

FLUSHING FINANCIAL CORP
Form 10-K
March 17, 2014

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

FORM 10-K

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

For the fiscal year ended December 31, 2013

Commission file number 001-33013

FLUSHING FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

11-3209278
(I.R.S. Employer Identification No.)

1979 Marcus Avenue, Suite E140, Lake Success, New York 11042
(Address of principal executive offices)

(718) 961-5400
(Registrant's telephone number, including area code)

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

Common Stock \$0.01 par value (and
associated Preferred Stock Purchase Rights)
(Title of each class)

NASDAQ Global Select Market
(Name of exchange on which registered)

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

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

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

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

Edgar Filing: FLUSHING FINANCIAL CORP - Form 10-K

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

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

Large accelerated filer _____

Accelerated filer _

Non-accelerated filer _____

Smaller reporting company ___

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

As of June 28, 2013, the last business day of the registrant's most recently completed second fiscal quarter; the aggregate market value of the voting stock held by non-affiliates of the registrant was \$471,117,000. This figure is based on the closing price on that date on the NASDAQ Global Select Market for a share of the registrant's Common Stock, \$0.01 par value, which was \$16.45.

The number of shares of the registrant's Common Stock outstanding as of February 28, 2014 was 30,249,341 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 20, 2014 are incorporated herein by reference in Part III.

TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>Item 1. Business.</u>	<u>1</u>
<u>GENERAL</u>	
<u>Overview</u>	<u>1</u>
<u>Market Area and Competition</u>	<u>5</u>
<u>Lending Activities</u>	<u>5</u>
<u>Loan Portfolio Composition</u>	<u>5</u>
<u>Loan Maturity and Repricing</u>	<u>9</u>
<u>Multi-Family Residential Lending</u>	<u>10</u>
<u>Commercial Real Estate Lending</u>	<u>10</u>
<u>One-to-Four Family Mortgage Lending – Mixed-Use Properties</u>	<u>11</u>
<u>One-to-Four Family Mortgage Lending – Residential Properties</u>	<u>11</u>
<u>Construction Loans</u>	<u>12</u>
<u>Small Business Administration Lending</u>	<u>13</u>
<u>Taxi medallion</u>	<u>13</u>
<u>Commercial Business and Other Lending</u>	<u>13</u>
<u>Loan Extensions, Renewals, Modifications and Restructuring</u>	<u>13</u>
<u>Loan Approval Procedures and Authority</u>	<u>14</u>
<u>Loan Concentrations</u>	<u>14</u>
<u>Loan Servicing</u>	<u>15</u>
<u>Asset Quality</u>	<u>15</u>
<u>Loan Collection</u>	<u>15</u>
<u>Troubled Debt Restructured</u>	<u>16</u>
<u>Delinquent Loans and Non-performing Assets</u>	<u>16</u>
<u>Hurricane Sandy</u>	<u>18</u>
<u>Other Real Estate Owned</u>	<u>18</u>
<u>Investment Securities</u>	<u>18</u>
<u>Environmental Concerns Relating to Loans</u>	<u>18</u>
<u>Classified Assets</u>	<u>19</u>
<u>Allowance for Loan Losses</u>	<u>21</u>
<u>Investment Activities</u>	<u>25</u>
<u>General</u>	<u>25</u>
<u>Mortgage-backed securities</u>	<u>26</u>
<u>Sources of Funds</u>	<u>29</u>
<u>General</u>	<u>29</u>
<u>Deposits</u>	<u>29</u>
<u>Borrowings</u>	<u>33</u>
<u>Subsidiary Activities</u>	<u>34</u>
<u>Personnel</u>	<u>35</u>
<u>Omnibus Incentive Plan</u>	<u>35</u>

<u>FEDERAL, STATE AND LOCAL TAXATION</u>	<u>35</u>
<u>Federal Taxation</u>	<u>35</u>

