

FLUSHING FINANCIAL CORP
Form 10-Q
May 10, 2012

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

FORM 10-Q

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

For the quarterly period ended March 31, 2012

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)

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 a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐
Non-accelerated filer ☐

Accelerated filer ☒
Smaller reporting company ☐

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

The number of shares of the registrant's Common Stock outstanding as of April 30, 2012 was 30,920,676.

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PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Financial Condition
(Unaudited)

Item 1. Financial Statements

(Dollars in thousands, except per share data)	March 31, 2012	December 31, 2011
ASSETS		
Cash and due from banks	\$ 35,390	\$ 55,721
Securities available for sale:		
Mortgage-backed securities (\$34,629 and \$37,787 at fair value pursuant to the fair value option at March 31, 2012 and December 31, 2011, respectively)	733,873	747,288
Other securities (\$31,247 and \$30,942 at fair value pursuant to the fair value option at March 31, 2012 and December 31, 2011 respectively)	163,760	65,242
Loans:		
Multi-family residential	1,418,254	1,391,221
Commercial real estate	557,688	580,783
One-to-four family mixed-use property	681,389	693,932
One-to-four family residential	214,163	220,431
Co-operative apartments	5,409	5,505
Construction	42,655	47,140
Small Business Administration	13,665	14,039
Taxi medallion	49,391	54,328
Commercial business and other	231,674	206,614
Net unamortized premiums and unearned loan fees	14,410	14,888
Allowance for loan losses	(30,618)	(30,344)
Net loans	3,198,080	3,198,537
Interest and dividends receivable	18,434	17,965
Bank premises and equipment, net	24,053	24,417
Federal Home Loan Bank of New York stock	32,221	30,245
Bank owned life insurance	84,150	83,454
Goodwill	16,127	16,127
Core deposit intangible	820	937
Other assets	51,049	48,016
Total assets	\$ 4,357,957	\$ 4,287,949
LIABILITIES		
Due to depositors:		
Non-interest bearing	\$ 131,428	\$ 118,507
Interest-bearing:		
Certificate of deposit accounts	1,461,651	1,529,110
Savings accounts	331,242	349,630
Money market accounts	193,569	200,183
NOW accounts	1,011,001	919,029
Total interest-bearing deposits	2,997,463	2,997,952
Mortgagors' escrow deposits	41,243	29,786
Borrowed funds (\$26,136 and \$26,311 at fair value pursuant to the fair value option at March 31, 2012 and December 31, 2011, respectively)	543,861	499,839

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Securities sold under agreements to repurchase	185,300	185,300
Other liabilities	35,706	39,654
Total liabilities	3,935,001	3,871,038
STOCKHOLDERS' EQUITY		
Preferred stock (\$0.01 par value; 5,000,000 shares authorized; None issued)	-	-
Common stock (\$0.01 par value; 100,000,000 shares authorized; 31,530,595 shares issued at March 31, 2012 and December 31, 2011; 30,919,551 shares and 30,904,177 shares outstanding at March 31, 2012 and December 31, 2011, respectively)	315	315
Additional paid-in capital	197,325	195,628
Treasury stock, at average cost (611,044 shares and 626,418 shares at March 31, 2012 and December 31, 2011, respectively)	(7,410)	(7,355)
Retained earnings	226,553	223,510
Accumulated other comprehensive income, net of taxes	6,173	4,813
Total stockholders' equity	422,956	416,911
Total liabilities and stockholders' equity	\$ 4,357,957	\$ 4,287,949

The accompanying notes are an integral part of these consolidated financial statements

PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Income
(Unaudited)

(Dollars in thousands, except per share data)	For the three months ended March 31,	
	2012	2011
Interest and dividend income		
Interest and fees on loans	\$ 46,560	\$ 48,690
Interest and dividends on securities:		
Interest	7,631	8,107
Dividends	207	202
Other interest income	17	27
Total interest and dividend income	54,415	57,026
Interest expense		
Deposits	10,910	12,334
Other interest expense	6,160	7,537
Total interest expense	17,070	19,871
Net interest income	37,345	37,155
Provision for loan losses	6,000	5,000
Net interest income after provision for loan losses	31,345	32,155
Non-interest income		
Other-than-temporary impairment ("OTTI") charge	-	(3,616)
Less: Non-credit portion of OTTI charge recorded in Other Comprehensive Income, before taxes	-	2,690
Net OTTI charge recognized in earnings	-	(926)
Loan fee income	466	434
Banking services fee income	455	461
Net loss from fair value adjustments	(448)	(655)
Federal Home Loan Bank of New York stock dividends	385	500
Bank owned life insurance	696	667
Other income	324	390
Total non-interest income	1,878	871
Non-interest expense		
Salaries and employee benefits	11,041	10,027
Occupancy and equipment	1,930	1,867
Professional services	1,722	1,599
FDIC deposit insurance	1,017	1,428
Data processing	976	1,005
Depreciation and amortization	834	766
Other real estate owned/foreclosure expense	712	337
Other operating expenses	3,304	2,986
Total non-interest expense	21,536	20,015

