30, 2015, there were no commitments to lend additional funds to borrowers whose loans were on nonaccrual status or were contractually past due in excess of 90 days and still accruing interest, or whose terms have been modified in troubled debt restructurings.

The policy of the Company generally is to grant commercial, mortgage and consumer loans to residents and businesses within its market area. The borrowers' abilities to repay their obligations are dependent upon various factors, including the borrowers' income and net worth, cash flows generated by the borrowers' underlying collateral, value of the underlying collateral, and priority of the lender's lien on the property. Such factors are dependent upon various economic conditions and individual circumstances beyond the control of the Company. The Company is therefore subject to risk of loss. The Company believes its lending policies and procedures adequately minimize the potential exposure to such risks and that adequate provisions for loan and lease losses are provided for all known and inherent risks. Collateral and/or personal guarantees are required for virtually all loans. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

Loans modified in a troubled debt restructuring totaled a recorded investment of \$77.1 million at September 30, 2015, of which \$1.1 million were on nonaccrual status. The remaining loans modified were current and have complied with the terms of their restructure agreement. At December 31, 2014, loans modified in a troubled debt restructuring totaled \$2.8 million, of which \$1.0 million were on nonaccrual status. The remaining loans modified were current at the time of the restructuring and have complied with the terms of their restructure agreement. The Company has allocated \$2.0 million in specific allocations with respect to loans whose loan terms had been modified in troubled debt restructurings as of September 30, 2015. There were no specific allocations with respect to troubled debt restructurings as of September 30, 2014. The TDRs presented as of September 30, 2015 increased the allowance for loan and lease losses by \$2.0 million for the three and nine months ended September 30, 2015. The TDRs presented as of September 30, 2014 did not increase the allowance for loan and lease losses for the three and nine months ended September 30, 2014.

The \$2.0 million in specific allocations associated with taxi medallion lending referred to above was calculated based on the present value of estimated cash flows, including contractual debt interest service through maturity and principal repayments based on the fair value of the collateral, and excludes any consideration for the personal guarantees of borrowers, which provides an additional source of repayment but cannot be relied upon. The valuation per corporate medallion used for the calculation at September 30, 2015 was \$814,000. A specific allocation was required at September 30, 2015 due to a decline in the valuation of taxi medallions from June 30, 2015, when there was no specific allocation required.

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine months ended September 30, 2015 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	47	\$ 75,363	\$ 75,363
Commercial real estate	—	—	—
Commercial construction	—	—	—
Residential real estate	—	—	—
Consumer	—	—	—
Total	47	\$ 75,363	\$ 75,363

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

There were no charge-offs in connection with a loan modification at the time of modification during the nine months ended September 30, 2015. There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the nine months ended September 30, 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 7. Loans and the Allowance for Loan and Lease Losses – (continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine months ended September 30, 2014 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	1	\$ 672	\$ 315
Commercial real estate	—	—	—
Commercial construction	—	—	—
Residential real estate	1	53	51
Consumer	—	—	—
Total	2	\$ 725	\$ 366

The Company had a \$333,000 charge-off in connection with a loan modification at the time of modification during the nine months ended September 30, 2014. There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the nine months ended September 30, 2014.

Note 8. Fair Value Measurements and Fair Value of Financial Instruments

ASC Topic 820, “Fair Value Measurements and Disclosures,” establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

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

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

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

An asset’s or liability’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 8. Fair Value Measurements and Fair Value of Financial Instruments – (continued)

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a recurring basis at September 30, 2015 and December 31, 2014:

Securities available-for-sale - Where quoted prices are available in an active market, securities are classified with Level 1 of the valuation hierarchy. Level 1 inputs include securities that have quoted prices in active markets for identical assets. Level 1 securities held include: US Treasury securities, publicly traded equity securities, mutual funds and overnight money market funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of instruments, which would generally be classified within Level 2 of the valuation hierarchy, include municipal bonds and certain agency collateralized mortgage obligations. In certain cases where there is limited activity in the market for a particular instrument, assumptions must be made to determine their fair value and are classified as Level 3. Due to the inactive condition of the markets amidst the financial crisis, the Company treated certain securities as Level 3 securities in order to provide more appropriate valuations. For assets in an inactive market, the infrequent trades that do occur are not a true indication of fair value. When measuring fair value, the valuation techniques available under the market approach, income approach and/or cost approach are used. The Company's evaluations are based on market data and the Company employs combinations of these approaches for its valuation methods depending on the asset class.

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

Loans held for sale - Loans held for sale are carried at the lower of cost or fair value. Management obtains quotes or bids on all or part of these loans directly from the purchasing financial institutions.

Loans receivable - The fair value of performing loans, except residential mortgages, is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risks inherent in the loan. The estimate of maturity is based on the historical experience of the Bank with prepayments for each loan classification, modified as required by an estimate of the effect of current economic and lending conditions. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources adjusted to reflect differences in servicing and credit costs.

Off-balance sheet financial instruments - The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, fair value also considers the difference between current market levels of interest rate and the committed rates.

The fair value of financial standby letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties.

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Note 8. Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2015 and December 31, 2014 are as follows:

	September 30, 2015			
	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(in thousands)				
Recurring fair value measurements:				
Assets				
<u>Investment securities :</u>				
<u>Available-for-sale :</u>				
Federal agency obligations	\$ 30,905	\$ —	\$ 30,905	\$ —
Residential mortgage pass-through securities	48,091	—	48,091	—
Commercial mortgage pass-through securities	3,055	—	3,055	—
Obligations of U.S. states and political subdivision	8,382	—	8,382	—
Trust preferred securities	16,322	—	16,322	—
Corporate bonds and notes	78,386	—	78,386	—
Asset-backed securities	21,130	—	21,130	—
Certificates of deposit	1,920	—	1,920	—
Equity securities	338	338	—	—
Other securities	15,685	15,685	—	—
Total available-for-sale	<u>224,214</u>	<u>16,023</u>	<u>208,191</u>	<u>—</u>
Loans held for sale	990	—	990	—
Total assets	<u>\$ 225,204</u>	<u>\$ 16,023</u>	<u>\$ 209,181</u>	<u>\$ —</u>
Liabilities				
Derivatives	\$ 1,105	\$ —	\$ 1,105	\$ —
Total liabilities	<u>\$ 1,105</u>	<u>\$ —</u>	<u>\$ 1,105</u>	<u>\$ —</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 8. Fair Value Measurements and Fair Value of Financial Instruments – (continued)

	December 31, 2014			
	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(in thousands)				
Recurring fair value measurements:				
Assets				
Investment securities:				
Available-for-sale:				
Federal agency obligations	\$ 32,817	\$ —	\$ 32,817	\$ —
Residential mortgage pass-through securities	60,356	—	60,356	—
Commercial mortgage pass-through securities	3,046	—	3,046	—
Obligations of U.S. states and political subdivision	8,406	—	8,406	—
Trust preferred securities	16,306	—	16,306	—
Corporate bonds and notes	125,777	—	125,777	—
Asset-backed securities	27,502	—	27,502	—
Certificates of deposit	2,123	—	2,123	—
Equity securities	307	307	—	—
Other securities	12,892	12,892	—	—
Total available-for-sale	<u>289,532</u>	<u>13,199</u>	<u>276,333</u>	<u>—</u>
Derivatives	48	—	48	—
Total assets	<u>\$ 289,580</u>	<u>\$ 13,199</u>	<u>\$ 276,381</u>	<u>\$ —</u>

For the nine months ended September 30, 2015, there were no transfers of investment securities available-for-sale into or out of Level 1, Level 2, or Level 3 assets.

Assets Measured at Fair Value on a Non-Recurring Basis

For assets measured at fair value on a non-recurring basis, the unobservable inputs used to derive fair value measurements at September 30, 2015 and December 31, 2014 were as follows:

<u>Impaired loans</u>	<u>Valuation Techniques</u>	<u>Range of Unobservable Inputs</u>
Commercial	Appraisals of collateral value	Adjustment for age of comparable sales, generally a decline of 0% to 15%
Commercial real estate	Appraisals of collateral value	Market capitalization rates between 8% and 12%. Market rental rates for similar properties

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 8. Fair Value Measurements and Fair Value of Financial Instruments – (continued)

<u>Assets measured at fair value on a nonrecurring basis:</u>	<u>September 30, 2015</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
		(in thousands)		
Impaired loans				
Commercial	\$ 3,360	\$ —	\$ —	\$ 3,360

<u>Assets Measured at Fair Value on a Non-Recurring Basis</u>	<u>December 31, 2014</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
		(in thousands)		
Impaired loans				
Commercial	\$ 276	\$ —	\$ —	\$ 276
Commercial real estate	3,369	—	—	3,369

The following methods and assumptions were used to estimate the fair values of the Company's assets measured at fair value on a non-recurring basis at September 30, 2015 and December 31, 2014.