i

	<u>General</u>	35
	<u>Bad Debt Reserves</u>	35
	<u>Distributions</u>	35
	<u>Corporate Alternative Minimum Tax</u>	36
<u>State and Local Taxation</u>		36
	<u>New York State and New York City Taxation</u>	36
	<u>Delaware State Taxation</u>	37
<u>REGULATION</u>		37
	<u>General</u>	37
	<u>The Dodd - Frank Act</u>	37
	<u>Basel III</u>	38
	<u>Volcker Rule</u>	38
	<u>New York State Law</u>	39
	<u>FDIC Regulation</u>	40
	<u>Brokered Deposits</u>	42
	<u>Transactions with Affiliates</u>	43
	<u>Community Reinvestment Act</u>	43
	<u>Federal Reserve System</u>	44
	<u>Federal Home Loan Bank System</u>	44
	<u>Holding Company Regulations</u>	44
	<u>Acquisition of the Holding Company</u>	45
	<u>Federal Securities Law</u>	45
	<u>Consumer Financial Protection Bureau</u>	45
	<u>Mortgage Banking and Related Consumer Protection Regulations</u>	45
	<u>Available Information</u>	46
<u>Item 1A. Risk Factors</u>		46
	<u>Changes in Interest Rates May Significantly Impact Our Financial Condition and Results of Operations</u>	46
	<u>Our Lending Activities Involve Risks that May Be Exacerbated Depending on the Mix of Loan Types</u>	47
	<u>Failure to Effectively Manage Our Liquidity Could Significantly Impact Our Financial Condition and Results of Operations</u>	48
	<u>Our Ability to Obtain Brokered Certificates of Deposit and Brokered Money Market Accounts as an Additional Funding Source Could be Limited</u>	48
	<u>The Markets in Which We Operate Are Highly Competitive</u>	49
	<u>Our Results of Operations May Be Adversely Affected by Changes in National and/or Local Economic Conditions</u>	49
	<u>Changes in Laws and Regulations Could Adversely Affect Our Business</u>	50
	<u>Current Conditions in, and Regulation of, the Banking Industry May Have a Material Adverse Effect on Our Results of Operations</u>	50
	<u>Certain Anti-Takeover Provisions May Increase the Costs to or Discourage an Acquirer</u>	51
	<u>We May Not Be Able to Successfully Implement Our Commercial Business Banking Initiative</u>	51
	<u>The FDIC's Adopted Restoration Plan and the Related Increased Assessment Rate Schedule May Have a Material Effect on Our Results of Operations</u>	52
	<u>A Failure in or Breach of Our Operational or Security Systems or Infrastructure, or Those of Our Third Party Vendors and Other Service Providers, Including as a Result of Cyber</u>	52

Attacks, could Disrupt Our Business, Result in the Disclosure or Misuse of Confidential or Proprietary Information, Damage Our Reputation, Increase Our Costs and Cause Losses

<u>We May Experience Increased Delays in Foreclosure Proceedings</u>	<u>53</u>
<u>We May Need to Recognize Other-Than-Temporary Impairment Charges in the Future</u>	<u>53</u>
<u>The Current Economic Environment Poses Significant Challenges for us and Could Adversely Affect our Financial Condition and Results of Operations</u>	<u>53</u>
<u>We May Not Pay Dividends on Our Common Stock.</u>	<u>54</u>
<u>Goodwill Recorded as a Result of Acquisitions Could Become Impaired, Negatively Impacting Our Earnings and Capital</u>	<u>54</u>
<u>We May Not Fully Realize the Expected Benefit of Our Deferred Tax Assets</u>	<u>54</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>54</u>
<u>Item 2. Properties</u>	<u>54</u>
<u>Item 3. Legal Proceedings</u>	<u>54</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>54</u>
<u>PART II</u>	
<u>Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>55</u>
<u>Stock Performance Graph</u>	<u>57</u>
<u>Item 6. Selected Financial Data</u>	<u>58</u>
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>60</u>
<u>General Overview</u>	<u>60</u>
<u>Management Strategy</u>	<u>61</u>
<u>Trends and Contingencies</u>	<u>64</u>
<u>Interest Rate Sensitivity Analysis</u>	<u>67</u>
<u>Interests Rate Risk</u>	<u>69</u>
<u>Analysis of Net Interest Income</u>	<u>69</u>
<u>Rate/Volume Analysis</u>	<u>71</u>
<u>Comparison of Operating Results for the Years Ended December 31, 2013 and 2012</u>	<u>71</u>
<u>Comparison of Operating Results for the Years Ended December 31, 2012 and 2011</u>	<u>73</u>
<u>Liquidity, Regulatory Capital and Capital Resources</u>	<u>75</u>
<u>Critical Accounting Policies</u>	<u>77</u>
<u>Contractual Obligations</u>	<u>78</u>
<u>New Authoritative Accounting Pronouncements</u>	<u>79</u>
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>80</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>81</u>
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>151</u>
<u>Item 9A. Controls and Procedures</u>	<u>151</u>
<u>Item 9B. Other Information</u>	<u>151</u>
<u>PART III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>152</u>
<u>Item 11. Executive Compensation</u>	<u>152</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>152</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>152</u>
<u>Item 14. Principal Accounting Fees and Services</u>	<u>152</u>