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Income before income taxes	11,687	13,011
Provision for income taxes		
Federal	3,624	3,912
State and local	934	1,146
Total taxes	4,558	5,058
Net income	\$ 7,129	\$ 7,953
Basic earnings per common share	\$ 0.23	\$ 0.26
Diluted earnings per common share	\$ 0.23	\$ 0.26
Dividends per common share	\$ 0.13	\$ 0.13

The accompanying notes are an integral part of these consolidated financial statements

PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(Unaudited)

(Dollars in thousands)	For the three months ended March 31,	
	2012	2011
Comprehensive Income		
Net income	\$ 7,129	\$ 7,953
Amortization of actuarial losses	149	77
Amortization of prior service credits	(6)	(6)
OTTI charges included in income	-	518
Unrealized gains (losses) on securities, net	1,217	(3,490)
Comprehensive income	\$ 8,489	\$ 5,052

The accompanying notes are an integral part of these consolidated financial statements.

PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited)

	For the three months ended March 31,	
	2012	2011
(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 7,129	\$ 7,953
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	6,000	5,000
Depreciation and amortization of bank premises and equipment	834	766
Amortization of premium, net of accretion of discount	1,561	1,423
Net loss from fair value adjustments	448	655
OTTI charge recognized in earnings	-	926
Income from bank owned life insurance	(696)	(667)
Stock-based compensation expense	1,418	1,167
Deferred compensation	(306)	103
Amortization of core deposit intangibles	117	117
Excess tax benefit from stock-based payment arrangements	(106)	(80)
Deferred income tax provision	713	125
Decrease in prepaid FDIC assesment	946	1,337
Decrease in other liabilities	(1,676)	(3,562)
Decrease (Increase) in other assets	540	(2,408)
Net cash provided by operating activities	16,922	12,855
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of bank premises and equipment	(470)	(754)
Net (purchase) redemptions of Federal Home Loan Bank of New York shares	(1,976)	1,683
Purchases of securities available for sale	(122,512)	(34,657)
Proceeds from maturities and prepayments of securities available for sale	39,035	38,108
Net (originations) and repayment of loans	(19,871)	5,396
Purchases of loans	(3,456)	(12,555)
Proceeds from sale of real estate owned	624	154
Proceeds from sale of delinquent loans	9,091	3,158
Net cash (used in) provided by investing activities	(99,535)	533
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in non-interest bearing deposits	12,921	8,374
Net (decrease) increase in interest-bearing deposits	(743)	19,648
Net increase in mortgagors' escrow deposits	11,457	12,512
Net proceeds from short-term borrowed funds	58,500	-
Proceeds from long-term borrowings	47,414	-
Repayment of long-term borrowings	(62,000)	(47,423)
Purchases of treasury stock	(1,652)	(209)
Excess tax benefit from stock-based payment arrangements	106	80
Proceeds from issuance of common stock upon exercise of stock options	244	525
Cash dividends paid	(3,965)	(3,995)

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Net cash provided by (used in) financing activities	62,282	(10,488)
Net (decrease) increase in cash and cash equivalents	(20,331)	2,900
Cash and cash equivalents, beginning of period	55,721	47,789
Cash and cash equivalents, end of period	\$ 35,390	\$ 50,689

SUPPLEMENTAL CASH FLOW DISCLOSURE

Interest paid	\$ 16,995	\$ 19,743
Income taxes paid	5,218	2,366
Taxes paid if excess tax benefits were not tax deductible	5,324	2,446
Non-cash activities:		
Loans transferred to real estate owned	1,293	980
Loans provided for the sale of real estate owned	221	244

The accompanying notes are an integral part of these consolidated financial statements.

PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
(Unaudited)

	For the three months ended March 31,	
(Dollars in thousands, except per share data)	2012	2011
Common Stock		
Balance, beginning of period	\$ 315	\$ 313
Issuance upon exercise of stock options (26,907 common shares for the three months ended March 31, 2011)	-	-
Shares issued upon vesting of restricted stock unit awards (67,886 commons shares for the three months ended March 31, 2011)	-	1
Balance, end of period	\$ 315	\$ 314
Additional Paid-In Capital		
Balance, beginning of period	\$ 195,628	\$ 189,348
Award of common shares released from Employee Benefit Trust (146,735 and 131,799 common shares for the three months ended March 31, 2012 and 2011, respectively)	1,363	1,429
Shares issued upon vesting of restricted stock unit awards (85,163 and 67,886 common shares for the three months ended March 31, 2012 and 2011, respectively)	151	724
Issuance upon exercise of stock options (56,850 and 41,825 common shares for the three months ended March 31, 2012 and 2011, respectively)	73	348
Stock-based compensation activity, net	4	405
Stock-based income tax benefit	106	80
Balance, end of period	\$ 197,325	\$ 192,334
Treasury Stock		
Balance, beginning of period	\$ (7,355)	\$ -
Purchases of outstanding shares (97,200 common shares for the three months ended March 31, 2012)	(1,282)	-
Shares issued upon vesting of restricted stock unit awards (113,993 common shares for the three months ended March 31, 2012)	1,343	-
Issuance upon exercise of stock options (67,330 and 14,378 common shares for the three months ended March 31, 2012 and 2011, respectively)	802	209
Purchases of shares to fund options exercised (40,866 common shares for the three months ended March 31, 2012)	(548)	-
Repurchase of shares to satisfy tax obligations (27,883 and 14,378 common shares for the three months ended March 31, 2012 and 2011, respectively)	(370)	(209)
Balance, end of period	\$ (7,410)	\$ -
Retained Earnings		
Balance, beginning of period	\$ 223,510	\$ 204,128
Net income	7,129	7,953
Cash dividends declared and paid on common shares (\$0.13 per common share for the three months ended March 31, 2012 and 2011)	(3,965)	(3,995)
Issuance upon exercise of stock options (10,480 and 41,825 common shares for the three months ended March 31, 2012 and 2011, respectively)	(24)	(32)
Shares issued upon vesting of restricted stock unit awards (28,830 common shares for the three months ended March 31, 2012)	(97)	-

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Balance, end of period	\$ 226,553	\$ 208,054
Accumulated Other Comprehensive Income (Loss)		
Balance, beginning of period	\$ 4,813	\$ (3,744)
Change in net unrealized gains (losses) on securities available for sale, net of taxes of approximately (\$962) and \$2,756 for the three months ended March 31, 2012 and 2011, respectively	1,217	(3,490)
Amortization of actuarial losses, net of taxes of approximately (\$117) and (\$61) for the three months ended March 31, 2012 and 2011, respectively	149	77
Amortization of prior service credits, net of taxes of approximately \$5 for the three months ended March 31, 2012 and 2011	(6)	(6)
OTTI charges included in income, net of taxes of approximately (\$408) for the three months ended March 31, 2011	-	518
Balance, end of period	\$ 6,173	\$ (6,645)
Total Stockholders' Equity	\$ 422,956	\$ 394,057

The accompanying notes are an integral part of these consolidated financial statements.

PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The primary business of Flushing Financial Corporation (the “Holding Company”) is the operation of its wholly-owned subsidiary, Flushing Savings Bank, FSB (the “Savings Bank”). The Holding Company and its direct and indirect wholly-owned subsidiaries, the Savings Bank, Flushing Commercial Bank, Flushing Preferred Funding Corporation, Flushing Service Corporation, and FSB Properties Inc., are collectively herein referred to as the “Company.” The unaudited consolidated financial statements presented in this Quarterly Report on Form 10-Q (“Quarterly Report”) include the collective results of the Company on a consolidated basis.

The accompanying unaudited consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and general practices within the banking industry. The information furnished in these interim statements reflects all adjustments which are, in the opinion of management, necessary for a fair statement of the results for such presented periods of the Company. Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Quarterly Report. All inter-company balances and transactions have been eliminated in consolidation. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for the full year.

The accompanying unaudited consolidated financial statements have been prepared in conformity with the instructions to Quarterly Report on Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The unaudited consolidated interim financial information should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

When necessary, certain reclassifications have been made to the prior-period consolidated financial statements to conform to the current-period presentation.

2. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenue and expenses during the reporting period. Estimates that are particularly susceptible to change in the near term are used in connection with the determination of the allowance for loan losses, the evaluation of goodwill for impairment, the evaluation of the need for a valuation allowance of the Company’s deferred tax assets and the evaluation of other-than-temporary impairment (“OTTI”) on securities. The current economic environment has increased the degree of uncertainty inherent in these material estimates. Actual results could differ from these estimates.

3. Earnings Per Share

Earnings per share are computed in accordance with Accounting Standards Codification (“ASC”) Topic 260 “Earnings Per Share,” which provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and as such should be included in the

calculation of earnings per share. Basic earnings per common share is computed by dividing net income available to common shareholders by the total weighted average number of common shares outstanding, which includes unvested participating securities. The Company's unvested restricted stock and restricted stock unit awards are considered participating securities. Therefore, weighted average common shares outstanding used for computing basic earnings per common share includes common shares outstanding plus unvested restricted stock and restricted stock unit awards. The computation of diluted earnings per share includes the additional dilutive effect of stock options outstanding during the period. Common stock equivalents that are anti-dilutive are not included in the computation of diluted earnings per common share. The numerator for calculating basic and diluted earnings per common share is net income available to common shareholders.

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PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Notes to Consolidated Financial Statements
(Unaudited)

Earnings per common share have been computed based on the following:

	For the three months ended March 31,	
	2012	2011
	(In thousands, except per share data)	
Net income, as reported	\$ 7,129	\$ 7,953
Divided by:		
Weighted average common shares outstanding	30,396	30,620
Weighted average common stock equivalents	24	66
Total weighted average common shares outstanding and common stock equivalents	30,420	30,686
Basic earnings per common share	\$ 0.23	\$ 0.26
Diluted earnings per common share (1)	\$ 0.23	\$ 0.26
Dividend payout ratio	56.5 %	50.0 %

- (1) For the three months ended March 31, 2012, options to purchase 720,340 shares at an average exercise price of \$16.71 were not included in the computation of diluted earnings per common share as they were anti-dilutive. For the three months ended March 31, 2011, options to purchase 560,550 shares at an average exercise price of \$17.62 were not included in the computation of diluted earnings per common share as they were anti-dilutive.

4. Debt and Equity Securities

The Company's investments are classified in one of the following three categories and accounted for accordingly: (1) trading securities, (2) securities available for sale and (3) securities held-to-maturity.

The Company did not hold any trading securities or securities held-to-maturity during the three month periods ended March 31, 2012 and 2011. Securities available for sale are recorded at fair value.

The following table summarizes the Company's portfolio of securities available for sale at March 31, 2012:

	Amortized Cost	Fair Value (In thousands)	Gross Unrealized Gains	Gross Unrealized Losses
U.S. government agencies	\$ 21,819	\$21,517	\$ 44	\$ 346
Corporate	61,810	63,143	1,333	-

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Municipals	40,324	39,648	-	676
Mutual funds	21,450	21,450	-	-
Other	22,296	18,002	15	4,309
Total other securities	167,699	163,760	1,392	5,331
REMIC and CMO	453,662	467,988	22,556	8,230
GNMA	57,869	62,870	5,001	-
FNMA	175,243	182,078	6,871	36
FHLMC	20,181	20,937	756	-
Total mortgage-backed securities	706,955	733,873	35,184	8,266
Total securities available for sale	\$ 874,654	\$ 897,633	\$ 36,576	\$ 13,597

Mortgage-backed securities shown in the table above include two private issue collateralized mortgage obligations (“CMO”) that are collateralized by commercial real estate mortgages with amortized cost and market values totaling \$18.1 million and \$18.5 million, respectively, at March 31, 2012. The remaining private issue mortgage-backed securities are backed by one-to-four family residential mortgage loans.

PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

The following table shows the Company's available for sale securities with gross unrealized losses and their fair value aggregated by category and length of time the individual securities have been in a continuous unrealized loss position, at March 31, 2012:

	Fair Value	Total Unrealized Losses	(In thousands)		Less than 12 months Fair Value	Less than 12 months Unrealized Losses	12 months or more Fair Value	12 months or more Unrealized Losses
U.S. government agencies	\$ 19,651	\$ 346	\$ 19,651	\$ 346	\$ -	\$ -		
Municipals	33,354	676	33,354	676	-	-		
Other	5,253	4,309	-	-	5,253	4,309		
Total other securities	58,258	5,331	53,005	1,022	5,253	4,309		
REMIC and CMO	40,607	8,230	13,525	254	27,082	7,976		
FNMA	10,444	36	10,444	36	-	-		
Total mortgage-backed securities	51,051	8,266	23,969	290	27,082	7,976		
Total securities available for sale	\$ 109,309	\$ 13,597	\$ 76,974	\$ 1,312	\$ 32,335	\$ 12,285		

Other-than-temporary impairment ("OTTI") losses on impaired securities must be fully recognized in earnings if an investor has the intent to sell the debt security or if it is more likely than not that the investor will be required to sell the debt security before recovery of its amortized cost. However, even if an investor does not expect to sell a debt security, the investor must evaluate the expected cash flows to be received and determine if a credit loss has occurred. In the event that a credit loss has occurred, only the amount of impairment associated with the credit loss is recognized in earnings in the Consolidated Statements of Income. Amounts relating to factors other than credit losses are recorded in accumulated other comprehensive income ("AOCI") within Stockholders' Equity. Additional disclosures regarding the calculation of credit losses as well as factors considered by the investor in reaching a conclusion that an investment is not other-than-temporarily impaired are required.

The Company reviewed each investment that had an unrealized loss at March 31, 2012. An unrealized loss exists when the current fair value of an investment is less than its amortized cost basis. Unrealized losses on available for sale securities, that are deemed to be temporary, are recorded in AOCI, net of tax. Unrealized losses that are considered to be other-than-temporary are split between credit related and noncredit related impairments, with the credit related impairment being recorded as a charge against earnings and the noncredit related impairment being recorded in AOCI, net of tax.

The Company evaluates its pooled trust preferred securities, included in the table above in the row labeled "Other", using an impairment model through an independent third party, which includes evaluating the financial condition of each counterparty. For single issuer trust preferred securities, the Company evaluates the issuer's financial condition. The Company evaluates its mortgage-backed securities by reviewing the characteristics of the securities, including delinquency and foreclosure levels, projected losses at various loss severity levels and credit enhancement and coverage. In addition, private issue CMOs are evaluated using an impairment model through an independent third party. When an OTTI is identified, the portion of the impairment that is credit related is determined by management using the following methods: (1) for trust preferred securities, the credit related impairment is determined by using a discounted cash flow model from an independent third party, with the difference between the present value of the projected cash flows and the amortized cost basis of the security recorded as a credit related loss against earnings; (2)

for mortgage-backed securities, credit related impairment is determined for each security by estimating losses based on a set of assumptions, which includes delinquency and foreclosure levels, projected losses at various loss severity levels, credit enhancement and coverage; and (3) for private issue CMOs, through an impairment model from an independent third party and then recording those estimated losses as a credit related loss against earnings.

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PART I – FINANCIAL INFORMATION

FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

U.S. Government Agencies:

The unrealized losses in U.S. Government Agencies at March 31, 2012, consist of losses on two U.S. Government securities. The unrealized losses were caused by movements in interest rates. It is not anticipated that these securities would be settled at a price that is less than the amortized cost of the Company's investment. Each of these securities is performing according to its terms and, in the opinion of management, will continue to perform according to its terms. The Company does not have the intent to sell these securities and it is more likely than not the Company will not be required to sell the securities before recovery of the securities amortized cost basis. This conclusion is based upon considering the Company's cash and working capital requirements and contractual and regulatory obligations, none of which the Company believes would cause the sale of the securities. Therefore, the Company did not consider these investments to be other-than-temporarily impaired at March 31, 2012.

Municipals:

The unrealized losses in Municipal securities at March 31, 2012, consist of losses on 12 municipal securities. The unrealized losses were caused by movements in interest rates. It is not anticipated that these securities would be settled at a price that is less than the amortized cost of the Company's investment. Each of these securities is performing according to its terms and, in the opinion of management, will continue to perform according to its terms. The Company does not have the intent to sell these securities and it is more likely than not the Company will not be required to sell the securities before recovery of the securities amortized cost basis. This conclusion is based upon considering the Company's cash and working capital requirements and contractual and regulatory obligations, none of which the Company believes would cause the sale of the securities. Therefore, the Company did not consider these investments to be other-than-temporarily impaired at March 31, 2012.

Other Securities:

The unrealized losses in Other Securities at March 31, 2012, consist of losses on one single issuer trust preferred security and two pooled trust preferred securities. The unrealized losses on such securities were caused by market interest volatility, a significant widening of credit spreads across markets for these securities and illiquidity and uncertainty in the financial markets. These securities are currently rated below investment grade. The pooled trust preferred securities do not have collateral that is subordinate to the classes the Company owns. The Company's management evaluates these securities using an impairment model, through an independent third party, that is applied to debt securities. In estimating other-than-temporary impairment losses, management considers: (1) the length of time and the extent to which the fair value has been less than amortized cost; (2) the current interest rate environment; (3) the financial condition and near-term prospects of the issuer, if applicable; and (4) the intent and ability of the Company to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value. Additionally, management reviews the financial condition of each individual issuer within the pooled trust preferred securities. All of the issuers of the underlying collateral of the pooled trust preferred securities we reviewed are banks.

For each bank, our review included the following performance items:

§ Ratio of tangible equity to assets

§ Tier 1 Risk Weighted Capital

§ Net interest margin

§ Efficiency ratio for most recent two quarters

§ Return on average assets for most recent two quarters

§

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Texas Ratio (ratio of non-performing assets plus assets past due over 90 days divided by tangible equity plus the reserve for loan losses)

§ Credit ratings (where applicable)

§ Capital issuances within the past year (where applicable)

§ Ability to complete Federal Deposit Insurance Corporation ("FDIC") assisted acquisitions (where applicable)

Based on the review of the above factors, we concluded that:

§ All of the performing issuers in our pools are well capitalized banks and do not appear likely to be closed by their regulators.

§ All of the performing issuers in our pools will continue as a going concern and will not default on their securities.

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In order to estimate potential future defaults and deferrals, we segregated the performing underlying issuers by their Texas Ratio. We then reviewed performing issuers with Texas Ratios in excess of 50%. The Texas Ratio is a key indicator of the health of the institution and the likelihood of failure. This ratio compares the problem assets of the institution to the institution's available capital and reserves to absorb losses that are likely to occur in these assets. There was one issuer with a Texas Ratio in excess of 50% for which we concluded there would not be a default, primarily due to its current operating results and demonstrated ability to raise additional capital.

There were no remaining performing issuers in our pooled trust preferred securities which had a Texas Ratio in excess of 85.00%. For the remaining issuers with a Texas Ratio between 50.00% and 84.99%, we estimated 25% of the related cash flows of the issuer would not be realized. We concluded that issuers with a Texas Ratio below 50.00% are considered healthy and there was a minimal risk of default. We assigned a zero default rate to these issuers. Our analysis also assumed that issuers currently deferring would default with no recovery and issuers that have defaulted will have no recovery.

We had an independent third party prepare a discounted cash flow analysis for each of these pooled trust preferred securities based on the assumptions discussed above. Other significant assumptions were: (1) no issuers will prepay; (2) senior classes will not call the debt on their portions; and (3) use of the forward London Interbank Offered Rate ("LIBOR") curve. The cash flows were discounted at the effective rate for each security. For each issuer that we assumed a 25% shortfall in the cash flows, the cash flow analysis eliminates 25% of the cash flow for each issuer effective immediately.

One of the pooled trust preferred securities is over 90 days past due and the Company has stopped accruing interest. The remaining pooled trust preferred security as well as the single issuer trust preferred security both are performing according to their terms. The Company also owns a pooled trust preferred security that is carried under the fair value option, where the unrealized losses are included in the Consolidated Statements of Income – Net gain (loss) from fair value adjustments. This security is over 90 days past due and the Company has stopped accruing interest.

It is not anticipated at this time that the one single issuer trust preferred security and the two pooled trust preferred securities would be settled at a price that is less than the amortized cost of the Company's investment. Each of these securities is performing according to its terms; except for the pooled trust preferred securities for which the Company has stopped accruing interest as discussed above and, in the opinion of management based on the review performed at March 31, 2012, will continue to perform according to its terms. The Company does not have the intent to sell these securities and it is more likely than not the Company will not be required to sell the securities before recovery of the securities' amortized cost basis. This conclusion is based upon considering the Company's cash and working capital requirements and contractual and regulatory obligations, none of which the Company believes would cause the sale of the securities. Therefore, the Company did not consider the one single issuer trust preferred security and the two pooled trust preferred securities to be other-than-temporarily impaired at March 31, 2012.

At March 31, 2012, the Company held six trust preferred issues which had a current credit rating of at least one rating below investment grade. Two of those issues are carried under the fair value option and therefore, changes in fair value are included in the Consolidated Statement of Income – Net gain (loss) from fair value adjustments.

The following table details the remaining four trust preferred issues that were evaluated to determine if they were other-than-temporarily impaired at March 31, 2012. The class the Company owns in pooled trust preferred securities

does not have any excess subordination.

Issuer Type	Class	Performing Banks	Amortized Cost	Fair Value	Cumulative Credit Related OTTI	Deferrals/Defaults (1)			
						Actual as a Percentage of Original Security	Expected Percentage of Performing Collateral	Current Lowest Rating	
(Dollars in thousands)									
Single issuer	n/a	1	\$300	\$ 268	\$ -	None	None		BB -
Single issuer	n/a	1	500	515	-	None	None		B +
Pooled issuer	B1	19	5,617	2,960	2,196	28.2 %	0.9 %		C
Pooled issuer	C1	19	3,645	2,025	1,542	25.6 %	0.0 %		C
Total			\$10,062	\$ 5,768	\$ 3,738				

(1) Represents deferrals/defaults as a percentage of the original security and expected deferrals/defaults as a percentage of performing issuers.

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REMIC and CMO:

The unrealized losses in Real Estate Mortgage Investment Conduit (“REMIC”) and CMO securities at March 31, 2012 consist of three issues from the Federal Home Loan Mortgage Corporation (“FHLMC”), one issue from the Federal National Mortgage Association (“FNMA”), one issue from Government National Mortgage Association (“GNMA”) and seven private issues.

The unrealized losses on the REMIC and CMO securities issued by FHLMC, FNMA and GNMA were caused by movements in interest rates. It is not anticipated that these securities would be settled at a price that is less than the amortized cost of the Company’s investment. Each of these securities is performing according to its terms and, in the opinion of management, will continue to perform according to its terms. The Company does not have the intent to sell these securities and it is more likely than not the Company will not be required to sell the securities before recovery of the securities amortized cost basis. This conclusion is based upon considering the Company’s cash and working capital requirements and contractual and regulatory obligations, none of which the Company believes would cause the sale of the securities. Therefore, the Company did not consider these investments to be other-than-temporarily impaired at March 31, 2012.

The unrealized losses at March 31, 2012 on REMIC and CMO securities issued by private issuers were caused by movements in interest rates, a significant widening of credit spreads across markets for these securities and illiquidity and uncertainty in the financial markets. Each of these securities has some level of credit enhancements and none are collateralized by sub-prime loans. Currently, three of these securities are performing according to their terms, with four of these securities remitting less than the full principal amount due. The principal loss for these four securities totaled \$0.4 million for the three months ended March 31, 2012. These losses were anticipated in the cumulative credit related OTTI charges recorded for these four securities.

Credit related impairment for mortgage-backed securities are determined for each security by estimating losses based on the following set of assumptions: (1) delinquency and foreclosure levels; (2) projected losses at various loss severity levels; and (3) credit enhancement and coverage. Based on these reviews, an OTTI charge was not recorded during the three months ended March 31, 2012.

It is not anticipated at this time that the seven private issue CMOs would be settled at a price that is less than the current amortized cost of the Company’s investment. The Company does not have the intent to sell these securities and it is more likely than not the Company will not be required to sell the securities before recovery of the securities amortized cost basis. This conclusion is based upon considering the Company’s cash and working capital requirements and contractual and regulatory obligations, none of which the Company believes would cause the sale of the securities. Therefore, the Company did not consider these investments to be other-than-temporarily impaired at March 31, 2012.

At March 31, 2012, the Company held 16 private issue CMOs which had a current credit rating of at least one rating below investment grade. Six of those issues are carried under the fair value option and therefore, changes in fair value are included in the Consolidated Statement of Income – Net gain (loss) from fair value adjustments.

The following table details the remaining 10 private issue CMOs that were evaluated to determine if they were other-than-temporarily impaired at March 31, 2012:

											Collateral Location				
Security	Amortized		Fair Value	Outstanding Principal	Cumulative OTTI Charges Recorded	Year of Issuance	Maturity	Current Lowest Rating	CA	FL	VA	NY	NJ		
	Cost														
(Dollars in thousands)															
1	\$	11,611	\$	8,529	\$	12,774	\$	3,279	2006	05/25/36	D	44%	15%		
2		5,218		3,745		5,310		447	2006	08/19/36	D	54%			
3		5,193		4,167		5,658		954	2006	08/25/36	D	36%	15%		
4		3,936		3,428		4,468		657	2006	08/25/36	D	38%	13%	12%	
5		3,156		2,868		3,439		221	2006	03/25/36	CC	36%			
6		1,705		1,732		1,716		-	2005	12/25/35	B-	39%			
7		4,781		3,193		5,057		222	2006	05/25/36	CC	27%	19%	10%	11%
8		884		892		892		-	2006	08/25/36	CCC	29%			
9		1,348		1,366		1,367		-	2005	11/25/35	B-	40%	17%		
10		1,162		1,153		1,164		-	2005	11/25/35	CC	46%	10%		
Total	\$	38,994	\$	31,073	\$	41,845	\$	5,780							

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FNMA:

The unrealized losses in FNMA securities at March 31, 2012 consist of losses on one FNMA security. The unrealized losses were caused by movements in interest rates. It is not anticipated that these securities would be settled at a price that is less than the amortized cost of the Company's investment. Each of these securities is performing according to its terms, and, in the opinion of management, will continue to perform according to its terms. The Company does not have the intent to sell these securities and it is more likely than not the Company will not be required to sell the securities before recovery of the securities amortized cost basis. This conclusion is based upon considering the Company's cash and working capital requirements, and contractual and regulatory obligations, none of which the Company believes would cause the sale of the securities. Therefore, the Company did not consider these investments to be other-than-temporarily impaired at March 31, 2012.

The following table details gross unrealized losses recorded in AOCI and the ending credit loss amount on debt securities, as of March 31, 2012, for which the Company has recorded a credit related OTTI charge in the Consolidated Statements of Income:

(in thousands)	Amortized Cost	Fair Value	Gross Unrealized Losses Recorded In AOCI	Cumulative Credit OTTI Losses
Private issued CMO's (1)	\$ 33,895	\$ 25,929	\$ 7,966	\$ 2,740
Trust preferred securities (1)	9,262	4,985	4,277	3,738
Total	\$ 43,157	\$ 30,914	\$ 12,243	\$ 6,478

- (1) The Company has recorded OTTI charges in the Consolidated Statements of Income on six private issue CMOs and two pooled trust preferred securities for which a portion of the OTTI is currently recorded in AOCI.

The following table represents the activity related to the credit loss component recognized in earnings on debt securities held by the Company for which a portion of OTTI was recognized in AOCI for the period indicated:

(in thousands)	For the three months ended March 31, 2012
Beginning balance	\$ 6,922
Recognition of actual losses	(444)
OTTI charges due to credit loss recorded in earnings	-
Securities sold during the period	-
Securities where there is an intent to sell or requirement to sell	-
Ending balance	\$ 6,478

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The following table details the amortized cost and estimated fair value of the Company's securities classified as available for sale at March 31, 2012, by contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value (In thousands)
Due in one year or less	\$34,369	\$ 34,412
Due after one year through five years	25,857	26,487
Due after five years through ten years	31,620	32,058
Due after ten years	75,853	70,803
Total other securities	167,699	163,760
Mortgage-backed securities	706,955	733,873
Total securities available for sale	\$874,654	\$ 897,633

The following table summarizes the Company's portfolio of securities available for sale at December 31, 2011:

	Amortized Cost	Fair Value (In thousands)	Gross Unrealized Gains	Gross Unrealized Losses
U.S. government agencies	\$ 1,980	\$2,039	\$ 59	\$ -
Corporate	20,777	20,592	-	185
Municipals	4,534	4,532	-	2
Mutual funds	21,369	21,369	-	-
Other	22,023	16,710	9	5,322
Total other securities	70,683	65,242	68	5,509
REMIC and CMO	460,824	473,639	22,796	9,981
GNMA	62,040	67,632	5,592	-
FNMA	175,627	182,630	7,003	-
FHLMC	22,556	23,387	831	-
Total mortgage-backed securities	721,047	747,288	36,222	9,981
Total securities available for sale	\$ 791,730	\$812,530	\$ 36,290	\$ 15,490

Mortgage-backed securities shown in the table above include two private issue CMO that are collateralized by commercial real estate mortgages with amortized cost and market values of \$19.0 million and \$19.2 million, respectively, at December 31, 2011. The remaining private issue mortgage-backed securities are backed by one-to-four family residential mortgage loans.

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The following table shows the Company's available for sale securities with gross unrealized losses and their fair value, aggregated by category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2011.

	Fair Value	Total Unrealized Losses	Fair Value	Less than 12 months Unrealized Losses	12 months or more Fair Value	12 months or more Unrealized Losses
			(In thousands)			
Corporate	\$17,980	\$ 185	\$17,980	\$ 185	\$-	\$ -
Municipals	1,997	2	1,997	2	-	-
Other	4,241	5,322	-	-	4,241	5,322
Total other securities	24,218	5,509	19,977	187	4,241	5,322
REMIC and CMO	38,684	9,981	12,560	124	26,124	9,857
Total securities available for sale	\$62,902	\$ 15,490	\$32,537	\$ 311	\$30,365	\$ 15,179

5. Loans

Loans are reported at their outstanding principal balance, net of any unearned income, charge-offs, deferred loan fees and costs on originated loans and unamortized premiums or discounts on purchased loans. Interest on loans is recognized on the accrual basis. The accrual of income on loans is generally discontinued when certain factors, such as contractual delinquency of 90 days or more, indicate reasonable doubt as to the timely collectability of such income. Uncollected interest previously recognized on non-accrual loans is reversed from interest income at the time the loan is placed on non-accrual status. A non-accrual loan can be returned to accrual status when contractual delinquency returns to less than 90 days delinquent. Subsequent cash payments received on non-accrual loans that do not bring the loan to less than 90 days delinquent are recorded on a cash basis. Subsequent cash payments can also be applied first as a reduction of principal until all principal is recovered and then subsequently to interest, if in management's opinion, it is evident that recovery of all principal due is unlikely to occur. Net loan origination costs and premiums or discounts on loans purchased are amortized into interest income over the contractual life of the loans using the level-yield method. Prepayment penalties received on loans which pay in full prior to their scheduled maturity are included in interest income in the period they are collected.

The Company maintains an allowance for loan losses at an amount, which, in management's judgment, is adequate to absorb probable estimated losses inherent in the loan portfolio. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revisions as more information becomes available. In assessing the adequacy of the Company's allowance for loan losses, management considers various factors such as, the current fair value of collateral for collateral dependent loans, the Company's historical loss experience, recent trends in losses, collection policies and collection experience, trends in the volume of non-performing and classified loans, changes in the composition and volume of the gross loan portfolio and local and national economic conditions. The Company's Board of Directors (the "Board of Directors") reviews and approves management's evaluation of the adequacy of the allowance for loan losses on a quarterly basis.

The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Increases and decreases in the allowance for loan losses other than charge-offs and recoveries are included in the

provision for loan losses. When a loan or a portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance.

The Company recognizes a loan as non-performing when the borrower has indicated the inability to bring the loan current, or due to other circumstances which, in our opinion, indicate the borrower will be unable to bring the loan current within a reasonable time. All loans classified as non-performing, which includes all loans past due 90 days or more, are classified as non-accrual unless there is, in our opinion, compelling evidence the borrower will bring the loan current in the immediate future. Appraisals and/or updated internal evaluations are obtained as soon as practical and before the loan become 90 days delinquent. The loan balances of collateral dependant impaired loans are compared to the loan's updated fair value. The balance which exceeds fair value is generally charged-off. Management reviews the allowance for loan losses on a quarterly basis and records as a provision the amount deemed appropriate, after considering current year charge-offs, charge-off trends, new loan production, current balance by particular loan categories and delinquent loans by particular loan categories.

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A loan is considered impaired when, based upon the most current information, the Company believes it is probable that it will be unable to collect all amounts due, both principal and interest, according to the contractual terms of the loan. Impaired loans are measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate, or at the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. Interest income on impaired loans is recorded on a cash basis. The Company's management considers all non-accrual loans impaired.

The Company reviews each impaired loan to determine if a charge-off is to be recorded or if a valuation allowance is to be allocated to the loan. The Company does not allocate a valuation allowance to loans for which we have concluded the current value of the underlying collateral will allow for recovery of the loan balance either through the sale of the loan or by foreclosure and sale of the property.

The Company evaluates the underlying collateral through a third party appraisal, or when a third party appraisal is not available, the Company will use an internal evaluation. The internal evaluations are performed using an income approach or a sales approach. The income approach is used for income producing properties and uses current revenues less operating expenses to determine the net cash flow of the property. Once the net cash flow is determined, the value of the property is calculated using an appropriate capitalization rate for the property. The sales approach uses comparable sales prices in the market. When an internal evaluation is used, we place greater reliance on the income approach to value the collateral.

In preparing internal evaluations of property values, the Company seeks to obtain current data on the subject property from various sources, including: (1) the borrower; (2) copies of existing leases; (3) local real estate brokers and appraisers; (4) public records (such as for real estate taxes and water and sewer charges); (5) comparable sales and rental data in the market; (6) an inspection of the property; and (7) interviews with tenants. These internal evaluations primarily focus on the income approach and comparable sales data to value the property.

As of March 31, 2012, the Company utilized recent third party appraisals of the collateral to measure impairment for \$143.1 million, or 75.5%, of collateral dependent impaired loans and used internal evaluations of the property's value for \$46.4 million, or 24.5%, of collateral dependent impaired loans.

The Company may restructure a loan to enable a borrower to continue making payments when it is deemed to be in the Company's best long-term interest. This restructure may include reducing the interest rate or amount of the monthly payment for a specified period of time, after which the interest rate and repayment terms revert to the original terms of the loan. We classify these loans as Troubled Debt Restructured ("TDR") when the Savings Bank grants a concession to a borrower who is experiencing financial difficulties.

These restructurings have not included a reduction of principal balance. The Company believes that restructuring these loans in this manner will allow certain borrowers to become and remain current on their loans. All loans classified as TDR are considered impaired, however TDR loans which have been current for six consecutive months at the time they are restructured as TDR remain on accrual status and are not included as part of non-performing loans. Loans which were delinquent at the time they are restructured as a TDR are placed on non-accrual status and reported as non-performing loans until they have made timely payments for six consecutive months. Loans that are restructured as TDR but are not performing in accordance with the restructured terms are placed on non-accrual status and reported as non-performing loans.