Impaired loans - Impaired loans at September 30, 2015 that required a valuation allowance during 2015 were \$4.4 million with a related valuation allowance of \$1,001,000 compared to \$3.9 million with a related valuation allowance of \$262,000 at December 31, 2014. Additional provision for loan and lease losses of \$211,000 and \$840,000 for the three and nine months ending September 30, 2015, respectively, and \$0 and \$210,500 three and nine months ending September 30, 2014, respectively, were recorded.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 8. Fair Value Measurements and Fair Value of Financial Instruments – (continued)

Fair Value of Financial Instruments

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

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

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

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

Loans - The fair value of the Company's loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans were segregated by types such as commercial, residential and consumer loans. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

Noninterest-bearing deposits - The fair value for non-interest-bearing deposits is equal to the amount payable on demand at the reporting date.

Interest-bearing deposits - The fair values of the Company's interest-bearing deposits were estimated using discounted cash flow analyses. The discount rates used were based on rates currently offered for deposits with similar remaining maturities. The fair values of the Company's interest-bearing deposits do not take into consideration the value of the Company's long-term relationships with depositors, which may have significant value.

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 8. Fair Value Measurements and Fair Value of Financial Instruments – (continued)

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of September 30, 2015 and December 31, 2014.

	Fair Value Measurements				
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)					
September 30, 2015					
<u>Financial assets</u>					
Cash and cash equivalents	\$ 158,521	\$ 158,521	\$ 158,521	\$ —	\$ —
Investment securities available-for-sale	224,214	224,214	16,023	208,191	—
Investment securities held-to-maturity	227,221	234,493	29,747	186,133	18,613
Investments in restricted stock, at cost	30,362	n/a	n/a	n/a	n/a
Loans held for sale	990	990	—	990	—
Net loans receivable	2,931,848	2,929,939	—	—	2,929,939
Accrued interest receivable	11,662	11,662	221	2,631	8,810
<u>Financial liabilities</u>					
Noninterest-bearing deposits	586,643	586,643	586,643	—	—
Interest-bearing deposits	2,079,981	2,084,440	—	2,084,440	—
Borrowings	621,674	627,399	—	627,399	—
Subordinated debentures	55,155	55,007	—	55,007	—
Derivatives	1,105	1,105	—	1,105	—
Accrued interest payable	5,198	5,198	—	5,198	—
(in thousands)					
December 31, 2014					
<u>Financial assets</u>					
Cash and cash equivalents	\$ 126,847	\$ 126,847	\$ 126,847	\$ —	\$ —
Investment securities available-for-sale	289,532	289,532	13,199	276,333	—
Investment securities held-to-maturity	224,682	231,445	29,184	183,489	18,772
Investments in restricted stock, at cost	23,535	n/a	n/a	n/a	n/a
Net loans receivable	2,524,481	2,538,415	—	—	2,538,415
Derivatives	48	48	—	48	—
Accrued interest receivable	11,700	11,700	68	3,674	7,958
<u>Financial liabilities</u>					
Noninterest-bearing deposits	492,516	492,516	492,516	—	—
Interest-bearing deposits	1,983,091	1,990,484	—	1,990,484	—
Borrowings	495,553	505,641	—	505,641	—
Subordinated debentures	5,155	4,768	—	4,768	—
Accrued interest payable	3,930	3,930	—	3,930	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 8. Fair Value Measurements and Fair Value of Financial Instruments – (continued)

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current market levels of interest rates and the committed rates. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date.

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

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

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

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

Note 9. Accumulated Other Comprehensive Income

Accumulated other comprehensive loss (net of tax) at September 30, 2015 and December 31, 2014 consisted of the following:

	September 30, 2015	December 31, 2014
	(in thousands)	
Net unrealized gain on investment securities available-for-sale	\$ 2,461	\$ 4,874
Cash flow hedge	(654)	28
Unamortized component of securities transferred from available-for-sale to held-to-maturity	(1,203)	(1,301)
Defined benefit pension and post-retirement plans	(3,914)	(4,615)
Total accumulated other comprehensive loss	<u>\$ (3,310)</u>	<u>\$ (1,014)</u>

Note 10. Stock-Based Compensation

The Company's stock-based compensation plans permit Parent Corporation common stock to be issued to key employees and directors of the Company and its subsidiaries. The options granted under the plans are intended to be either incentive stock options or non-qualified options. Under the 2009 Equity Incentive Plan, a total of 303,615 shares are available for grant and issuance as of September 30, 2015. In addition, a total of 114,327 shares remain available for grant and issuance under Legacy ConnectOne equity plans. Options may be exercised with shares issued from Treasury shares, newly issued shares or a combination of both.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 10. Stock-Based Compensation

Options have been granted to purchase common stock at the fair market value of the stock at the date of grant. Options granted to date are exercisable after a three to five-year vesting period starting one year after the date of grant and generally expire ten years from the date of grant. Restricted shares granted to date have a vesting schedule ranging from one to three years.

Stock-based compensation expense for share-based payment awards is based on the grant date fair value estimated on the date of grant. The Company recognizes compensation costs for those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of three years. The Company estimates the forfeiture rate based on its historical experience during the preceding seven fiscal years.

Under the principal stock-based compensation plans, the Company may also grant stock awards to certain employees. Stock awards are independent of option grants and are generally subject to forfeiture if employment terminates prior to the release of any applicable restrictions. During that period, ownership of the shares cannot be transferred. Restricted stock and stock awards that are fully vested at the time of grant have the same cash dividend and voting rights as other common stock and are considered to be currently issued and outstanding. The Company expenses the cost of stock awards, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which any restrictions lapse.

There were 97,544 and 50,303 restricted stock awards outstanding at September 30, 2015 and December 31, 2014, respectively. These awards were issued with an award price equal to the market price of the Company's common stock on the award date and with a three year vesting period. Forfeiture provisions exist for personnel that separate employment before the vesting period expires.

There were no shares of common stock underlying options that were granted during the three and nine months ended September 30, 2015 and 2014, respectively.

Options activity under the stock-based compensation plans as of September 30, 2015 and changes during the nine months ended September 30, 2015 were as follows:

	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term (Years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at December 31, 2014	882,657	\$ 5.65		
Exercised	(340,492)	\$ 4.19		
Canceled/expired	—			
Forfeited	(4,731)			
Outstanding at September 30, 2015	<u>537,434</u>	\$ 6.50	3.43	\$ 6,878,825
Exercisable at September 30, 2015	<u>532,636</u>	\$ 6.44	3.38	\$ 6,829,750

The aggregate intrinsic value of options above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the third quarter of 2015 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2015. This amount changes based on the fair value of the Company's stock.

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Note 10. Stock-Based Compensation – (continued)

In conjunction with the plans above, the Company granted restricted shares to certain executive officers. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date. The fair value of the stock granted was based on the closing market price of the Company's common stock as of the grant date. Generally, grants of restricted shares to date vest one-third, each, on the first, second and third anniversaries of the grant date.

	Nonvested Shares	Weighted- Average Grant Date Fair Value
Nonvested at December 31, 2014	50,203	\$ 11.79
Granted	67,906	18.50
Vested	(20,565)	10.76
Forfeited/cancelled/expired	—	—
Outstanding at September 30, 2015	<u>97,544</u>	<u>\$ 16.62</u>

As of September 30, 2015, there was approximately \$30,500 of total unrecognized compensation expense relating to unvested stock options. As of September 30, 2015, there was approximately \$1,167,500 of total unrecognized compensation expense relating to unvested restricted stock awards. These costs are expected to be recognized over a weighted average period of 1.6 years.

On April 30, 2015, the Company granted to various key employees performance unit awards (which are classified as equity awards), with each unit entitling the holder to one share of the Company's common stock contingent upon the Company meeting or exceeding certain return on asset targets over the course of a three-year period ending April 30, 2018. Under the agreement, and assuming the Company has met or exceeded the applicable targets, grants of performance unit awards will vest on the third anniversary of the grant date or on an earlier date in the event of a change in control, as defined in the grant agreement. At September 30, 2015, the specific number of shares related to performance unit awards that were expected to vest was 94,585, determined by actual performance in consideration of the established range of the performance targets, which is consistent with the level of expense currently being recognized over the vesting period. Should this expectation change, additional compensation expense could be recorded in future periods or previously recognized expense could be reversed. The maximum amount of performance unit awards is 113,502.

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

	Shares	Weighted- Average Grant Date Fair Value
Unearned at June 30, 2015	94,585	\$ 19.46
Awarded	—	—
Forfeited	—	—
Expired	—	—
Unearned at September 30, 2015	<u>94,585</u>	<u>\$ 19.46</u>

The Company recognized \$256,000 in compensation expense related to the performance units for the quarter ended September 30, 2015. As of September 30, 2015, there was approximately \$1,584,985 of unrecognized compensation expense related to unearned performance units. These costs are expected to be recognized over a period of 2.5 years.

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Note 11. Components of Net Periodic Pension Cost

The Company maintained a non-contributory defined benefit pension plan for substantially all of its employees until March 31, 2007, at which time the Company froze the plan. The following table sets forth the net periodic pension cost of the Company's pension plan for the periods indicated.

	Three Months Ended September 30,		Nine months Ended September 30,	
	2015	2014	2015	2014
	(in thousands)			
Interest cost	\$ 127	\$ 143	\$ 394	\$ 429
Expected return on plan assets	(123)	(148)	(387)	(444)
Net amortization	108	55	324	165
Recognized settlement loss	64	—	629	—
Net periodic pension cost	<u>\$ 176</u>	<u>\$ 50</u>	<u>\$ 960</u>	<u>\$ 150</u>
Net actuarial gain	<u>\$ (183)</u>	<u>\$ —</u>	<u>\$ (1,186)</u>	<u>\$ (1,281)</u>
Total recognized in other comprehensive income	<u>\$ (183)</u>	<u>\$ —</u>	<u>\$ (1,186)</u>	<u>\$ (1,281)</u>
Total recognized in net expense and OCI (before tax)	<u>\$ (7)</u>	<u>\$ 50</u>	<u>\$ (226)</u>	<u>\$ (1,131)</u>

Contributions

The Company contributed \$2.0 million to its Pension Trust during the second quarter of 2015. The Company does not plan on contributing additional amounts to the Pension Trust for the remainder of 2015. The trust is established to provide retirement and other benefits for eligible employees and their beneficiaries. No part of the trust assets may be applied to any purpose other than providing benefits under the plan and for defraying expenses of administering the plan and the trust.

Note 12. FHLB and other borrowings

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

	September 30, 2015		December 31, 2014	
	Amount	Rate	Amount	Rate
	(in thousands)			
By type of borrowing:				
FHLB borrowings	\$ 606,674	1.16%	\$ 464,553	1.18%
Repurchase agreements	15,000	5.95%	31,000	5.90%
Total borrowings	<u>\$ 621,674</u>	1.28%	<u>\$ 495,553</u>	1.48%
By remaining period to maturity:				
One year or less	\$ 290,674	0.53%	258,553	0.50%
One to two years	151,000	1.60%	30,000	1.40%
Two to three years	35,000	1.00%	71,000	2.33%
Three to four years	80,000	1.67%	96,000	2.67%
Four to five years	65,000	2.82%	—	—
Greater than five years	—	0.00%	40,000	3.42%
Total borrowings	<u>\$ 621,674</u>	1.28%	<u>\$ 495,553</u>	1.48%

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

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Note 12. FHLB and other borrowings – (continued)

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

Three of the FHLB notes (\$2,500,000 and \$7,500,000 each due April 2, 2018, and \$5,000,000 due July 16, 2018) contain a convertible option which allows the FHLB, at quarterly intervals, to convert the fixed convertible advance into replacement funding for the same or lesser principal based on any advance then offered by the FHLB at its current market rate. The Company has the option to repay these advances, if converted, without penalty. The remaining advances are payable at stated maturity, with a prepayment penalty for fixed rate advances. All FHLB advances are fixed rate while the REPOs are variable rate advances. The advances at September 30, 2015 were collateralized by approximately \$1.1 billion of commercial mortgage loans, net of required over collateralization amounts, under a blanket lien arrangement. At September 30, 2015 the Company had remaining borrowing capacity of approximately \$550 million.

Note 13 - Subordinated Debentures

During 2003, the Company formed a statutory business trust, which exists for the exclusive purpose of (i) issuing Trust Securities representing undivided beneficial interests in the assets of the Trust; (ii) investing the gross proceeds of the Trust securities in junior subordinated deferrable interest debentures (subordinated debentures) of the Company; and (iii) engaging in only those activities necessary or incidental thereto. On December 19, 2003, Center Bancorp Statutory Trust II, a statutory business trust and wholly-owned subsidiary of the Parent Corporation issued \$5.0 million of, MMCapS capital securities to investors due on January 23, 2034. The capital securities presently qualify as Tier I capital. The trust loaned the proceeds of this offering to the Company and received in exchange \$5.2 million of the Parent Corporation's subordinated debentures. The subordinated debentures are redeemable in whole or in part prior to maturity. The floating interest rate on the subordinate debentures is three-month LIBOR plus 2.85% and reprices quarterly. The rate at September 30, 2015 was 3.15%. These subordinated debentures and the related income effects are not eliminated in the consolidated financial statements as the statutory business trust is not consolidated in accordance with FASB ASC 810-10. Distributions on the subordinated debentures owned by the subsidiary trust have been classified as interest expense in the Consolidated Statements of Income.

The following table summarizes the mandatory redeemable trust preferred securities of the Company's Statutory Trust II at September 30, 2015 and December 31, 2014.

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

During June 2015, the Parent Corporation issued \$50 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the "Notes") to certain institutional investors. The Notes are non-callable for five years, have a stated maturity of July 1, 2025, and bear interest at a fixed rate of 5.75% per year, from and including September 30, 2015 to, but excluding July 1, 2020. From and including July 1, 2020 to the maturity date or early redemption date, the interest rate will reset quarterly to a level equal to the then current three-month LIBOR rate plus 393 basis points. As of September 30, 2015, there were costs related to the debt issuance of \$828,000.

The net proceeds from the sale of the Notes will be used to redeem, on or before January 1, 2016, \$11.3 million of Senior Noncumulative Perpetual Preferred Stock issued in 2011 to the U.S. Treasury under the Small Business Lending Fund Program, and for general corporate purposes, which included the Parent Corporation contributing \$35.0 million of common equity to the Bank on September 30, 2015.

In connection with the issuance of the Notes, the Parent Corporation obtained ratings from Kroll Bond Rating Agency ("KBRA"). KBRA assigned investment grade ratings of BBB- for the Company's subordinated debt and a senior deposit rating of BBB+ for the Bank.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing the Company’s results of operations for the periods presented herein and financial condition as of September 30, 2015 and December 31, 2014. In order to fully understand this analysis, the reader is encouraged to review the consolidated financial statements and accompanying notes thereto appearing elsewhere in this report.

Cautionary Statement Concerning Forward-Looking Statements

This report includes forward-looking statements within the meaning of Sections 27A of the Securities Act of 1933, as amended, and 21E of the Securities Exchange Act of 1934, as amended, that involve inherent risks and uncertainties. This report contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of ConnectOne Bancorp Inc. and its subsidiaries, including statements preceded by, followed by or that include words or phrases such as “believes,” “expects,” “anticipates,” “plans,” “trend,” “objective,” “continue,” “remain,” “pattern” or similar expressions or future or conditional verbs such as “will,” “would,” “should,” “could,” “might,” “can,” “may” or similar expressions. There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to: (1) competitive pressures among depository institutions may increase significantly; (2) changes in the interest rate environment may reduce interest margins; (3) prepayment speeds, loan origination and sale volumes, charge-offs and loan and lease loss provisions may vary substantially from period to period; (4) general economic conditions may be less favorable than expected; (5) political developments, sovereign debt problems, wars or other hostilities may disrupt or increase volatility in securities markets or other economic conditions; (6) legislative or regulatory changes or actions may adversely affect the businesses in which ConnectOne Bancorp is engaged, including, without limitation, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and regulations issued thereafter; (7) changes and trends in the securities markets may adversely impact ConnectOne Bancorp; (8) a delayed or incomplete resolution of regulatory issues could adversely impact planning by ConnectOne Bancorp; (9) the impact on reputation risk created by the developments discussed above on such matters as business generation and retention, funding and liquidity could be significant; and (10) the outcome of regulatory and legal investigations and proceedings may not be anticipated. Further information on other factors that could affect the financial results of ConnectOne Bancorp is included in Item 1A. of ConnectOne Bancorp’s Annual Report on Form 10-K and in ConnectOne Bancorp’s other filings with the Securities and Exchange Commission. These documents are available free of charge at the Commission’s website at <http://www.sec.gov> and/or from ConnectOne Bancorp, Inc.

Critical Accounting Policies and Estimates

The accounting and reporting policies followed by ConnectOne Bancorp, Inc. and its subsidiaries (collectively, the “Company”) conform, in all material respects, to U.S. generally accepted accounting principles. In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of condition and for the periods indicated in the consolidated statements of operations. Actual results could differ significantly from those estimates.

The Company’s accounting policies are fundamental to understanding Management’s Discussion and Analysis (“MD&A”) of financial condition and results of operations. The Company has identified the determination of the allowance for loan and lease losses, the other-than-temporary impairment evaluation of securities, the evaluation of the impairment of goodwill and the evaluation of deferred tax assets to be critical because management must make subjective and/or complex judgments about matters that are inherently uncertain and could be most subject to revision as new information becomes available. Additional information on these policies is provided below.

Allowance for loan and lease losses and Related Provision

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

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

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

Other-Than-Temporary Impairment of Investment Securities

Investment securities are evaluated on at least a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether a decline in their value is other-than-temporary. FASB ASC 320-10-65 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management assesses whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery.

In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

Fair Value of Investment Securities

FASB ASC 820-10-35 clarifies the application of the provisions of FASB ASC 820-10-05 in an inactive market and how an entity would determine fair value in an inactive market. The Company applies the guidance in FASB ASC 820-10-35 when determining fair value for the Company's private label collateralized mortgage obligations, pooled trust preferred securities and single name corporate trust preferred securities. See Note 8 of the Notes to Consolidated Financial Statements for further discussion.

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

Goodwill

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

Income Taxes

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

Fluctuations in the actual outcome of these future tax consequences could impact the Company's consolidated financial condition or results of operations. Note 12 of the Notes to Consolidated Financial Statements included in the Company's 2014 Form 10-K includes additional discussion on the accounting for income taxes.

Operating Results Overview

On July 1, 2014, the merger of equals with Center Bancorp, Inc. and legacy ConnectOne was completed (the “Merger”). Accordingly, third quarter 2015 and 2014 results reflect the operations of the combined entity, whereas, historical financial information prior to July 1, 2014 includes only the operations of Center Bancorp, Inc., the legal and accounting acquirer in the transaction. On July 1, 2014, the combined company changed its name to ConnectOne.

Net income available to common stockholders for the three months ended September 30, 2015 amounted to \$10.8 million compared to \$1.7 million for the comparable three-month period ended September 30, 2014. The Company’s diluted earnings per share were \$0.36 for the three months ended September 30, 2015 as compared with diluted earnings per share of \$0.06 for the same three months of 2014. Two significant items negatively impacted 2014 pre-tax results: (i) \$8.8 million in merger-related expenses and (ii) \$4.6 million loss on extinguishment of debt.

Net income available to common stockholders for the nine months ended September 30, 2015 amounted to \$31.7 million compared to \$10.5 million for the comparable nine-month period ended September 30, 2014. The Company’s diluted earnings per share were \$1.04 for the nine months ended September 30, 2015 as compared with diluted earnings per share of \$0.49 for the first nine months of 2014. Two significant items negatively impacted 2014 pre-tax results: (i) \$10.6 million in merger-related expenses and (ii) \$4.6 million loss on extinguishment of debt.

Net Interest Income and Margin

Net interest income is the difference between the interest earned on the portfolio of earning assets (principally loans and investments) and the interest paid for deposits and borrowings, which support these assets. Net interest income is presented on a tax-equivalent basis by adjusting tax-exempt income (primarily interest earned on obligations of state and political subdivisions) by the amount of income tax which would have been paid had the assets been invested in taxable issues. Net interest margin is defined as net interest income on a tax-equivalent basis as a percentage of total average interest-earning assets.

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Fully taxable equivalent (“FTE”) net interest income for the third quarter of 2015 was \$30.4 million, an increase of \$2.2 million, or 7.9%, from the same quarter of 2014. This was a result of a 12.8% increase in average interest-earning assets, partially offset by a 16 basis-point contraction in the net interest margin. Included in net interest income was accretion and amortization of purchase accounting adjustments of \$1.3 million during the third quarter of 2015 and \$2.9 million in the third quarter of 2014. Excluding these purchase accounting adjustments, the adjusted net interest margin was 3.35% in the third quarter of 2015, 6 basis points higher than the 2014 third quarter adjusted net interest margin of 3.29%. The improvement in the adjusted net interest margin in the third quarter of 2015 versus the same 2014 period was primarily attributable to an improved mix of interest earning assets arising from a greater proportion of average loans in third quarter of 2015 along with a reduction in the average rate paid on borrowings, which resulted from a \$70 million debt extinguishment and subsequent refinancing accomplished at the end of the third quarter of 2014.

FTE net interest income for the first nine months of 2015 was \$88.6 million, an increase of \$36.0 million, from the same period of 2014. This was a result of a 63.3% increase in average interest-earning assets, due primarily to the Merger and, to a lesser extent, strong organic growth, coupled with a 10 basis-point widening in the net interest margin. Included in net interest income was accretion and amortization of purchase accounting adjustments of \$4.7 million during the first nine months of 2015 and \$2.9 million for the first nine months of 2014. Excluding these purchase accounting adjustments, the adjusted net interest margin was 3.41% in the first nine months of 2015, 11 basis points higher than the same prior-year period. The improvement in the adjusted net interest margin in 2015 versus 2014 was attributable to an improved mix of interest earning assets (specifically, a greater proportion of higher yielding loans and a lower proportion of lower-yielding securities) arising primarily from the Merger.

The following tables, "Average Statements of Condition with Interest and Average Rates", present for the three and nine months ended September 30, 2015 and 2014, the Company's average assets, liabilities and stockholders' equity. The Company's net interest income, net interest spread and net interest margin are also reflected.

Average Statements of Condition with Interest and Average Rates

	Three Months Ended September 30,					
	2015			2014		
	Average Balance	Interest Income/ Expense	Average Rate (7)	Average Balance	Interest Income/ Expense	Average Rate (7)
(dollars in thousands)						
Interest-earning assets:						
Investment securities (1) (2)	\$ 483,677	\$ 4,055	3.33%	\$ 520,568	\$ 4,372	3.33%
Loans (2) (3) (4)	2,863,708	32,446	4.50%	2,344,410	28,218	4.78%
Restricted investment in bank stocks	66,867	297	4.38%	163,471	265	4.98%
Federal funds sold and interest bearing with banks	26,899	43	0.26%	21,107	88	0.21%
Total interest-earning assets	3,441,151	36,841	4.25%	3,049,556	32,943	4.29%
Allowance for loan and lease losses	(18,157)			(11,250)		
Noninterest earning assets	306,509			312,293		
Total liabilities and stockholders' equity	<u>\$3,729,503</u>			<u>\$3,350,599</u>		
Interest-bearing liabilities:						
Money market deposits	\$ 710,767	\$ 794	0.44%	\$ 698,686	\$ 677	0.38%
Savings deposits	220,481	146	0.26%	233,041	144	0.25%
Time deposits	787,262	2,391	1.20%	676,291	1,474	0.86%
Other interest-bearing deposits	352,156	324	0.37%	375,041	429	0.45%
Total interest-bearing deposits	2,070,666	3,655	0.70%	1,983,059	2,724	0.54%
Borrowings	544,774	1,944	1.42%	430,238	1,988	1.83%
Capital lease	2,933	44	5.95%	3,044	45	5.87%
Subordinated debentures	55,155	816	5.87%	5,155	40	3.08%
Total interest-bearing liabilities	2,673,528	6,459	0.96%	2,421,496	4,797	0.79%
Demand deposits	560,129			465,369		
Other liabilities	24,164			17,349		
Total noninterest-bearing liabilities	584,293			482,718		
Stockholders' equity	471,682			446,385		
Total liabilities and stockholders' equity	<u>\$3,729,503</u>			<u>\$3,350,599</u>		
Net interest income (tax equivalent basis)		30,382			28,146	
Net interest spread (5)			3.29%			3.50%
Net interest margin (6)			3.50%			3.66%
Tax equivalent adjustment		(655)			(600)	
Net interest income		<u>\$ 29,727</u>			<u>\$ 27,546</u>	

- (1) Average balances are based on amortized cost.
- (2) Interest income is presented on a tax equivalent basis using 35% federal tax rate.
- (3) Includes loan fee income.
- (4) Loans include nonaccrual loans.
- (5) Represents difference between the average yield on interest earning assets and the average cost of interest bearing liabilities and is presented on a tax equivalent basis.
- (6) Represents net interest income on a tax equivalent basis divided by average total interest-earning assets
- (7) Rates are annualized.

Average Statements of Condition with Interest and Average Rates

	Nine Months Ended September 30,					
	2015			2014		
	Average Balance	Interest Income/ Expense	Average Rate (7)	Average Balance	Interest Income/ Expense	Average Rate (7)
	(dollars in thousands)					
Interest-earning assets:						
Investment securities (1) (2)	\$ 496,375	\$ 12,442	3.35%	\$ 513,221	\$ 13,441	3.50%
Loans (2) (3) (4)	2,709,332	92,279	4.55%	1,437,381	48,969	4.55%
Federal funds sold and interest bearing with banks	65,663	127	0.26%	13,146	408	4.15%
Restricted investment in bank stock	26,385	797	4.04%	55,089	88	0.21%
Total interest-earning assets	<u>3,297,755</u>	<u>105,645</u>	4.28%	<u>2,018,837</u>	<u>62,906</u>	4.17%
Allowance for loan and lease losses	(16,469)			(10,791)		
Noninterest earning assets	302,316			226,410		
Total liabilities and stockholders' equity	<u>\$3,583,602</u>			<u>\$2,234,456</u>		
Interest-bearing liabilities:						
Money market deposits	\$ 692,919	\$ 2,204	0.43%	\$ 509,212	\$ 1,771	0.46%
Savings deposits	220,639	465	0.28%	185,986	394	0.28%
Time deposits	742,037	6,339	1.14%	342,177	2,205	0.86%
Other interest-bearing deposits	349,626	972	0.37%	358,482	973	0.36%
Total interest-bearing deposits	<u>2,005,221</u>	<u>9,980</u>	0.67%	<u>1,395,857</u>	<u>5,343</u>	0.51%
Borrowings	548,013	6,022	1.47%	243,597	4,752	2.61%
Capital lease	2,961	134	6.05%	1,026	45	5.87%
Subordinated debentures	22,188	904	5.45%	5,155	117	3.03%
Total interest-bearing liabilities	<u>2,578,383</u>	<u>17,040</u>	0.88%	<u>1,645,635</u>	<u>10,257</u>	0.83%
Demand deposits	514,936			307,249		
Other liabilities	26,917			15,018		
Total noninterest-bearing liabilities	<u>541,853</u>			<u>322,267</u>		
Stockholders' equity	463,366			266,374		
Total liabilities and stockholders' equity	<u>\$3,583,602</u>			<u>\$2,234,276</u>		
Net interest income (tax equivalent basis)		88,605			52,649	
Net interest spread (5)			3.40%			3.34%
Net interest margin (6)			3.59%			3.49%
Tax equivalent adjustment		(1,908)			(1,829)	
Net interest income		<u>\$ 86,697</u>			<u>\$ 50,820</u>	

(1) Average balances are based on amortized cost.

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

(3) Includes loan fee income.

(4) Loans include nonaccrual loans.

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

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

(7) Rates are annualized.

Noninterest Income

Noninterest income totaled \$3.8 million in the third quarter of 2015, an increase of \$2.6 million from \$1.2 million in the comparable prior-year quarter. The increase was due to an increase in net gains on sale of investment securities of \$1.9 million and a fee of approximately \$0.7 million collected in satisfaction of an equity participation in a certain credit extension. Net securities gains were \$2.1 million and \$0.1 million for the third quarter of 2015 and 2014, respectively.

Noninterest income includes bank-owned life insurance income, deposit and loan fees, annuities and life insurance commissions, and gains on sales of residential mortgages in the secondary market and represents a relatively small portion of the Bank's total revenue. Although management intends to continue its strategy of de-emphasizing service charges in order to attract new and retain existing clients, it expects fee income to increase modestly in future periods.

Noninterest income totaled \$8.8 million for the nine months ended September 30, 2015, an increase of \$3.4 million from \$5.4 million in the comparable prior-year period. The increase was primarily due to an insurance recovery of \$2.2 million and an increase of \$0.7 million in net securities gains.

Noninterest Expense

Noninterest expenses for the third quarter of 2015 were \$13.3 million, a \$12.1 million, or 47.6%, decrease from \$25.4 million in the third quarter of 2014, and were \$40.9 million for the first nine months of 2015, a \$1.3 million, or 3.3%, increase from \$39.6 million in the first nine months of 2014. The factors contributing to the decrease in the quarterly comparison were merger expenses of \$8.8 million and debt extinguishment charges of \$4.6 million incurred in 2014, offset by increases of \$0.6 million in salaries and employee benefits expenses, \$0.3 million in professional and consulting expenses and \$0.1 million in occupancy and equipment expenses. The factors contributing to the increase in the year-to-date comparison were increases, due to the merger and organic growth, in salary and employee benefits expenses of \$7.3 million, occupancy charges of \$2.1 million and all other expenses, including data processing and consulting fees, of \$4.7 million, partially offset by decreases in merger expenses of \$10.6 million and debt extinguishment charges of \$4.6 million.

Income Taxes

Income tax expense was \$5.2 million and \$15.3 million for the three and nine months ended September 30, 2015, respectively, compared with \$0.3 million and \$3.9 million for the three and nine months ended September 30, 2014, respectively. The effective tax rates were 32.5% for both the third quarter and first nine months of 2015, compared with 12.5% and 26.8%, for the third quarter and first nine months of 2014, respectively. The lower effective tax rates in 2014 were due to a relatively lower level of taxable income compared with 2015, primarily due to merger charges.

Financial Condition

Loan Portfolio

Commercial lending is the Company's primary business activity. The Company's loan portfolio consists of commercial, residential and consumer loans, serving the diverse client base in its market area. The composition of the Company's portfolio remains relatively constant but can change due to factors such as the economic climate, the level and fluctuations in interest rates, real estate values and employment metrics. Organic growth (i.e., growth other than through mergers and acquisitions) is generated through business development, repeat client requests for new financings, penetration into existing markets and entry into new markets.

The Company seeks to create growth in commercial lending by offering client-focused products, competitive pricing and by capitalizing on the positive trends in its market area. Products offered are designed to meet the financial requirements of the Company's clients. It is the objective of the Company's credit policies to diversify the commercial loan portfolio to limit concentrations in any single segment.

The following table sets forth the composition of our loan portfolio, excluding loans held for sale, by type of loan at the periods indicated.

	September 30, 2015		December 31, 2014		Dollar
	Amount	%	Amount	%	Change
(dollars in thousands)					
Commercial	\$ 569,605	19.3%	\$ 499,816	19.7%	\$ 69,789
Commercial real estate	1,873,714	63.4	1,634,510	64.4	239,204
Commercial construction	283,623	9.6	167,359	6.6	116,264
Residential real estate	225,158	7.6	234,967	9.2	(9,809)
Consumer	3,569	0.1	2,879	0.1	690
Gross loans	<u>\$ 2,955,669</u>	<u>100.0%</u>	<u>\$ 2,539,531</u>	<u>100.0%</u>	<u>\$ 416,138</u>

At September 30, 2015, total gross loans amounted to \$3.0 billion, an increase of \$0.4 billion, or 16.4%, as compared to December 31, 2014. Net loan growth was primarily attributable to multi-family (\$165 million), other commercial real estate (\$74 million), commercial and industrial (“C&I”) (\$70 million) and construction (\$116 million). Management’s current intent is to maintain a multi-family portfolio concentration in the range of 25-30% of total loans, while growing the C&I and construction segments. The growth in loans was funded with increases in deposits, borrowings and subordinated debt. At September 30, 2015, acquired loans remaining in the loan portfolio totaled \$0.9 billion, compared to \$1.2 billion as of December 31, 2014.

Allowance for Loan and lease Losses and related Provision

The purpose of the allowance for loan and lease losses (the “ALLL”) is to establish a valuation allowance for probable incurred losses in the loan portfolio. Additions to the ALLL are made through provisions charged against current operations and through recoveries made on loans previously charged off. The ALLL is maintained at an amount considered adequate by management to provide for probable credit losses inherent in the loan portfolio based upon historical losses and a periodic evaluation of external and portfolio risk factors. In establishing an appropriate ALLL, an assessment of the individual borrowers, a determination of the value of the underlying collateral, a review of historical loss experience and an analysis of the levels and trends of loan categories, delinquencies and problem loans are considered. Such factors as the level and trend of interest rates and current economic conditions and peer group statistics are also reviewed. The Company’s analysis of its ALLL also takes into consideration the potential impact that current trends may have on the Company’s borrower base.

Although management uses the best information available, the level of the allowance for loan and lease losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan and lease losses. Such agencies may require the Company to increase the ALLL based on their analysis of information available to them at the time of their examination. Furthermore, the majority of the Company’s loans are secured by real estate in the State of New Jersey. Future adjustments to the ALLL may be necessary due to economic factors impacting New Jersey real estate and the economy in general, as well as operating, regulatory and other conditions beyond the Company’s control.

At September 30, 2015, the allowance was \$21.5 million as compared to \$14.2 million at December 31, 2014. Provisions to the allowance for the three and nine months ended September 30, 2015 totaled \$4.2 million and \$7.6 million, respectively, compared to \$1.3 and \$2.2 million for the same periods in 2014. The increase to the three and nine months ended September 30, 2015 primarily resulted from approximately \$2.0 million in additional provisioning related to the taxi cab medallion loan portfolio and the remainder of the increase reflects higher organic loan growth. See “Asset Quality” for a discussion of the taxi cab medallion portfolio. There were \$122 thousand and \$177 thousand net charge-offs during the three months and nine months ended September 30, 2015, respectively, compared to \$7 thousand and \$424 thousand in net charge-offs for the three month and nine months ended September 30, 2014, respectively. The allowance for loan and lease losses as a percentage of total loans amounted to 0.73% at September 30, 2015 compared to 0.56% at December 31, 2014 and 0.50% at September 30, 2014.

The level of the allowance for the respective periods of 2015 and 2014 reflects the credit quality within the loan portfolio, the loan volume recorded during the periods, the changing composition of the commercial and residential real estate loan portfolios and other related factors. In management’s view, the level of the ALLL at September 30, 2015 is adequate to cover losses inherent in the loan portfolio. Management’s judgment regarding the adequacy of the allowance constitutes a “Forward-Looking Statement” under the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from management’s analysis, based principally upon the factors considered by management in establishing the allowance.

Changes in the allowance for loan and lease losses are presented in the following table for the periods indicated.

	Nine Months Ended September 30,	
	2015	2014
	(dollars in thousands)	
Average loans for the period	\$ 2,709,332	\$ 1,437,381
Loans receivable at end of period	2,953,381	2,426,765
Analysis of the Allowance for loan and lease losses:		
Balance - beginning of year	\$ 14,160	\$ 10,333
Charge-offs:		
Commercial	(100)	(333)
Commercial real estate	(406)	—
Residential real estate	—	(108)
Consumer	(13)	(7)
Total charge-offs	(519)	(448)
Recoveries:		
Commercial	12	—
Commercial real estate	327	11
Residential real estate	2	13
Consumer	1	—
Total recoveries	342	24
Net charge-offs	(177)	(424)
Provision for loan and lease losses	7,550	2,209
Balance - end of period	\$ 21,533	\$ 12,118
Ratio of annualized net charge-offs during the period to average loans during the period	0.01%	0.04%
Allowance for loan and lease losses as a percent of total loans	0.73%	0.50%

Asset Quality

The Company manages asset quality and credit risk by maintaining diversification in its loan portfolio and through review processes that include analysis of credit requests and ongoing examination of outstanding loans, delinquencies, and potential problem loans, with particular attention to portfolio dynamics and mix. The Company strives to identify loans experiencing difficulty early enough to correct the problems, to record charge-offs promptly based on realistic assessments of current collateral values and cash flows, and to maintain an adequate allowance for loan and lease losses at all times.

It is generally the Company's policy to discontinue interest accruals once a loan is past due as to interest or principal payments for a period of ninety days. When a loan is placed on nonaccrual status, interest accruals cease and uncollected accrued interest is reversed and charged against current income. Payments received on nonaccrual loans are generally applied against principal. A loan may be restored to an accruing basis when all past due amounts have been collected. Loans past due 90 days or more which are both well-secured and in the process of collection may remain on an accrual basis.

Nonperforming assets include nonaccrual loans and other real estate owned. Nonaccrual loans represent loans on which interest accruals have been suspended. In general, it is the policy of management to consider the charge-off of uncollectible amounts of loans at the point they become past due 90 days. Performing troubled debt restructured loans represent loans to borrowers experiencing financial difficulties on which a concession was granted, such as a reduction in interest rate below the current market rate for new debt with similar risks or modified repayment terms, and are performing under the restructured terms.

The following table sets forth, as of the dates indicated, the amount of the Company's nonaccrual loans, other real estate owned, loans 90 days or more past due and still accruing, performing troubled debt restructured loans and the carrying amount of the purchased-credit impaired loans.

	September 30, 2015	December 31, 2014
	(in thousands)	
Nonaccrual loans	\$ 12,888	\$ 11,609
Other real estate owned	3,244	1,108
Total nonperforming assets	<u>\$ 16,132</u>	<u>\$ 12,717</u>
Performing troubled debt restructured loans	\$ 77,090	\$ 1,763
Loans 90 days or more past due and still accruing	268	1,211
Purchased-credit impaired loans (carrying amount)	9,168	9,821

The increase in TDRs was due to 47 loans secured by NYC taxi medallions totaling \$75.4 million that were modified in troubled debt restructurings during the second quarter of 2015. The modifications consisted of a deferral of principal amortization from approximately 25-30 year amortization to interest-only. There was no extension of the loans' contractual maturity dates and the loans' interest rates were increased from approximately 3%-3.25% to 3.75%. There was no forgiveness of principal and the average remaining maturity of the loans was approximately 23 months at the time of modification. These loans were accruing prior to modification and remained in accrual status post-modification.

The \$2.0 million in specific allocations associated with taxi medallion lending referred to above was calculated based on the present value of estimated cash flows, including contractual debt interest service through maturity and principal repayments based on the fair value of the collateral, and excludes any consideration for the personal guarantees of borrowers, which provides an additional source of repayment but cannot be relied upon. The valuation per corporate medallion used for the calculation at September 30, 2015 was \$814,000. A specific allocation was required at September 30, 2015 due to a decline in the valuation of taxi medallions from June 30, 2015, when there was no specific reserve.

As of September 30, 2015, taxi medallion loans, all of which are secured by New York City taxi medallions, totaled \$103.3 million, and were 100% current as to principal and interest. The average loan-to-value ratio, assuming current estimated values was approximately 92.7%.

During the nine months ended September 30, 2015, "special mention" loans, which include acceptable credit quality loans which possess higher risk characteristics than satisfactory assets, increased from \$19.3 million, or 0.8% of total loans, at December 31, 2014 to \$105.7 million, or 3.6% of total loans, at September 30, 2015. The increase in "special mention" loans was due to downgrades of specific credits in both the commercial and commercial real estate segments of the loan portfolio. The commercial loans were downgraded due to \$75.4 million of taxi medallion loans being classified as troubled debt restructurings during the second quarter of 2015.

Investment Portfolio

At September 30, 2015, the principal components of the investment securities portfolio were U.S. Treasury and agency obligations, federal agency obligations, mortgage-backed securities, obligations of U.S. states and political subdivisions, corporate bonds and notes, trust preferred securities, asset backed securities and equity securities.

During the nine months ended September 30, 2015, approximately \$44.4 million in investment securities were sold from the available-for-sale portfolio. The cash flow from the sale of investment securities was primarily used to fund loan growth.

For the three months ended September 30, 2015, average investment securities decreased \$36.9 million to approximately \$483.7 million, or 14.1% of average interest-earning assets, from \$520.6 million on average, or 17.1% of average interest-earning assets, for the comparable period in 2014. For the nine months ended September 30, 2015, average investment securities decreased \$16.8 million to approximately \$496.4 million, or 15.1% of average interest-earning assets, from \$513.2 million on average, or 25.4% of average interest-earnings assets, for the comparable period in 2014.

At September 30, 2015, net unrealized gains on investment securities available-for-sale, which are carried as a component of accumulated other comprehensive income and included in stockholders' equity, net of tax, amounted to \$2.5 million as compared with net unrealized gains of \$4.9 million at December 31, 2014. At September 30, 2015, the net unrealized gains and losses on investment securities held-to-maturity that were transferred from securities available-for-sale, are carried, net of tax, as a component of accumulated other comprehensive income and included in stockholders' equity. The gross unrealized losses associated with agency securities and federal agency obligations, mortgage-backed securities, corporate bonds and tax-exempt securities are not considered to be other-than-temporary because their unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer.

Interest Rate Sensitivity Analysis

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

We currently utilize net interest income simulation and economic value of equity ("EVE") models to measure the potential impact to the Bank of future changes in interest rates. As of September 30, 2015 and December 31, 2014 the results of the models were within guidelines prescribed by our Board of Directors. If model results were to fall outside prescribed ranges, action, including additional monitoring and reporting to the Board, would be required by the ALCO and Bank's management.

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

Based on our model, which was run as of September 30, 2015, we estimated that over the next one-year period a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 3.84%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 3.78%. As of December 31, 2014, we estimated that over the next one-year period, a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 0.29%, while a 100 basis-point instantaneous decrease in the general level of interest rates would decrease our net interest income by 3.41%.

Based on our model, which was run as of September 30, 2015, we estimated that over the next three years, on a cumulative basis, a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 5.36%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 6.41%. As of December 31, 2014, we estimated that over the next three years, on a cumulative basis, a 200 basis-point instantaneous increase in the general level of interest rates would increase our net interest income by 2.76%, while a 100 basis-point instantaneous decrease in interest rates would decrease net interest income by 6.54%.

An EVE analysis is also used to dynamically model the present value of asset and liability cash flows with instantaneous rate shocks of up 200 basis points and down 100 basis points. The economic value of equity is likely to be different as interest rates change. Our EVE as of September 30, 2015, would decline by 10.95% with an instantaneous rate shock of up 200 basis points, and increase by 10.62% with an instantaneous rate shock of down 100 basis points. Our EVE as of December 31, 2014, would decline by 15.02% with an instantaneous rate shock of up 200 basis points, and increase by 13.65% with an instantaneous rate shock of down 100 basis points.

Interest Rates (basis points)	Estimated EVE	Estimated change in EVE		Estimated NII	Estimated change in NII	
		Amount	%		Amount	%
+300	\$ 357,062	\$ (77,571)	(17.8)%	\$ 124,943	\$ 7,230	6.1%
+200	387,045	(47,588)	(10.9)	122,227	4,514	3.8
+100	412,208	(22,425)	(5.2)	119,609	1,896	1.6
0	434,633	—	0.0	117,713	—	0.0
-100	480,809	46,176	10.6	113,259	(4,454)	(3.8)

Estimates of Fair Value

The estimation of fair value is significant to a number of the Company's assets, including loans held for sale and investment securities available-for-sale. These are all recorded at either fair value or the lower of cost or fair value. Fair values are volatile and may be influenced by a number of factors. Circumstances that could cause estimates of the fair value of certain assets and liabilities to change include a change in prepayment speeds, discount rates, or market interest rates. Fair values for most available-for-sale investment securities are based on quoted market prices. If quoted market prices are not available, fair values are based on judgments regarding future expected loss experience, current economic condition risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Impact of Inflation and Changing Prices

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

Liquidity

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

At September 30, 2015, the amount of liquid assets remained at a level management deemed adequate to ensure that, on a short and long-term basis, contractual liabilities, depositors' withdrawal requirements, and other operational and client credit needs could be satisfied. As of September 30, 2015, liquid assets (cash and due from banks, interest-bearing deposits with banks and unencumbered investment securities) were \$466.5 million, which represented 12.2% of total assets and 17.5% of total deposits and borrowings, compared to \$416.4 million at December 31, 2014, which represented 12.1% of total assets and 14.0% of total deposits and borrowings on such date.

The Bank is a member of the Federal Home Loan Bank of New York and, based on available qualified collateral as of September 30, 2015, had the ability to borrow \$1.6 billion. In addition, at September 30, 2015, the Bank had in place borrowing capacity of \$37 million through correspondent banks. The Bank also has a credit facility established with the Federal Reserve Bank of New York for direct discount window borrowings with capacity based on pledged collateral of \$94 million. At September 30, 2015, the Bank had aggregate available and unused credit of \$686.3 million, which represents the aforementioned facilities totaling \$1.3 billion net of \$606 million in outstanding borrowings. At September 30, 2015, outstanding commitments for the Bank to extend credit were \$589 million.

Cash and cash equivalents totaled \$158.5 million on September 30, 2015, increasing by \$31.7 million from \$126.8 million at December 31, 2014. Operating activities provided \$36.2 million in net cash. Investing activities used \$366.3 million in net cash, primarily reflecting an increase in loans, which was offset in part by cash flow from the securities portfolio. Financing activities provided \$361.7 million in net cash, primarily reflecting a net increase of \$191.0 million in deposits, \$50.0 million of new subordinated debt, and a net increase of \$142.1 in borrowings (consisting of \$625.0 million in new borrowings offset by repayments of \$482.9 million). Borrowing activity was significantly higher during the nine months ended September 30, 2015 when compared to the same period of 2014 due to the Merger and continued growth in our lending operations.

Deposits

Total deposits increased by \$191.0 million, or 7.7% to \$2.6 billion at September 30, 2015. The following table sets forth the composition of our deposit base by the periods indicated.

	<u>September 30, 2015</u>		<u>December 31, 2014</u>		Dollar Change 2015 vs. 2014
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	
	(dollars in thousands)				
Noninterest-bearing demand	\$ 586,643	22.0%	\$ 492,515	19.9%	\$ 94,129
Interest-bearing demand	334,018	12.5	365,550	14.8	(31,533)
Savings Deposits	220,199	8.3	224,638	9.1	(4,439)
Money market deposits	743,277	27.9	723,505	29.2	19,772
Time Deposits	<u>782,487</u>	<u>29.3</u>	<u>669,399</u>	<u>27.0</u>	<u>113,088</u>
Total deposits	<u>\$ 2,666,624</u>	<u>100.0%</u>	<u>\$ 2,475,607</u>	<u>100.0%</u>	<u>\$ 191,017</u>

Subordinated Debentures

During December 2003, Center Bancorp Statutory Trust II, a statutory business trust and wholly-owned subsidiary of the Parent Corporation issued \$5.0 million of MMCapS capital securities to investors due on January 23, 2034. The trust loaned the proceeds of this offering to the Company and received in exchange \$5.2 million of the Parent Corporation's subordinated debentures. The subordinated debentures are redeemable in whole or part. The floating interest rate on the subordinated debentures is three-month LIBOR plus 2.85% and re-prices quarterly. The rate at September 30, 2015 was 3.13%.

During June 2015, the Parent Corporation issued \$50 million in aggregate principal amount of fixed-to-floating rate subordinated notes (the “Notes”) to certain institutional accredited investors. The net proceeds from the sale of the Notes are expected to be used to redeem, on January 1, 2016, \$11.3 million outstanding of its Senior Noncumulative Perpetual Preferred Stock issued in 2011 to the U.S. Treasury under the Small Business Lending Fund Program, and for general corporate purposes, which included the Parent Corporation contributing \$35 million of the net proceeds to the Bank in the form of common equity. The Notes are non-callable for five years, have a stated maturity of July 1, 2025, and bear interest at a fixed rate of 5.75% per year, from and including September 30, 2015 to, but excluding July 1, 2020. From and including July 1, 2020 to the maturity date or early redemption date, the interest rate will reset quarterly to a level equal to the then current three-month LIBOR rate plus 393 basis points.

Stockholders’ Equity

Total stockholders’ equity amounted to \$471.1 million at September 30, 2015, compared to \$446.2 million at December 31, 2014. The increase in total stockholders’ equity was primarily attributable to an increase in retained earnings of \$24.9 million and approximately \$2.3 million of equity issuance related to stock-based compensation, including the exercise of options, offset by a \$2.3 million decrease in other comprehensive income (primarily \$2.3 million in unrealized losses on available for sale securities and \$0.7 million in unrealized losses on cash flow hedges, offset by \$0.7 million in pension plan actuarial gains). Book value per common share was \$15.23 at September 30, 2015, compared to \$14.65 at December 31, 2014. Tangible book value (i.e., total stockholders’ equity less preferred stock, goodwill and other intangible assets) per common share was \$10.26 at September 30, 2015, compared to \$9.57 at December 31, 2014.

Tangible book value per share is a non-GAAP financial measure and represents tangible stockholders’ equity (or tangible book value) calculated on a per common share basis. The Company believes that a disclosure of tangible book value per share may be helpful for those investors who seek to evaluate the Company’s book value per share without giving effect to goodwill and other intangible assets. The following table presents a reconciliation of total book value per share to tangible book value per share as of September 30, 2015 and December 31, 2014.

	September 30, 2015	December 31, 2014
	(in thousands, except for share data)	
Stockholders’ equity	\$ 471,146	\$ 446,219
Less: Preferred stock	11,250	11,250
Less: Goodwill and other intangible assets	150,034	150,734
Tangible common stockholders’ equity	<u>\$ 309,862</u>	<u>\$ 284,235</u>
Common stock outstanding at period end	30,197,619	29,694,636
Book value per common share	\$ 15.23	\$ 14.65
Less: Goodwill and other intangible assets	4.97	5.08
Tangible book value per common share	<u>\$ 10.26</u>	<u>\$ 9.57</u>

During the nine months ended September 30, 2015, the Company had no purchases of common stock associated with its stock buyback programs. At September 30, 2015, there were 652,868 shares available for repurchase under the Company’s stock buyback programs.

Regulatory Capital and Capital Adequacy

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

The Company and the Bank are subject to regulatory guidelines establishing minimum capital standards that involve quantitative measures of assets, and certain off-balance sheet items, as risk-adjusted assets under regulatory accounting practices.

The following is a summary of regulatory capital amounts and ratios as of September 30, 2015 for the Company and the Bank, compared with minimum capital adequacy requirements and the regulatory requirements for classification as a well-capitalized depository institution.

At September 30, 2015	ConnectOne Bancorp, Inc.		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(dollars in thousands)					
Tier 1 leverage capital	\$ 331,649	9.26%	\$ 143,263	4.00%	N/A	N/A
CET I risk-based ratio	315,244	9.33	151,990	4.50	N/A	N/A
Tier 1 risk-based capital	331,649	9.82	202,653	6.00	N/A	N/A
Total risk-based capital	403,182	11.94	270,204	8.00	N/A	N/A

At September 30, 2015	ConnectOne Bank		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(dollars in thousands)					
Tier 1 leverage capital	\$ 365,768	10.22%	\$ 143,215	4.00%	\$ 179,019	5.00%
CET I risk-based ratio	365,768	10.83	151,945	4.50	219,476	6.50%
Tier 1 risk-based capital	365,768	10.83	202,594	6.00	270,125	8.00%
Total risk-based capital	387,301	11.47	270,125	8.00	337,656	10.00%

N/A - not applicable

As of September 30, 2015, management believes that each of the Bank and the Company meet all capital adequacy requirements to which they are subject.

Basel III

The Basel Committee on Banking Supervision (the “Basel Committee”) provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques, with a view to promoting common understanding. At times, the Basel Committee uses this common understanding to develop guidelines and supervisory standards in areas where they are considered desirable. In this regard, the Basel Committee is best known for its international standards on capital adequacy; the Core Principles for Effective Banking Supervision; and the Concordat on cross-border banking supervision.

The Basel Committee released a comprehensive list of proposals for changes to capital, leverage, and liquidity requirements for banks in December 2009 (commonly referred to as “Basel III”). In July 2010, the Basel Committee announced the design for its capital and liquidity reform proposals and in September 2010, the oversight body of the Basel Committee announced minimum capital ratios and transition periods.

In December 2010 and January 2011, the Basel Committee published the final texts of reforms on capital and liquidity generally referred to as “Basel III.” Although Basel III is intended to be implemented by participating countries for large, internationally active banks, its provisions have also been considered by United States banking regulators in developing new regulations applicable to other banks in the United States, including the Bank.

On July 9, 2013, the Federal Deposit Insurance Corporation, along with the other U.S. bank regulatory agencies, approved a final rule revising regulatory capital rules applicable to banks, implementing Basel III. This rule redefines Tier 1 capital as two components (Common Equity Tier 1 and Additional Tier 1), creates a new capital ratio (Common Equity Tier 1 Risk-based Capital Ratio) and implements a capital conservation buffer. It also revises the prompt corrective action thresholds and makes changes to risk weights for certain assets and off-balance-sheet exposures. Banks were required to transition into the new rule beginning on January 1, 2015. The new rules also include a one-time opportunity to opt-out of the changes to the treatment of accumulated other comprehensive income (“AOCI”) components. By making the election to opt-out, an institution may continue to treat AOCI items in a manner consistent with risk-based capital rules in effect prior to January 1, 2015. The election, which cannot be reversed, must be made in the institution’s regulatory financial report for the period ending September 30, 2015. As of that time, the Company and the Bank elected to opt-out of the treatment of AOCI within Basel III.

Item 3. Qualitative and Quantitative Disclosures about Market Risks

Market Risk

Interest rate risk management is our primary market risk. See “Item 2- Management’s Discussion and Analysis of Financial Condition and Results of Operation- Interest Rate Sensitivity Analysis” herein for a discussion of our management of our interest rate risk.

Item 4. Controls and Procedures

a) *Disclosure controls and procedures* . As of the end of the Company's most recently completed fiscal quarter covered by this report, the Company carried out an evaluation, with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, the Company's disclosure controls and procedures are not effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and are operating in an effective manner and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In the course of business, and from time to time, the Company modifies loans at the request of borrowers. Modifications that involve borrowers experiencing financial difficulties and that result in concessions regarding loan terms including reduced interest rates, deferral of principal and extension of maturities can be deemed troubled debt restructurings. We recently identified material weaknesses in our controls over the identification and measurement of troubled debt restructurings in our taxi medallion portfolio, which, due to loan size and structure, is underwritten using market and industry data, and did not contain individual loan information required to accurately assess whether or not a modification should be deemed a TDR. Upon completion of the review, it was determined that \$75.4 million carrying value of taxi medallion loans, which were originally deemed to not be TDRs, should have been deemed TDRs when they were modified in April 2015. None of the remaining \$27.9 million taxi medallion loan portfolio have been modified.

b) *Changes in internal controls over financial reporting* . There have been no changes in the Company's internal controls over financial reporting that occurred during the Company's last fiscal quarter to which this report relates that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting. Management is currently in the process of improving its controls with respect to identifying and measuring impairment of TDRs when loans are modified by reviewing and enhancing the financial documentation on an individual loan basis, calculating impairment based on objectively verifiable evidence and by strengthening management oversight.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not subject to any legal proceedings, which could have a materially adverse impact on its results of operations and financial condition.

Item 1a. Risk Factors

In addition to the risks described under Item 1A –Risk Factors of our Annual Report on Form 10-K, investors in our securities should consider the following additional information:

Due to the restatement of our Quarterly Report for the quarter ended June 30, 2015, we have concluded that our disclosure controls and procedures may not be effective.

As disclosed elsewhere in this Quarterly Report, we recently identified material weaknesses in our controls over the identification and measurement of troubled debt restructurings in our taxi medallion portfolio, which, due to loan size and structure, is underwritten using market and industry data, and did not contain individual loan information required to accurately assess whether or not a modification should be deemed a troubled debt restructuring (“TDR”). Upon completion of the review, it was determined that \$75.4 million in carrying value of taxi medallion loans, which were originally deemed to not be TDRs, should have been deemed TDRs when they were modified in April 2015. All of the modified loans are fully performing in accordance with their modified terms, and there have been no missed payments regarding any of the modified loans.

When such errors occur, we evaluate the impact on our disclosure controls and procedures, including our internal controls over financial reporting. Because our controls did not timely identify the modified loans as TDRs, we have concluded our disclosure controls and procedures, with regard to the identification of TDRs in our taxi medallion portfolio, are not effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Management is currently in the process of improving its controls with respect to identifying and measuring impairment of TDRs when loans are modified by reviewing and enhancing the financial documentation on an individual loan basis, calculating impairment based on objectively verifiable evidence and by strengthening management oversight. However, we can give you no assurances that we may not discover additional issues which make us conclude that our disclosure controls and procedures are not effective in the future, or that the failure of our disclosure controls and procedures may not have a material adverse effect on our results of operations or financial condition.

Changes in the value of New York City taxi medallions could have a material impact on our future reported results of operations, and could cause significant volatility in our reported results of operations in future periods.

A significant portion (\$75.4 million) of our portfolio of loans secured by New York City taxi medallions has been classified as troubled debt restructurings (“TDRs”) and the level of specific allocations we may need to recognize with regard to these loans in future periods will be largely dependent upon the valuation we assign to these medallions. Because reported sales prices of these medallions recently have been very volatile, as the industry is under competitive stress, and do not necessarily represent orderly sales, we may also need to take into consideration factors beyond the market price of the medallions in determining our valuation, such as cash flow and industry prospects. In any case, our valuation may be volatile from period to period, and could result in our recognizing significant additional provisions if our valuation declines, while an increase in our valuation could result in a recapture, or reversal, of any such additional provisions. As a result, our results of operations could be materially adversely affected by declines in our valuation of New York City taxi medallions, even if our loans continue to perform as agreed, and we could experience significant volatility in our reported earnings if the reported prices for these medallions continue to be unsettled.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5 Other Information

Not applicable

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of the Chief Executive Officer of the Parent Corporation Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer of the Parent Corporation Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer of the Parent Corporation Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer of the Parent Corporation Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Definition Taxonomy Extension Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf, by the undersigned, thereunto duly authorized.

CONNECTONE BANCORP, INC.
(Registrant)

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

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

Date: November 9, 2015

Date: November 9, 2015

CERTIFICATION

I, Frank Sorrentino III, certify that:

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

Date: November 9, 2015

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

CERTIFICATION

I, William S. Burns, certify that:

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

Date: November 9, 2015

/s/ William S. Burns

William S. Burns

Executive Vice President and Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with this Quarterly Report of ConnectOne Bancorp, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2015 filed with the Securities and Exchange Commission (the "Report"), I, Frank Sorrentino III, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13 (a) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company as of the dates presented and the consolidated results of operations of the Company for the periods presented.

Date: November 9, 2015

/s/ Frank Sorrentino III

Frank Sorrentino III
Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with this Quarterly Report of ConnectOne Bancorp, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2015 filed with the Securities and Exchange Commission (the "Report"), I, William S. Burns, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13 (a) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company as of the dates presented and the consolidated results of operations of the Company for the periods presented.

Date: November 9, 2015

/s/ William S. Burns

William S. Burns

Executive Vice President and Chief Financial Officer