PART IV

<u>Item 15. Exhibits. Financial Statement Schedules</u>	<u>153</u>
<u>(a) 1. Financial Statements</u>	<u>153</u>
<u>(a) 2. Financial Statement Schedules</u>	<u>153</u>
<u>(a) 3. Exhibits Required by Securities and Exchange Commission</u> <u>Regulation S-K</u>	<u>154</u>
<u>SIGNATURES</u>	<u>156</u>
<u>POWER OF ATTORNEY</u>	<u>156</u>

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

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

PART I

As used in this Annual Report on Form 10-K, the words “we,” “us,” “our” and the “Company” are used to refer to Flushing Financial Corporation and our consolidated subsidiaries, including the surviving entity of the merger (the “Merger”) on February 28, 2013 of our wholly owned subsidiary, Flushing Savings Bank, FSB (the “Savings Bank”) with and into Flushing Commercial Bank (the “Commercial Bank”). The surviving entity of the Merger was the Commercial Bank, whose name has been changed to “Flushing Bank.” References herein to the “Bank” mean the Savings Bank (including its wholly owned subsidiary, the Commercial Bank) prior to the Merger and the surviving entity after the Merger.

Item 1. Business.

GENERAL

Overview

We are a Delaware corporation organized in May 1994. The Savings Bank was organized in 1929 as a New York State-chartered mutual savings bank. In 1994, the Savings Bank converted to a federally chartered mutual savings bank and changed its name from Flushing Savings Bank to Flushing Savings Bank, FSB. The Savings Bank converted from a federally chartered mutual savings bank to a federally chartered stock savings bank on November 21, 1995, at which time Flushing Financial Corporation acquired all of the stock of the Savings Bank. On February 28, 2013, in the Merger, the Savings Bank merged with and into the Commercial Bank, with the Commercial Bank as the surviving entity. Pursuant to the Merger, the Commercial Bank’s charter was changed to a full-service New York State commercial bank charter, and its name was changed to Flushing Bank. Also in connection with the Merger, Flushing Financial Corporation became a bank holding company. We have not made any significant changes to our operations or services as a result of the Merger. The primary business of Flushing Financial Corporation has been the operation of the Bank. The Bank owns three subsidiaries: Flushing Preferred Funding Corporation, Flushing Service Corporation, and FSB Properties Inc. The Bank has an internet branch, iGObanking.com®. The activities of Flushing Financial Corporation are primarily funded by dividends, if any, received from the Bank, issuances of junior subordinated debt, and issuances of equity securities. Flushing Financial Corporation’s common stock is traded on the NASDAQ Global Select Market under the symbol “FFIC.”

Flushing Financial Corporation also owns Flushing Financial Capital Trust II, Flushing Financial Capital Trust III, and Flushing Financial Capital Trust IV (the “Trusts”), which are special purpose business trusts formed to issue a total of \$60.0 million of capital securities and \$1.9 million of common securities (which are the only voting securities). Flushing Financial Corporation owns 100% of the common securities of the Trusts. The Trusts used the proceeds from the issuance of these securities to purchase junior subordinated debentures from Flushing Financial Corporation. The Trusts are not included in our consolidated financial statements as we would not absorb the losses of the Trusts if losses were to occur.

Unless otherwise disclosed, the information presented in this Annual Report reflects the financial condition and results of operations of Flushing Financial Corporation, the Bank and the Bank's subsidiaries on a consolidated basis (collectively, the "Company"). Management views the Company as operating a single unit – a community bank. Therefore, segment information is not provided. At December 31, 2013, the Company had total assets of \$4.7 billion, deposits of \$3.2 billion and stockholders' equity of \$432.5 million.

Our principal business is attracting retail deposits from the general public and investing those deposits together with funds generated from ongoing operations and borrowings, primarily in (1) originations and purchases of multi-family residential properties and, to a lesser extent, one-to-four family (focusing on mixed-use properties, which are properties that contain both residential dwelling units and commercial units) and commercial real estate mortgage loans; (2) construction loans, primarily for residential properties; (3) Small Business Administration ("SBA") loans and other small business loans; (4) mortgage loan surrogates such as mortgage-backed securities; and (5) U.S. government securities, corporate fixed-income securities and other marketable securities. We also originate certain other consumer loans including overdraft lines of credit. At December 31, 2013, we had gross loans outstanding of \$3,423.0 million (before the allowance for loan losses and net deferred costs), with gross mortgage loans totaling \$3,028.5 million, or 88.5% of gross loans, and non-mortgage loans totaling \$394.6 million, or 11.5% of gross loans. Mortgage loans are primarily multi-family, commercial and one-to-four family mixed-use properties, which combined totaled 82.4% of gross loans. Our revenues are derived principally from interest on our mortgage and other loans and mortgage-backed securities portfolio, and interest and dividends on other investments in our securities portfolio. Our primary sources of funds are deposits, Federal Home Loan Bank of New York ("FHLB-NY") borrowings, repurchase agreements, principal and interest payments on loans, mortgage-backed and other securities, proceeds from sales of securities and, to a lesser extent, proceeds from sales of loans. On July 21, 2011, as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Savings Bank's primary regulator became the Office of the Comptroller of the Currency ("OCC") and Flushing Financial Corporation's primary regulator became the Federal Reserve Board of Governors ("Federal Reserve"). Upon completion of the Merger, the Bank's primary regulator became the New York State Department of Financial Services ("NYSDFS") (formerly, the New York State Banking Department), and its primary federal regulator became the Federal Deposit Insurance Corporation ("FDIC"). Deposits are insured to the maximum allowable amount by the FDIC. Additionally, the Bank is a member of the Federal Home Loan Bank ("FHLB") system.

Our operating results are significantly affected by national and local economic conditions, including the strength of the local economy. The national and local economies were generally considered to be in a recession from December 2007 through the middle of 2009. This resulted in increased unemployment and declining property values, although the property value declines in our market, the New York City metropolitan area, have not been as great as many other areas of the country. While the national and local economies have shown signs of improvement since the middle of 2010, improvements in unemployment have lagged, with the unemployment rate decreasing but remaining at an elevated level of 7.5% at December 2013 and 8.8% at December 2012, for the New York City region, according to the New York State Department of Labor. We have also seen improvements in our level of non-performing loans, although they still remain at elevated levels. Non-performing loans totaled \$49.0 million, \$89.8 million and \$117.4 million at December 31, 2013, 2012 and 2011, respectively. Additionally, we have not experienced a significant increase in foreclosed properties due to an extended foreclosure process in our market. Net charge-offs of impaired loans have decreased in 2013 to \$13.3 million from \$20.2 million and \$18.9 million for the years ended December 31, 2012 and 2011, respectively. In response to the economic conditions in our market and the increase in non-performing loans resulting from the recession, we tightened our conservative underwriting standards in 2008 to reduce the risk associated with lending.

The following changes were made in our underwriting standards since 2008 to reduce the risk associated with lending on income producing real estate properties:

When borrowers requested a refinance of an existing mortgage loan when they had acquired the property or obtained their existing loan within two years of the request, we generally required evidence of improvements to the property that increased the property value to support the additional funds and generally restricted the loan-to-value ratio for the new loan to 65% of the appraised value.

§ The debt coverage ratio was increased and the loan-to-value ratio decreased for income producing properties with fewer than ten units. This required the borrower to have an additional investment in the property than previously required and provided additional protection should rental units become vacant.

§ Borrowers who owned multiple properties were required to provide detail on all their properties to allow us to evaluate their total cash flow requirements. Based on this review, we may decline the loan application, or require a lower loan-to-value ratio and a higher debt coverage ratio.

§ Income producing properties with existing rents that were at or above the current market rent for similar properties were required to have a higher debt coverage ratio to provide protection should rents decline.

§ Borrowers purchasing properties were required to demonstrate they had satisfactory liquidity and management ability to carry the property should vacancies occur or increase.

The following changes were made in our underwriting standards since 2008 to reduce the risk on one-to-four family residential property mortgage loans and home equity lines of credit:

§ We discontinued originating home equity lines of credit without verifying the borrower's income. This was done in two stages. Beginning in May 2008, we began verifying the borrower's income when the home equity line of credit exceeded \$100,000. Beginning in October 2009, we verified the income of all borrowers applying for a home equity line of credit.

§ We discontinued offering one-to-four family residential property mortgage loans to self-employed individuals based on stated income and verifiable assets in June 2010.

The following changes were made in our underwriting standards since 2008 to reduce the risk associated with business lending: