

Flushing Financial Corporation



thriving

▶ Flushing Financial Corporation, a Delaware corporation, was formed in May 1994 to serve as the holding company for Flushing Savings Bank, FSB, a federally chartered, FDIC-insured savings institution originally organized in 1929.

▶ The Bank is a customer-oriented, full-service community bank primarily engaged in attracting deposits from residents and businesses in the local communities of Queens, Nassau, Brooklyn, the Bronx and Manhattan and investing such deposits and other available funds primarily in originations of multi-family mortgage loans, commercial real estate loans and one-to-four family residential loans.

▶ Flushing Financial Corporation's common stock is publicly traded on the Nasdaq National Market® under the symbol "FFIC."

▶ Additional information on Flushing Financial Corporation may be obtained by visiting the Company's web site at <http://www.flushingsavings.com>.

▶ FINANCIAL HIGHLIGHTS

At or for the year ended December 31,

2002 2001

(Dollars in thousands, except per share data)

▶ Selected Financial Data

Total assets	\$1,652,958	\$1,487,529
Loans receivable, net	1,169,560	1,067,197
Securities available for sale	358,984	305,539
Certificate of deposit accounts	543,330	467,172
Other deposit accounts.....	468,495	361,410
Stockholders' equity	131,386	133,387
Dividends paid per common share.....	\$ 0.36	\$ 0.31
Book value per share	\$ 10.43	\$ 9.89

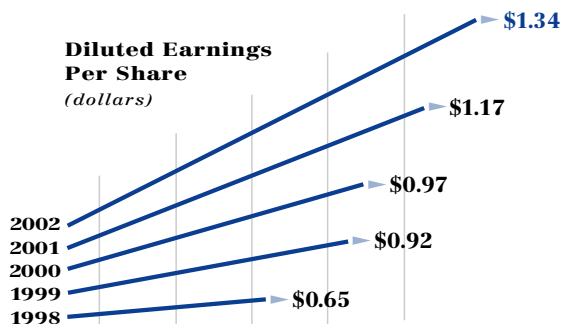
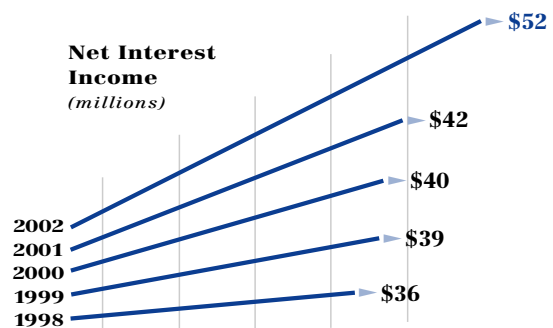
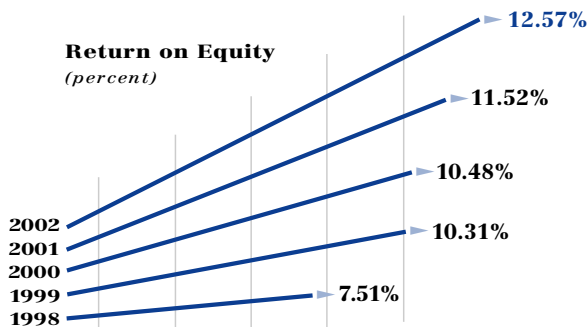
▶ Selected Operating Data

Net interest income	\$ 52,342	\$ 42,197
Net income ⁽¹⁾	16,263	14,929
Basic earnings per share ⁽¹⁾	\$ 1.40	\$ 1.22
Diluted earnings per share ⁽¹⁾	\$ 1.34	\$ 1.17

▶ Financial Ratios

Return on average assets ⁽¹⁾	1.03%	1.06%
Return on average equity ⁽¹⁾	12.57	11.52
Net interest spread	3.32	2.89
Interest rate margin	3.55	3.20
Efficiency ratio	47.41	50.06
Equity to total assets	7.95	8.97
Non-performing assets to total assets.....	0.26	0.16
Allowance for possible loan losses to gross loans	0.56	0.61
Allowance for possible loan losses to non-performing loans.....	183.23	283.85

(1) Excluding the \$2.6 million after-tax impairment charge for a WorldCom, Inc. senior note recorded during the second quarter of 2002, these amounts would have been as follows: net income \$18,843, basic earnings per share \$1.62, diluted earnings per share \$1.56, return on average assets 1.20%, return on average equity 14.56%.



▶ TO OUR SHAREHOLDERS

thriving

IN OUR MARKETS



Michael J. Hegarty

Michael J. Hegarty
President and Chief Executive Officer

We are pleased to report that 2002 was another outstanding year for Flushing Financial Corporation. The strategic initiatives that we began carefully implementing in 2001 have culminated in the strongest financial performance in our history as a public company. We believe we are attaining the goals we set out to accomplish and consider ourselves well positioned for the future.

In addition to generating record earnings of \$1.34 per diluted share, up 14.5% from \$1.17 a year earlier, our assets surpassed \$1.65 billion and stockholders' equity ended the year at a level to support continued growth in the future. Return on average equity increased to 12.57%. In the environment of economic uncertainty and sustained low interest rates that prevailed during 2002, we produced significant increases in net interest margin and grew our balance sheet, while continuing to maintain strong asset quality.

But those numbers do not tell the full story of our operating success for 2002. Our results were negatively influenced by a \$2.6 million after-tax writedown of a WorldCom senior note. Excluding that one-time event, earnings per diluted share would have been \$1.56, up 33% from the prior year and return on average equity would have reached 14.6%. Underpinning our strong results was a focus on the continued implementation of key objectives of our strategic plan, and concentration on our core businesses of retail banking and real estate lending.

Our retail banking business hit a milestone in 2002, as deposits exceeded the \$1 billion mark, including more than 30% growth in core deposits. Our customer base continued to grow as more local families and businesses across our multi-ethnic market chose Flushing for their banking needs. Customers who have been with us continued to show their loyalty as average household balances grew throughout the year.

Lower interest rates and high refinance activity made 2002 a very active and challenging lending year. In our view, our strategy of diversifying our lending to emphasize higher yields worked extremely well. As single-family mortgages were refinancing at lower rates, we remained true to our strategic plan and focused on higher yielding lending niches. Average loan yields remained strong throughout the declining rate environment. In addition to increased income from loan volume and yields, the brisk business done in loans throughout the year brought in a substantial increase in loan related fees.

Our sales and service culture continued to mature as we completed our first full year of incentive based pay, tied to strategic goals and profitability. Our people responded well to these incentives that reinforced customer-friendly behaviors and enhanced financial results. Customers, we believe, responded to our more motivated and knowledgeable staff.

Ever mindful of you, the shareholder, we completed our 9th and 10th share repurchase programs, buying back more than one million shares during the year to increase the value of your outstanding shares. Late in the year we announced our 11th program to repurchase 630,000 shares. We increased our quarterly dividend to \$0.09 per common share—for an annual rate of \$0.36, making 26 straight quarters of uninterrupted dividend payments.

In our opinion, we successfully met the challenges of 2002 and emerged a stronger, more profitable institution. As we face a year of continued economic uncertainty, we are confident that we have the strategy, the management and the people to meet the new challenges ahead.

We wish to acknowledge the commitment and dedication of Robert A. Marani, a Director of

Flushing for the past 25 years, who has chosen not to stand for re-election to the Board at this year's annual meeting. On a personal note, we and all who have worked with Bob will miss his great generosity, dependability and vision. We have been fortunate to benefit from his expertise and friendship. We wish him well.

In closing, we would like to thank our Board of Directors for their commitment and guidance, our customers for their continued allegiance, and our employees for their exceptional contributions to our remarkable story. We would also like to thank our shareholders for their confidence and investment in our future.



Gerard P. Tully, Sr.
Chairman of the Board

▶ PRESERVING LOAN YIELD

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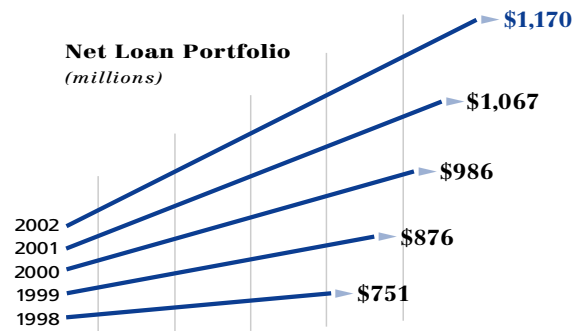
IN LENDING



We focused on higher margin niche products—multi-family, mixed use and commercial real estate mortgages.

▶ The bank's lending businesses emerged stronger than ever in 2002. Originations for the first time topped the \$300 million mark, although this increase was partially offset by amortization and satisfactions, resulting in net loan growth of over \$100 million. Our core multi-family real estate mortgage business led the way with robust support from mixed-use one-to-four family real estate mortgages and commercial real estate mortgages. Preserving loan yield was the real story. Despite a significantly lower rate environment, our average loan yields dropped only 10 basis points. We accomplished this by focusing on higher margin niche products where our lenders had significant experience and knowledge. Results for our key niche product—mixed-use one-to-four family property loans—were particularly strong as we built upon last year's changes in sales processes and marketing to increase loan originations in this category. Not only did we increase loan volume, we also gained market share vs. our competition.

During the year, we added to our talent pool of experienced loan officers and processing staff as our business expanded. We restructured our loan processing area and introduced new systems to better serve our growing customer base. While our lending operations grew, we remained true to our longstanding focus on quality of underwriting. Loan delinquencies remained minimal and charge-offs were negligible despite a lackluster economy.



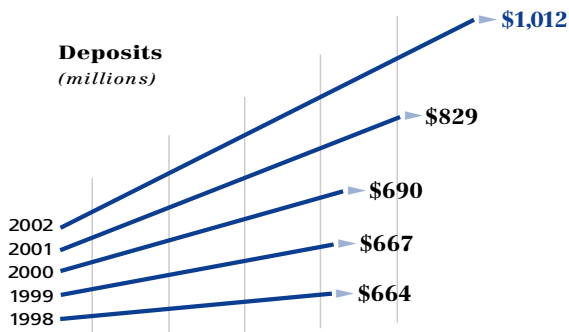
▶ PERSONALIZED BANKING SERVICES

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IN RETAIL BANKING

▶ It was a banner year for our retail banking business. We grew deposits over \$180 million and exceeded last year's record deposit growth by 34%. We not only hit a milestone \$1 billion in deposits, but we did it while making substantial improvements in our approach to the business. Our retail banking staff in 2002 was, in our view, better trained, better motivated and better supported than in 2001. A competitive profitability-based compensation structure was introduced and provided our branch network with the added incentive to grow and deepen customer relationships. In addition, our lending operation led an effort to cross-sell loan customers on full banking relationships. We grew deposit share in every one of our branch markets and reinforced to our staff and our competitors the strength of our approach to personalized banking services delivered through a more thorough understanding of customer needs.

Furthermore, we introduced several new services in 2002 including Internet banking and a debit card, both of which have been very well received. We enhanced our ability to offer investment products by training and licensing the majority of our sales staff. We refined our direct mail capabilities using a more targeted approach resulting in a more positive customer response to our marketing messages.





We hit a milestone \$1 billion in deposits—our retail banking staff was better trained, better motivated and better supported.

▶ A WELL - CAPITALIZED INSTITUTION

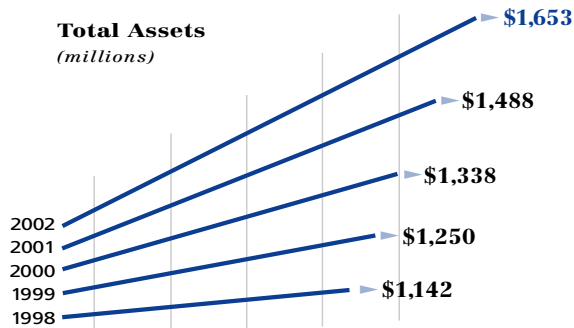
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IN THE FUTURE

▶ Throughout our history, we have been, and intend to remain, a strongly capitalized bank. During 2002, the low interest rate environment enabled us to enhance our capital position through the issuance of \$20 million of floating rate capital securities in anticipation of continued investment in our future. In 2003, we plan to open a new modern banking facility, in a bustling market of almost a billion dollars in deposits in Northern Queens. In the coming years we will continue to evaluate new opportunities for expansion of our retail banking business.

In 2002, we embarked upon a review of our technology infrastructure. As a result, work has already begun on modernizing the branch, back office and administrative communications network to more rapidly exchange information and respond to customers and changing market conditions. We expect to substantially complete that effort in 2003. In the coming months, we plan to upgrade our branch teller and customer service systems to put better customer information on the desktops of our most important asset—our customer contact staff. We are still in the early stages of our development of a strong core deposit business and the reshaping of our loan business. Continued focus on staff and managerial training and development will, we believe, help support the necessary growth in both of these areas.

Most importantly, we are committed to growing our business in a manner that serves our customers in an exemplary fashion while providing strong returns for our shareholders. We expect to accomplish this, as we have done since 1929, by offering valuable banking services, controlling our costs, managing our capital effectively and growing our asset base in a prudent manner.



We are committed to growing our business in a manner that serves our customers in an exemplary fashion while providing strong returns for our shareholders.

▶ SELECTED FINANCIAL DATA

<i>At or for the year ended December 31,</i>	2002	2001	2000	1999	1998
	<i>(Dollars in thousands, except per share data)</i>				
▶ Selected Financial Condition Data					
Total assets.....	\$1,652,958	\$1,487,529	\$1,338,092	\$1,249,529	\$1,142,055
Loans, net.....	1,169,560	1,067,197	986,359	875,886	750,555
Securities available for sale.....	358,984	305,539	255,220	285,016	326,690
Real estate owned, net.....	—	93	44	368	77
Deposits.....	1,011,825	828,582	689,811	666,941	664,059
Borrowed funds.....	493,164	513,435	508,839	451,831	335,458
Stockholders' equity.....	131,386	133,387	126,737	118,176	132,087
Book value per share ^{(1) (2)}	\$ 10.43	\$ 9.89	\$ 9.11	\$ 8.10	\$ 8.08
▶ Selected Operating Data					
Interest and dividend income.....	\$ 106,906	\$ 101,899	\$ 96,941	\$ 87,143	\$ 82,846
Interest expense.....	54,564	59,702	57,048	47,795	46,702
Net interest income.....	52,342	42,197	39,893	39,348	36,144
Provision for loan losses.....	—	—	—	36	214
Net interest income after provision for loan losses.....	52,342	42,197	39,893	39,312	35,930
Non-interest income:					
Net gains (losses) on sales of securities and loans.....	(4,158)	321	(651)	252	368
Other income.....	5,667	5,737	4,509	3,622	2,927
Total non-interest income.....	1,509	6,058	3,858	3,874	3,295
Non-interest expense.....	27,621	24,457	23,797	22,646	23,023
Income before income tax provision.....	26,230	23,798	19,954	20,540	16,202
Income tax provision.....	9,967	8,869	7,532	7,805	6,012
Net income.....	\$ 16,263	\$ 14,929	\$ 12,422	\$ 12,735	\$ 10,190
Basic earnings per share ^{(2) (3)}	\$ 1.40	\$ 1.22	\$ 0.99	\$ 0.94	\$ 0.67
Diluted earnings per share ^{(2) (3)}	\$ 1.34	\$ 1.17	\$ 0.97	\$ 0.92	\$ 0.65
Dividends declared per share ⁽²⁾	\$ 0.36	\$ 0.31	\$ 0.27	\$ 0.21	\$ 0.15
Dividend payout ratio.....	25.7%	25.4%	27.3%	22.3%	22.3%

Continued

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▶ SELECTED FINANCIAL DATA (continued)

At or for the year ended December 31,	2002	2001	2000	1999	1998
▶ Selected Financial Ratios and Other Data					
Performance ratios:					
Return on average assets	1.03%	1.06%	0.96%	1.08%	0.92%
Return on average equity	12.57	11.52	10.48	10.31	7.51
Average equity to average assets	8.22	9.19	9.18	10.49	12.24
Equity to total assets	7.95	8.97	9.47	9.46	11.57
Interest rate spread	3.32	2.89	2.87	3.05	2.88
Net interest margin	3.55	3.20	3.24	3.49	3.43
Non-interest expense to average assets	1.76	1.74	1.84	1.92	2.08
Efficiency ratio.....	47.41	50.06	53.07	51.54	53.44
Average interest-earning assets to average interest-bearing liabilities ...	1.06x	1.07x	1.08x	1.11x	1.12x
Regulatory capital ratios ⁽⁴⁾ :					
Tangible capital	7.74%	7.32%	8.02%	8.28%	9.46%
Core capital	7.74	7.32	8.02	8.28	9.46
Total risk-based capital	14.27	13.58	15.77	16.33	19.43
Asset quality ratios:					
Non-performing loans to gross loans ⁽⁵⁾	0.31%	0.22%	0.16%	0.36%	0.34%
Non-performing assets to total assets ⁽⁶⁾	0.26	0.16	0.12	0.29	0.23
Net charge-offs (recoveries) to average loans	—	0.01	0.01	—	(0.01)
Allowance for loan losses to gross loans	0.56	0.61	0.68	0.77	0.89
Allowance for loan losses to total non-performing assets ⁽⁶⁾	153.34	272.94	404.28	191.29	252.83
Allowance for loan losses to total non-performing loans ⁽⁵⁾	183.23	283.85	415.32	213.29	260.36
Full-service customer facilities.....	10	10	10	9	8

(1) Calculated by dividing stockholders' equity of \$131.4 million and \$133.4 million at December 31, 2002 and 2001, respectively, by 12,598,343 and 13,487,784 shares outstanding at December 31, 2002 and 2001, respectively.

(2) All per share data has been adjusted for the three-for-two stock split distributed on August 30, 2001 in the form of a stock dividend.

(3) The shares held in the Company's Employee Benefit Trust are not included in shares outstanding for purposes of calculating earnings per share. Unvested restricted stock awards are not included in basic earnings per share calculations, but are included in diluted earnings per share calculations.

(4) The Bank exceeded all minimum regulatory capital requirements during the periods presented.

(5) Non-performing loans consist of non-accrual loans and loans delinquent 90 days or more that are still accruing.

(6) Non-performing assets consist of non-performing loans, real estate owned and non-performing investment securities.

▶ MARKET PRICE OF COMMON STOCK

Flushing Financial Corporation Common Stock is traded on the Nasdaq National Market® under the symbol "FFIC." As of December 31, 2002 the Company had approximately 750 shareholders of record, not including the number of persons or entities holding stock in nominee or street name through various brokers and banks. The Company's stock closed at \$16.38 on December 31, 2002. The following table shows the high and low sales price of the Common Stock during the periods indicated. Such prices do not necessarily reflect retail markups, markdowns or commissions. All price and dividend information has been adjusted for the three-for-two stock split distributed on August 30, 2001 in the form of a stock dividend. See Note 12 of Notes to Consolidated Financial Statements for dividend restrictions.

	2002			2001		
	High	Low	Dividend	High	Low	Dividend
First Quarter.....	\$18.08	\$15.95	\$0.090	\$12.54	\$11.00	\$0.073
Second Quarter.....	20.83	16.45	0.090	16.20	12.17	0.073
Third Quarter	20.84	16.00	0.090	17.00	13.71	0.080
Fourth Quarter.....	18.52	14.85	0.090	18.96	15.44	0.080

▶ MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

▶ GENERAL

Flushing Financial Corporation ("Holding Company") is the parent holding company for Flushing Savings Bank, FSB ("Bank"), a federally chartered stock savings bank. The Holding Company also owns a special purpose business trust, Flushing Financial Capital Trust I ("Trust"). The following discussion of financial condition and results of operations includes the collective results of the Holding Company, the Trust and the Bank (collectively the "Company"), but reflects principally the Bank's activities.

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

The Company's results of operations depend primarily on net interest income, which is the difference between the interest income earned on its loan and investment portfolios, and its cost of funds, consisting primarily of interest paid on deposit accounts and borrowed funds. Net interest income is the result of the Company's interest rate margin, which is the difference between the average yield earned on interest-earning assets and the average cost of interest-bearing liabilities, and the average balance of interest-earning assets compared to the average balance of interest-bearing liabilities. The Company also generates non-interest income from loan fees, service charges on deposit accounts, mortgage servicing fees, late charges and other fees, income earned on Bank Owned Life Insurance ("BOLI"), dividends on Federal Home Bank of NY ("FHLB-NY") stock and net gains and losses on sales of securities and loans. The Company's operating expenses consist principally of employee compensation and benefits, occupancy and equipment costs, other general and administrative expenses and income tax expense. The Company's results of operations also can be significantly affected by its periodic provision for loan losses and specific provision

for losses on real estate owned. Such results also are significantly affected by general economic and competitive conditions, including changes in market interest rates, the strength of the local economy, government policies and actions of regulatory authorities.

In September 2000, the Bank sold certain lower-yielding mortgage-backed securities and invested the proceeds in \$20.0 million of BOLI. The purchase of BOLI, with its tax-advantaged earnings and other benefits, allows the Company to fund a substantial portion of the Company's employee benefit costs.

During the fourth quarter of 2001, the Bank began to: (1) expand its business loan and deposit products, (2) increase its focus on the investment products it offers, and (3) plan for the anticipated introduction in 2002 of a debit card and Internet banking. This effort continued into 2002, as the Bank continued to explore new products that will help it continue to be the provider of choice for existing customers and help attract new customers. The debit card and Internet banking were introduced in 2002.

During the third quarter of 2002, the Holding Company issued \$20.0 million of floating rate capital securities through the Trust, a newly created special purpose business trust formed by the Holding Company. The capital securities have a maturity date of October 7, 2032, are callable at par in five years and every quarter thereafter, and pay cumulative cash distributions at a floating per annum rate of interest, reset quarterly, equal to 3.65% over 3-month LIBOR, with an initial rate of 5.51387%. A rate cap of 12.50% is effective through October 7, 2007. The rate at December 31, 2002 was 5.425%.

As part of the Company's strategy to find ways to best utilize its available capital, during 2002 Flushing Financial Corporation continued its stock repurchase programs by repurchasing 1,202,450 shares of its common stock. The total number of treasury shares, at December 31, 2002 is 1,253,720 and the total number of outstanding common shares is 12,598,343. At December 31, 2002, 630,000 shares remain to be repurchased under the current stock repurchase program.

Statements contained in this Annual Report relating to plans, strategies, objectives, 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 the Private Securities Litigation Reform Act

▶ **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *(continued)*

of 1995, 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, the factors set forth in the third paragraph of this section, and under captions "Management Strategy" and "Other Trends and Contingencies" 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," "forecasts," "potential" 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. The Company has no obligation to update these forward-looking statements.

▶ **FLUSHING SAVINGS BANK, FSB**

The Bank was organized in 1929 as a New York State chartered mutual savings bank. On May 10, 1994, the Bank converted to a federally chartered mutual savings bank and changed its name from Flushing Savings Bank to Flushing Savings Bank, FSB. The Bank converted to a federally chartered stock savings bank in 1995. As a federal savings bank, the Bank's primary regulator is the Office of Thrift Supervision ("OTS"). The Bank's deposits are insured to the maximum allowable amount by the Federal Deposit Insurance Corporation ("FDIC"). The Bank owns three subsidiaries: (1) Flushing Preferred Funding Corporation ("FPFC")—a real estate investment trust; (2) Flushing Service Corporation ("FSC")—a service corporation which markets insurance products and mutual funds; and (3) FSB Properties, Inc.—a service corporation formed to manage certain real estate properties, which is currently inactive.

▶ **MANAGEMENT STRATEGY**

Management's strategy is to continue the Bank's focus as a consumer-oriented institution serving its local markets. In furtherance of this objective, the Company intends to (1) continue its emphasis on the origination of one-to-four family residential mortgage (focusing on mixed-use

properties), multi-family residential mortgage and commercial real estate mortgage loans, (2) maintain asset quality, (3) manage deposit growth and maintain a low cost of funds, (4) manage interest rate risk, and (5) explore new business opportunities. The Company has in the past increased growth through acquisitions of financial institutions and branches of other financial institutions, and will continue to pursue growth through acquisitions that are, or are expected to be within a reasonable time frame, accretive to earnings. The Company has also opened new branches. There can be no assurance that the Company will be able to effectively implement this strategy. The Company's strategy is subject to change by the Board of Directors.

One-to-Four Family, Multi-Family Real Estate and Commercial Real Estate Lending. The Company has traditionally emphasized the origination and acquisition of one-to-four family residential mortgage loans, which include mixed-use property mortgage loans, adjustable rate mortgage ("ARM") loans, fixed rate mortgage loans and home equity loans. Market interest rates on conventional one-to-four family residential mortgage loans declined to their lowest levels in almost 40 years during 2002. As a result, many borrowers sought to refinance their mortgages. The Company decided not to actively pursue this refinance market due to the low rates. The Company focused its origination efforts on higher yielding mixed-use property one-to-four family residential mortgage loans, multi-family residential mortgage loans and commercial real estate mortgage loans. The Company expects to continue this emphasis on the higher yielding mortgage loan products. During 2002, loan originations and purchases were \$19.4 million for conventional one-to-four family residential mortgage loans, \$71.9 million for mixed-use property one-to-four family residential mortgage loans, \$136.9 million for multi-family residential mortgage loans, \$73.1 million for commercial real estate loans and \$13.8 million for construction loans. At December 31, 2002, the Company's conventional one-to-four family residential mortgage loans, mixed-use property one-to-four family residential mortgage loans, multi-family residential mortgage loans and commercial real estate loans amounted to \$268.1 million (22.8%), \$170.5 million (14.5%), \$452.7 million (38.5%) and \$257.1 million (21.9%), respectively, of gross loans.

The Company seeks to increase its originations of mixed-use property one-to-four family residential mortgage, multi-family residential mortgage and commercial real estate mortgage loans through aggressive marketing and by maintaining competitive interest rates and origination fees. The Company's marketing efforts include frequent contacts with mortgage brokers and other professionals who serve as referral sources. From time-to-time, the Company may purchase loans from mortgage bankers and other financial institutions. Loans purchased by the Company comply with the Bank's underwriting standards.

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

Maintain Asset Quality. By adherence to its strict underwriting standards the Bank has been able to minimize net losses from impaired loans with net charge-offs of \$4,000 and \$136,000 for the years ended December 31, 2002 and 2001, respectively. The Company has maintained the strength of its loan portfolio, as evidenced by the Company's ratio of its allowance for loan losses to non-performing loans of 183.23% and 283.85% at December 31, 2002 and 2001, respectively. The Company seeks to maintain its loans in performing status through, among other things, strict collection efforts, and consistently monitors

non-performing assets in an effort to return them to performing status. To this end, management reviews the quality of loans and reports to the Loan Committee of the Board of Directors of the Bank on a monthly basis. From time to time, the Company has sold and may continue to make sales of non-performing assets. Non-performing assets amounted to \$4.3 million and \$2.4 million at December 31, 2002 and 2001, respectively. This increase in non-performing assets is primarily attributed to one borrower. None of the loan-to-value ratios for each of this borrower's three loans is greater than 65 percent. Therefore, management believes the Bank will recover its investment in these loans. Non-performing assets as a percentage of total assets were 0.26% and 0.16% at December 31, 2002 and 2001, respectively.

Managing Deposit Growth and Maintaining Low Cost of Funds. The Company has a relatively stable retail deposit base drawn from its market area through its ten full-service offices. Although the Company seeks to retain existing deposits and maintain depositor relationships by offering quality service and competitive interest rates to its customers, the Company seeks to keep deposit growth within reasonable limits and its strategic plan. Management intends to balance its goal to maintain competitive interest rates on deposits while seeking to manage its overall cost of funds to finance its strategies. Historically, the Company has relied on its deposit base as its principal source of funding. The Bank is also a member of the FHLB-NY, which provides it with an additional source of borrowing, which the Company has utilized to provide funding for asset growth which has increased net interest income. During 2002, the Company realized an increase in due to depositors of \$183.5 million and a reduction in borrowed funds of \$20.3 million.

Managing Interest Rate Risk. The Company seeks to manage its interest rate risk by actively reviewing the repricing and maturities of its interest rate sensitive assets and liabilities. The mix of loans originated by the Company (fixed or ARM) is determined in large part by borrowers' preferences and prevailing market conditions. The Company seeks to manage the interest rate risk of the loan portfolio by actively managing its security portfolio and borrowings.

▶ **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *(continued)*

By adjusting the mix of fixed and adjustable rate securities, as well as the maturities of the securities, the Company has the ability to manage the combined interest rate sensitivity of its assets. In order to maintain flexibility in managing the Company's interest rate sensitive assets, the majority of fixed rate residential mortgage loans originated by the Company in recent years were made in accordance with Federal National Mortgage Association requirements to facilitate sale in the secondary market. Additionally, the Company seeks to balance the interest rate sensitivity of its assets by managing the maturities of its liabilities.

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

Exploring New Business Opportunities. As part of the Company's strategy to expand its operations, the Bank opened a traditional branch in July 2000 on Kissena Boulevard in Flushing, Queens, and plans to open a traditional branch in Northern Queens in the second half of 2003.

During the second quarter of 1998, the Company launched Flushing Service Corporation, which began offering mutual funds, tax-deferred annuities and other investment products, expanding the services offered by the Bank. The Bank placed additional emphasis on the sale of these products in 2002 through the licensing of Bank employees, allowing them to sell certain of these products.

The Bank also established, in June 1998, a Business and Community Development Department. In the Company's demanding and constantly evolving marketplace, this office plays an active role in enhancing the Company's reputation as an essential player in the local economy, and expanding its participation in new business opportunities. In the fourth quarter of 2001, staffing was increased in this department, which has allowed the Bank to further expand these efforts.

During 2002, the Bank introduced a debit card and Internet banking, and continued to expand its business loan and deposit products. Management plans to continue reviewing the profitability potential of various new products to further expand the Company's product lines and market. These initiatives are designed to allow us to continue to be the provider of choice for our current customers and help attract new customers.

▶ **INTEREST RATE SENSITIVITY ANALYSIS**

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

The table below sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2002 which are anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown. Except as stated below, the amount of assets and liabilities shown which reprice or mature during a particular period was determined in accordance with the earlier of the term to repricing or the contractual terms of the asset or liability. Prepayment assumptions for mortgage loans, other loans and mortgage-backed securities are based on industry averages, which generally range from 6% to 40%. Passbook and Money Market accounts were assumed to have a withdrawal or "run-off" rate of 5%, based on historical experience. While management believes that these assumptions are indicative of actual prepayments and withdrawals experienced by the Company, there is no guarantee that these trends will continue in the future.

Interest Rate Sensitivity Gap Analysis at December 31, 2002							
	Three Months and Less	More Than Three Months to One Year	More Than One Year to Three Years	More Than Three Years to Five Years	More Than Five Years to Ten Years	More Than Ten Years	Total
<i>(Dollars in thousands)</i>							
Interest-Earning Assets							
Mortgage loans	\$ 23,947	\$ 108,442	\$390,626	\$442,711	\$150,357	\$ 50,109	\$1,166,192
Other loans.....	946	1,314	1,755	1,590	2,881	—	8,486
Short-term securities ⁽¹⁾	34,785	—	—	—	—	—	34,785
Securities available for sale:							
Mortgage-backed securities.....	33,686	87,178	112,687	58,093	25,202	2,409	319,255
Other.....	21,033	—	2,252	276	10,462	5,706	39,729
Total interest-earning assets.....	114,397	196,934	507,320	502,670	188,902	58,224	1,568,447
Interest-Bearing Liabilities							
Passbook accounts.....	2,670	8,010	19,782	17,854	37,384	127,872	213,572
NOW accounts	—	—	—	—	—	39,795	39,795
Money market accounts	2,125	6,375	15,749	14,214	29,762	101,804	170,029
Certificate of deposit accounts	97,460	161,083	197,647	78,958	8,182	—	543,330
Mortgagors' escrow deposits.....	—	—	—	—	—	9,812	9,812
Borrowed funds.....	75,000	95,000	114,900	113,000	95,264	—	493,164
Total interest-bearing liabilities ⁽²⁾	\$177,255	\$ 270,468	\$348,078	\$224,026	\$170,592	\$ 279,283	\$1,469,702
Interest rate sensitivity gap	\$ (62,858)	\$ (73,534)	\$159,242	\$278,644	\$ 18,310	\$(221,059)	\$ 98,745
Cumulative interest-rate sensitivity gap.....	\$ (62,858)	\$(136,392)	\$ 22,850	\$301,494	\$319,804	\$ 98,745	
Cumulative interest-rate sensitivity gap as a percentage of total assets.....	(3.80)%	(8.25)%	1.38%	18.24%	19.35%	5.97%	
Cumulative interest-earning assets as a percentage of cumulative interest- bearing liabilities.....	64.54%	69.54%	102.87%	129.56%	126.86%	106.72%	

(1) Consists of interest-earning deposits and federal funds sold.

(2) Does not include non-interest-bearing demand accounts totaling \$35.3 million at December 31, 2002.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar estimated maturities or periods to repricing, they may react in differing degrees to changes in market interest rates and may bear rates that differ in varying degrees from the rates that would apply upon maturity and reinvestment or upon repricing. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types

may lag behind changes in market rates. Additionally, certain assets, such as ARM loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a significant change in the level of interest rates, prepayments on loans and mortgage-backed securities, and deposit withdrawal or "run-off" levels, would likely deviate materially from those assumed in calculating the above table. In the event of an interest rate increase, some borrowers may be

▶ **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *(continued)*

unable to meet the increased payments on their adjustable-rate debt. The interest rate sensitivity analysis assumes that the nature of the Company's assets and liabilities remains static. Interest rates may have an effect on customer preferences for deposits and loan products. Finally, the maturity and repricing characteristics of many assets and liabilities as set forth in the above table are not governed by contract but rather by management's best judgment based on current market conditions and anticipated business strategies.

▶ **INTEREST RATE RISK**

The Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles, which requires the measurement of financial position and operating results in terms of historical dollars without considering the changes in fair value of certain investments due to changes in interest rates. Generally, the fair value of financial investments such as loans and securities fluctuates inversely with changes in interest rates. As a result, increases in interest rates could result in decreases in the fair value of the Company's interest-earning assets which could adversely affect the Company's results of operations if such assets were sold, or, in the case of securities classified as available for sale, decreases in the Company's stockholders' equity, if such securities were retained.

The Company manages the mix of interest-earning assets and interest-bearing liabilities on a continuous basis to maximize return and adjust its exposure to interest rate risk. On a quarterly basis, management prepares the "Earnings and Economic Exposure to Changes in Interest

Rate" report for review by the Board of Directors, as summarized below. This report quantifies the potential changes in net interest income and net portfolio value should interest rates go up or down (shocked) 300 basis points, assuming the yield curves of the rate shocks will be parallel to each other. The OTS currently places its focus on the net portfolio value ratio, focusing on a rate shock up or down of 200 basis points. The OTS uses the change in Net Portfolio Value Ratio to measure the interest rate sensitivity of the Company. Net portfolio value is defined as the market value of assets net of the market value of liabilities. The market value of assets and liabilities is determined using a discounted cash flow calculation. The net portfolio value ratio is the ratio of the net portfolio value to the market value of assets. All changes in income and value are measured as percentage changes from the projected net interest income and net portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at December 31, 2002. Various estimates regarding prepayment assumptions are made at each level of rate shock. Actual results could differ significantly from these estimates. At December 31, 2002, the Company is within the guidelines established by the Board of Directors for each interest rate level for Net Interest Income and Net Portfolio Value. The Company, however, does not meet the guideline established by the Board of Directors for the Net Portfolio Value Ratio for plus 300 basis points, which is 6.00%. This exception has been reviewed with the Board of Directors, who is monitoring the exception and considering the steps to be taken, if any, required to bring this exposure into compliance in the near term.

Change in Interest Rate	Projected Percentage Change In				Net Portfolio Value Ratio	
	Net Interest Income		Net Portfolio Value			
	2002	2001	2002	2001	2002	2001
-300 basis points.....	-0.09%	-4.72%	12.04%	-3.02%	9.48%	9.76%
-200 basis points.....	1.70	-1.11	4.84	-1.28	9.10	10.13
-100 basis points.....	1.15	0.17	2.29	1.97	9.09	10.65
Base interest rate.....	—	—	—	—	9.09	10.67
+100 basis points.....	-2.10	-2.63	-8.58	-14.47	8.55	9.42
+200 basis points.....	-5.39	-5.89	-25.42	-28.81	7.22	8.10
+300 basis points.....	-10.06	-9.29	-43.83	-43.21	5.64	6.68

▶ **ANALYSIS OF NET INTEREST INCOME**

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends upon the relative amount of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them.

The following table sets forth certain information relating to the Company's Consolidated Statements of Financial Condition and the Consolidated Statements of Income for the years ended December 31, 2002, 2001 and 2000, and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The yields include amortization of fees that are considered adjustments to yields.

	2002			2001			2000		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
<i>(Dollars in thousands)</i>									
Assets									
Interest-earning assets:									
Mortgage loans, net ^{(1) (2)}	\$1,118,016	\$ 89,978	8.05%	\$1,030,126	\$ 83,811	8.14%	\$ 936,222	\$76,094	8.13%
Other loans, net ^{(1) (2)}	7,293	523	7.17	6,405	558	8.71	6,681	686	10.27
Total loans, net	<u>1,125,309</u>	<u>90,501</u>	<u>8.04</u>	<u>1,036,531</u>	<u>84,369</u>	<u>8.14</u>	<u>942,903</u>	<u>76,780</u>	<u>8.14</u>
Mortgage-backed securities	247,733	13,342	5.39	228,681	14,938	6.53	261,903	18,304	6.99
Other securities	62,110	2,436	3.92	21,640	1,260	5.82	16,504	1,182	7.16
Total securities	<u>309,843</u>	<u>15,778</u>	<u>5.09</u>	<u>250,321</u>	<u>16,198</u>	<u>6.47</u>	<u>278,407</u>	<u>19,486</u>	<u>7.00</u>
Interest-earning deposits and federal funds sold	39,798	627	1.58	33,810	1,332	3.94	9,542	675	7.07
Total interest-earning assets	<u>1,474,950</u>	<u>106,906</u>	<u>7.25</u>	<u>1,320,662</u>	<u>101,899</u>	<u>7.72</u>	<u>1,230,852</u>	<u>96,941</u>	<u>7.88</u>
Other assets	98,201			88,237			60,344		
Total assets	<u>\$1,573,151</u>			<u>\$1,408,899</u>			<u>\$1,291,196</u>		
Liabilities and Equity									
Interest-bearing liabilities:									
Deposits:									
Passbook accounts	\$ 208,250	3,147	1.51	\$ 188,701	3,767	2.00	\$ 189,852	3,931	2.07
NOW accounts	36,054	321	0.89	30,736	504	1.64	27,838	530	1.90
Money market accounts	126,431	3,039	2.40	71,820	2,309	3.21	42,791	1,438	3.36
Certificate of deposit accounts	507,104	21,640	4.27	423,812	23,062	5.44	385,237	21,488	5.58
Total due to depositors	<u>877,839</u>	<u>28,147</u>	<u>3.21</u>	<u>715,069</u>	<u>29,642</u>	<u>4.15</u>	<u>645,718</u>	<u>27,387</u>	<u>4.24</u>
Mortgagors' escrow accounts	15,064	57	0.38	13,013	69	0.53	13,177	86	0.65
Total deposits	<u>892,903</u>	<u>28,204</u>	<u>3.16</u>	<u>728,082</u>	<u>29,711</u>	<u>4.08</u>	<u>658,895</u>	<u>27,473</u>	<u>4.17</u>
Other borrowed funds	496,964	26,360	5.30	508,434	29,991	5.90	478,675	29,575	6.18
Total interest-bearing liabilities	<u>1,389,867</u>	<u>54,564</u>	<u>3.93</u>	<u>1,236,516</u>	<u>59,702</u>	<u>4.83</u>	<u>1,137,570</u>	<u>57,048</u>	<u>5.01</u>
Other liabilities ⁽³⁾	53,905			42,845			35,073		
Total liabilities	<u>1,443,772</u>			<u>1,279,361</u>			<u>1,172,643</u>		
Equity	129,379			129,538			118,553		
Total liabilities and equity	<u>\$1,573,151</u>			<u>\$1,408,899</u>			<u>\$1,291,196</u>		
Net interest income/net interest rate spread ⁽⁴⁾		\$52,342	3.32%		\$ 42,197	2.89%		\$39,893	2.87%
Net interest-earning assets/net interest margin ⁽⁵⁾	\$ 85,083		3.55%	\$ 84,146		3.20%	\$ 93,282		3.24%
Ratio of interest-earning assets to interest-bearing liabilities			1.06x			1.07x			1.08x

(1) Average balances include non-accrual loans.

(2) Loan interest income includes loan fee income of approximately \$186,000, \$321,000 and \$555,000 for the years ended December 31, 2002, 2001 and 2000, respectively.

(3) Includes non-interest-bearing demand deposit accounts of \$29,827, \$23,200 and \$24,624 for the years ended December 31, 2002, 2001 and 2000, respectively.

(4) Interest rate spread represents the difference between the average rate on interest-earning assets and the average cost of interest-bearing liabilities.

(5) Net interest margin represents net interest income before the provision for loan losses divided by average interest-earning assets.

▶ **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *(continued)*

▶ **RATE/VOLUME ANALYSIS**

The following table presents the impact of changes in interest rates and in the volume of interest-earning assets and interest-bearing liabilities on the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (1) changes attributable to changes in volume (changes in volume multiplied by the prior rate), (2) changes attributable to changes in rate (changes in rate multiplied by the prior volume) and (3) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Increase (Decrease) in Net Interest Income					
	Year Ended December 31, 2002 Compared to Year Ended December 31, 2001			Year Ended December 31, 2001 Compared to Year Ended December 31, 2000		
	Due to			Due to		
	Volume	Rate	Net	Volume	Rate	Net
	<i>(Dollars in thousands)</i>					
Interest-Earning Assets						
Mortgage loans, net	\$ 7,101	\$ (934)	\$ 6,167	\$ 7,623	\$ 94	\$ 7,717
Other loans, net.....	71	(106)	(35)	(27)	(101)	(128)
Mortgage-backed securities	1,169	(2,765)	(1,596)	(2,216)	(1,150)	(3,366)
Other securities.....	1,701	(525)	1,176	195	(117)	78
Interest-earning deposits and federal funds sold	203	(908)	(705)	796	(139)	657
Total interest-earning assets	10,245	(5,238)	5,007	6,371	(1,413)	4,958
Interest-Bearing Liabilities						
Deposits:						
Passbook accounts.....	365	(985)	(620)	(25)	(139)	(164)
NOW accounts.....	76	(259)	(183)	84	(110)	(26)
Money market accounts	1,422	(692)	730	932	(61)	871
Certificate of deposit accounts.....	4,056	(5,478)	(1,422)	2,100	(526)	1,574
Mortgagors' escrow deposits	10	(22)	(12)	(1)	(16)	(17)
Other borrowed funds	(659)	(2,972)	(3,631)	1,533	(1,117)	416
Total interest-bearing liabilities	5,270	(10,408)	(5,138)	4,623	(1,969)	2,654
Net change in net interest income	\$ 4,975	\$ 5,170	\$ 10,145	\$ 1,748	\$ 556	\$ 2,304

▶ **COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001**

General. Diluted earnings per share increased 14.5% to \$1.34 for the year ended December 31, 2002 from \$1.17 for the year ended December 31, 2001. Net income increased \$1.4 million, or 8.9%, to \$16.3 million for the year ended December 31, 2002 from \$14.9 million for the year ended December 31, 2001. This was due to an increase in net interest income of \$10.1 million, partially offset by a decrease in non-interest income of \$4.6 million and an increase in non-interest expense of \$3.1 million. As a result of the increased net income before income taxes, there was a \$1.1 million increase in income tax expense. The decrease in non-interest income was primarily attributed to a \$4.4 million pre-tax impairment writedown of the Bank's investment in a WorldCom, Inc. senior note during the second quarter of 2002. Excluding this impairment writedown,

which on an after-tax basis was \$2.6 million, diluted earnings per share would have increased 33.3% to \$1.56 for the year ended December 31, 2002 from \$1.17 per share for the year ended December 31, 2001, and net income for the year ended December 31, 2002 would have increased 26.2% to \$18.8 million from \$14.9 million for the year ended December 31, 2001.

Return on average assets declined to 1.03% for the year ended December 31, 2002 from 1.06% for the year ended December 31, 2001, due to the increase in average assets. Return on average equity increased to 12.57% for the year ended December 31, 2002 from 11.52% for the year ended December 31, 2001. Excluding the above mentioned impairment writedown, return on average assets and return on average equity would have been 1.20% and 14.56%, respectively, for the year ended December 31, 2002.

Interest Income. Interest income increased \$5.0 million, or 4.9%, to \$106.9 million for the year ended December 31, 2002 from \$101.9 million for the year ended December 31, 2001. This increase is due to an increase of \$154.3 million in the average balance of interest-earning assets, partially offset by a 47 basis point decline in the yield on interest-earning assets to 7.25% for 2002. The increase in interest and fees on loans of \$6.1 million was partially offset by decreases in interest and dividends on investment securities and interest on interest-earning deposits and federal funds sold of \$0.4 million and \$0.7 million, respectively. The increase in interest and fee income from loans is due to an \$88.8 million increase in the average balance of loans to \$1.13 billion during the year ended December 31, 2002, which was partially offset by a decrease in the yield of 10 basis points to 8.04% for the year ended December 31, 2002 from 8.14% for the year ended December 31, 2001. Our focus on the origination of higher yielding multi-family residential and commercial real estate mortgage loans, along with the origination of mixed-use property one-to-four family residential mortgage loans, allowed us to maintain a higher yield on our loan portfolio than we would have otherwise experienced, despite the declining interest rate environment experienced during 2002 and 2001. The decrease in interest and dividend income from investment securities is due to a 138 basis point decline in the yield to 5.09% for 2002 from 6.47% in 2001, partially offset by a \$59.5 million increase in the average balances of investment securities during 2002 to \$309.8 million. The decrease in interest on interest-earning deposits and federal funds sold is due to a 236 basis point decline in the yield to 1.58% for 2002 from 3.94% in 2001, partially offset by a \$6.0 million increase in the average balance of these items in 2002.

Interest Expense. Interest expense decreased \$5.1 million, or 8.6%, to \$54.6 million for the year ended December 31, 2002 from \$59.7 million for the year ended December 31, 2001. The decrease in interest expense is due to a 90 basis point decline in the cost of interest-bearing liabilities, partially offset by a \$153.4 million increase in the average balance of total interest-bearing liabilities to \$1.39 billion during 2002.

The average balance for due to depositors increased \$162.8 million to \$877.8 million for 2002. The cost of these deposits decreased 94 basis points to 3.21% during 2002,

as decreases in cost were seen in all categories of deposits due to the declining interest rate environment experienced during 2002 and 2001. The average balance for borrowed funds decreased \$11.4 million to \$497.0 million for 2002 from \$508.4 million for 2001. The cost of borrowed funds decreased 60 basis points to 5.30% during 2002.

Net Interest Income. Net interest income for the year ended December 31, 2002 totaled \$52.3 million, an increase of \$10.1 million from \$42.2 million for 2001. The net interest spread improved 43 basis points to 3.32% for 2002 from 2.89% in 2001, as the yield on interest-earning assets declined 47 basis points while the cost of interest-bearing liabilities declined 90 basis points. The net interest margin improved 35 basis points to 3.55% for the year ended December 31, 2002 from 3.20% for the year ended December 31, 2001.

Provision for Loan Losses. There was no provision for loan losses for the years ended December 31, 2002 and 2001. In assessing the adequacy of the Company's allowance for loan losses, management considers the Company's historical loss experience, recent trends in losses, collection policies and collection experience, trends in the volume of non-performing loans, changes in the composition and volume of the gross loan portfolio, and local and national economic conditions. Based on these reviews, no provision for loan losses was deemed necessary for the years ended December 31, 2002 and 2001. The ratio of non-performing loans to gross loans was 0.31% at December 31, 2002 compared to 0.22% at December 31, 2001. The allowance for loan losses as percentage of non-performing loans was 183.23% and 283.85% at December 31, 2002 and 2001, respectively. The ratio of allowance for loan losses to gross loans was 0.56% and 0.61% at December 31, 2002 and 2001, respectively. The Company experienced net charge-offs of \$4,000 and \$136,000 for the years ended December 31, 2002 and 2001, respectively.

Non-Interest Income. Non-interest income for the year ended December 31, 2002 decreased \$4.6 million, or 75.1%, to \$1.5 million from \$6.1 million for the year ended December 31, 2001. The decrease is primarily due to a \$4.4 million pretax impairment writedown of the Bank's investment in a WorldCom, Inc. senior note. In addition, higher income from loan fees and banking services were offset by reduced dividends on Federal Home Loan Bank of New York stock.

▶ **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *(continued)*

Non-Interest Expense. Non-interest expense for the year ended December 31, 2002 totaled \$27.6 million, representing an increase of \$3.1 million, or 12.9%, from the year ended December 31, 2001. The increase is primarily attributed to the Bank's continued focus on expanding its current product offerings to enhance its ability to serve its customers. During the fourth quarter of 2001, the Bank began increasing its staffing to provide additional services to its customers, and to process the increasing volume of loan applications. Additional staffing increases for these same purposes were made in 2002. The Bank also expanded its training program to provide its staff with the knowledge needed to expand into new services. Advertising and business promotions were also expanded in 2002 to better promote new and existing services. Management continues to closely monitor expenditures, resulting in an efficiency ratio of 47.4% for the year ended December 31, 2002 compared to 50.1% for 2001.

Income Tax Provisions. Income tax expense for the year ended December 31, 2002 totaled \$10.0 million, compared to \$8.9 million for the year ended December 31, 2000. This increase is primarily attributed to the increase of \$2.4 million in income before income taxes. The effective tax rate was 38.0% for the year ended December 31, 2002 compared to 37.3% for the year ended December 31, 2001.

▶ **COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2001 AND 2000**

General. Diluted earnings per share increased 20.6% to \$1.17 for the year ended December 31, 2001 from \$0.97 for the year ended December 31, 2000. Net income increased \$2.5 million, or 20.2%, to \$14.9 million for the year ended December 31, 2001 from \$12.4 million for the year ended December 31, 2000. This was due to increases in net interest income and non-interest income of \$2.3 million and \$2.2 million, respectively, partially offset by an increase in non-interest expense of \$0.7 million. As a result of the increased net income before income taxes, there was a \$1.3 million increase in income tax expense. The year ended December 31, 2000 included the sale of approximately \$20.7 million of mortgage-backed securities in September, which resulted in an after tax loss of \$445,000. Excluding this loss on sale of securities, net income for the year ended December 31, 2000 would have been \$12.9 million, or \$1.01 per diluted share.

Return on average assets increased to 1.06% for the year ended December 31, 2001 from 0.96% for the year ended December 31, 2000. Return on average equity increased to 11.52% for the year ended December 31, 2001 from 10.48% for the year ended December 31, 2000.

Interest Income. Interest income increased \$5.0 million, or 5.1%, to \$101.9 million for the year ended December 31, 2001 from \$96.9 million for the year ended December 31, 2000. This increase was due to an increase of \$89.8 million in the average balance of interest-earning assets, partially offset by a 16 basis point decline in the yield on interest-earning assets to 7.72% for 2001. Interest and fees on loans increased \$7.6 million while interest on interest-earning deposits and federal funds sold increased \$0.7 million. These increases were partially offset by a \$3.3 million decrease in interest and dividends on investment securities. The increase in interest and fee income from loans was due to a \$93.6 million increase in the average balance of loans to \$1.04 billion during the year ended December 31, 2001, as the yield of 8.14% remained unchanged for 2001 from 2000. Our focus on the origination of higher yielding multi-family residential and commercial real estate mortgage loans, along with the origination of mixed-use property one-to-four family residential mortgage loans, allowed us to maintain the yield on our loan portfolio despite the declining interest rate environment experienced during the year ended December 31, 2001. The increase in interest on interest-earning deposits and federal funds sold was due to a \$24.3 million increase in the average balance of these items, partially offset by a decline in the yield to 3.94% for 2001 from 7.07% for 2000. The decrease in interest and dividend income from investment securities reflected a \$28.1 million decrease in the average balances of investment securities during 2001 to \$250.3 million, combined with a 53 basis point decline in the yield on investment securities. The decrease in the average balance of investment securities was primarily due to the sale of mortgage-backed securities in the third quarter of 2000 and the reinvestment of the proceeds in BOLI. The investment in BOLI is included in Other Assets in the Consolidated Statements of Financial Condition, and the income earned on BOLI is included in Non-Interest Income in the Consolidated Statements of Income. The income on BOLI amounted to \$1.3 million for the year ended December 31, 2001 compared to \$0.4 million for the year ended December 31, 2000.

Interest Expense. Interest expense increased \$2.7 million, or 4.7%, to \$59.7 million for the year ended December 31, 2001 from \$57.0 million for the year ended December 31, 2000. The increase in interest expense was due to a \$98.9 million increase in the average balance of total interest-bearing liabilities during 2001, partially offset by an 18 basis point decline in the cost of interest-bearing liabilities.

The average balance for deposits increased \$69.2 million to \$728.1 million for 2001. The cost of deposits decreased nine basis points to 4.08% during 2001, as decreases in cost were seen in all categories of deposits in the declining interest rate environment experienced during the year. The average balance for borrowed funds increased \$29.7 million to \$508.4 million for 2001 from \$478.7 million for 2000. The cost of borrowed funds decreased 28 basis points to 5.90% during 2001.

Net Interest Income. Net interest income for the year ended December 31, 2001 totaled \$42.2 million, an increase of \$2.3 million from \$39.9 million for 2000. The net interest spread improved two basis points to 2.89% for 2001 from 2.87% in 2000, as the yield on interest-earning assets declined 16 basis points while the cost of interest-bearing liabilities declined 18 basis points. However, the net interest margin declined four basis points to 3.20% for the year ended December 31, 2001 from 3.24% for the year ended December 31, 2000. The decline in the net interest margin was primarily due to a decline in the amount by which interest-earning assets exceed interest-bearing liabilities. During 2001, average interest-earning assets exceeded average interest-bearing liabilities by \$84.2 million, a decline of \$9.1 million from the \$93.3 million during 2000. This decline was primarily due to the sale of mortgage-backed securities in September 2000 and the reinvestment of the proceeds in BOLI.

Provision for Loan Losses. There was no provision for loan losses for the years ended December 31, 2001 and 2000. The ratio of non-performing loans to gross loans was 0.22% at December 31, 2001 compared to 0.16% at December 31, 2000. The allowance for loan losses as percentage of non-performing loans was 283.85% and 415.32% at December 31, 2001 and 2000, respectively. The ratio of allowance for loan losses to gross loans was 0.61% and 0.68% at December 31, 2001 and 2000, respectively. The Company experienced net charge-offs of \$136,000 and \$97,000 for the years ended December 31, 2001 and 2000, respectively.

Non-Interest Income. Non-interest income for the year ended December 31, 2001 increased \$2.2 million, or 57.0%, to \$6.1 million from \$3.9 million for the year ended December 31, 2000. The increase was due to net gains on the sale of securities and loans of \$0.3 million for the year ended December 31, 2001 compared to net losses on sales of securities and loans of \$0.7 million in the year ended December 31, 2000, increased income earned on BOLI, and higher fee income from loan fees and banking services.

Non-Interest Expense. Non-interest expense for the year ended December 31, 2001 totaled \$24.5 million, representing an increase of \$0.7 million, or 2.8%, from the year ended December 31, 2000. The increase was primarily attributed to the full year impact of the expenses associated with the operations of the Kissena branch (opened in July 2000) and an increase in salaries and benefits and professional services (which includes advertising) in the fourth quarter of 2001 as the Bank focused on expanding its product offerings to enhance its ability to serve its customers. Management continued to closely monitor expenditures, resulting in an efficiency ratio of 50.1% for the year ended December 31, 2001 compared to 53.1% for 2000.

Income Tax Provisions. Income tax expense for the year ended December 31, 2001 totaled \$8.9 million, compared to \$7.5 million for the year ended December 31, 2000. This increase was primarily attributed to the increase of \$3.8 million in income before income taxes. The effective tax rate was 37.3% for the year ended December 31, 2001 compared to 37.7% for the year ended December 31, 2000.

▶ LIQUIDITY, REGULATORY CAPITAL AND CAPITAL RESOURCES

The Company's primary sources of funds are deposits, borrowings, 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. Deposit flows and mortgage prepayments, however, are greatly influenced by general interest rates, economic conditions and competition. At December 31, 2002, the Bank had an approved overnight line of credit of \$46.0 million with the FHLB-NY. In total, as of December 31, 2002, the Bank may borrow up to \$557.7 million from the FHLB-NY in Federal Home Loan advances and overnight lines of credit. As of December 31, 2002, the Bank had borrowed \$359.3 million in FHLB-NY advances. There

▶ **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *(continued)*

were no funds outstanding at December 31, 2002 under the overnight line of credit with the FHLB-NY. In addition, the Trust has \$20.0 million in capital securities (which are included in Borrowed Funds) and the Bank had \$113.9 million in repurchase agreements to fund lending and investment opportunities. (See Note 8 of Notes to Consolidated Financial Statements.)

The Company's most liquid assets are cash and cash equivalents, which include cash and due from banks, overnight interest-earning deposits and federal funds sold with original maturities of 90 days or less. The level of these assets is dependent on the Company's operating, financing, lending and investing activities during any given period. At December 31, 2002, cash and cash equivalents totaled \$47.6 million, an increase of \$9.1 million from December 31, 2001. The Company also held marketable securities available for sale with a carrying value of \$359.0 million at December 31, 2002.

At December 31, 2002, the Company had commitments to extend credit (principally real estate mortgage loans) of \$53.0 million and open lines of credit for borrowers (principally construction loan and home equity loan lines of credit) of \$17.7 million. Since generally all of the loan commitments are expected to be drawn upon, the total loan commitments approximate future cash requirements, whereas the amounts of lines of credit may not be indicative of the Company's future cash requirements. The loan commitments generally expire in ninety days, while construction loan lines of credit mature within eighteen months and home equity loan lines of credit mature within ten years. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Company's total interest and operating expenses in 2002 were \$54.6 million and \$27.6 million, respectively. Certificates of deposit accounts which are scheduled to mature in one year or less as of December 31, 2002 totaled \$258.5 million.

The market value of the assets of the Company's defined benefit pension plan is \$10.1 million at December 31, 2002, which is \$1.2 million less than the benefit obligation. During 2002, the Bank contributed \$2.5 million to the pension plan. The underfunding is due to a decline in the market value of pension plan's investments in 2002 and 2001. The Company does not anticipate a change in the market value of these assets which would have a significant effect on liquidity, capital resources, or results of operations.

During 2002, funds provided by the Company's operating activities amounted to \$25.1 million. These funds, together with \$139.2 million provided by financing activities and \$38.5 million available at the beginning of the year, were utilized to fund net investing activities of \$155.2 million. Financing activities were primarily provided by a growth in due to depositors of \$183.5 million. Principal payments and calls on loans and securities provided additional funds. The primary investment activity of the Company is the origination of loans, and the purchase of mortgage-backed securities. During 2002, the Bank had loan originations and purchases of \$325.0 million. Further, during 2002, the Company purchased \$262.5 million of mortgage-backed and other securities.

At the time of the Bank's conversion from a federally chartered mutual savings bank to a federally chartered stock savings bank, the Bank was required by the OTS to establish a liquidation account which is reduced as and to the extent that eligible account holders reduce their qualifying deposits. The balance of the liquidation account at December 31, 2002 was \$6.2 million. In the unlikely event of a complete liquidation of the Bank, each eligible account holder will be entitled to receive a distribution from the liquidation account. The Bank is not permitted to declare or pay a dividend or to repurchase any of its capital stock if the effect would be to cause the Bank's regulatory capital to be reduced below the amount required for the liquidation account. Unlike the Bank, the Holding Company is not subject to OTS regulatory restrictions on the declaration or payment of dividends to its stockholders, although the source of such dividends could depend upon dividend payments from the Bank. The Holding Company is subject, however, to the requirements of Delaware law, which generally limit dividends to an amount equal to the excess of its net assets (the amount by which total assets exceed total liabilities) over its stated capital or, if there is no such excess, to its net profits for the current and/or immediately preceding fiscal year.

Regulatory Capital Position. Under OTS capital regulations, the Bank is required to comply with each of three separate capital adequacy standards: tangible capital, core capital and total risk-based capital. Such classifications are used by the OTS and other bank regulatory agencies to determine matters ranging from each institution's semi-annual FDIC deposit insurance premium assessments, to approvals of applications authorizing institutions to grow their asset size or otherwise expand business activities. At

December 31, 2002 and 2001, the Bank exceeded each of the three OTS capital requirements. (See Note 13 of Notes to Consolidated Financial Statements.)

▶ IMPACT OF NEW ACCOUNTING STANDARDS

In June 2001, The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," which is effective for fiscal years beginning after December 15, 2001. The Statement changes the approach to how goodwill and other intangible assets are accounted for subsequent to their recognition. Goodwill and intangible assets that have indefinite useful lives will not be amortized but rather will be tested at least annually for impairment. Intangible assets that have finite useful lives will be amortized over their useful lives. The Statement provides specific guidance on testing intangible assets that will not be amortized for impairment. As of December 31, 2001, the Company had goodwill with a remaining balance of \$3.9 million recorded in connection with its purchase of New York Federal Savings Bank in 1997. Amortization expense for each of the years in the two-year period ended December 31, 2001 was \$0.4 million. Effective January 1, 2002, the Company no longer recorded this amortization expense, but rather is required, at least annually, to test the remaining goodwill for impairment. The impairment test performed in connection with the adoption of this Statement in January 2002, and the subsequent annual impairment test performed in January 2003, did not require an adjustment to the carrying value of the goodwill.

▶ CRITICAL ACCOUNTING POLICIES

The Company's accounting policies are integral to understanding the results of operations and statement of financial condition. These policies are described in the Notes to Consolidated Financial Statements. Several of these policies require management's judgment to determine the value of the Company's assets and liabilities. The Company has established detailed written policies and control procedures to ensure consistent application of these policies. The accounting policy that requires significant management valuation judgment is determining the allowance for loan losses.

An allowance for loan losses is provided to absorb estimated losses on existing loans that may be uncollectable. Management reviews the adequacy of the allowance for loan losses by reviewing all impaired loans on an individual basis. The remaining portfolio is evaluated based on the Company's historical loss experience, recent trends in losses, collection policies and collection experience, trends in the volume of non-performing loans, changes in the composition and volume of the gross loan portfolio, and local and national economic conditions. Judgment is required to determine how many years of historical loss experience are to be included when reviewing historical loss experience. A full credit cycle must be used, or loss estimates may be inaccurate. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revisions as more information becomes available.

Notwithstanding the judgment required in assessing the components of the allowance for loan losses, the Company believes that the allowance for loan losses is adequate to cover losses inherent in the loan portfolio. The policy has been applied on a consistent basis for all periods presented in the Consolidated Financial Statements.

▶ OTHER TRENDS AND CONTINGENCIES

Interest rates remained low during 2002, with long-term rates declining over the course of the year, while short-term rates remained stable at low levels until November, when they declined approximately 50 basis points. At December 31, 2002, interest rates were at their lowest level in almost 40 years. This presented significant challenges and opportunities in managing our mortgage loan and investment portfolios. We remained strategically focused in 2002 on the origination of multi-family residential and commercial real estate mortgage loans, and on mixed-use property one-to-four family residential mortgage loans. Mixed-use properties are those that contain both residential dwelling units and commercial units. These types of loans have higher interest rates than traditional one-to-four family residential mortgage loans. As a result of this strategy, we were able to achieve a higher yield on our mortgage portfolio than we would have otherwise experienced, despite the declining interest-rate environment experienced during 2002 and 2001.

▶ MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *(continued)*

Due to the availability of lower interest rates, many of our mortgagors chose to refinance their loans. We saw a significant increase in our mortgagors refinancing with other institutions. In addition, due to depositors increased \$183.5 million during 2002. Combining the increase in deposits with higher than anticipated loan prepayments, we experienced an increase in our cash position. Rather than investing these funds in low-yielding long-term investment securities, we invested these funds in readily marketable mortgage-backed securities and shorter-term investment securities to provide readily available funding for loan originations. Other securities primarily consists of securities issued by government agencies and mutual or bond funds that invest in government and government agency securities. At December 31, 2002, we had loans in process of \$189.2 million.

For the year ended December 31, 2002, the higher costing certificate of deposits increased \$76.2 million while lower costing deposits increased \$107.3 million. We seek to maintain our deposits at competitive rates. In recent years, we had increased our utilization of FHLB-NY advances and repurchase agreements as alternative sources of funding. During 2002, as a result of the increase in deposits, we decreased our borrowed funds by \$20.3 million. As a result of the declining interest rate environment experienced during 2002 and 2001, and the increase in lower costing deposits, we experienced a decrease in our cost of funds in each quarter during 2002. The cost of funds declined to 3.76% in the fourth quarter of 2002 from 4.47% in the fourth quarter of 2001.

As a result of the low interest-rate environment during 2002 and 2001, the yield on our total interest-earning assets declined 47 basis points. This was more than offset by a 90 basis point decline in the cost of our total interest-bearing liabilities. This resulted in an increase of 43 basis points in the net interest spread to 3.32% for the year ended December 31, 2002 from 2.89% for the year ended December 31, 2001. The net interest rate margin improved 35 basis points to 3.55% for the year ended December 31, 2002 from 3.20% for the year ended December 31, 2001. The net interest margin improved to 3.55% in the fourth quarter of 2002 from 3.34% in the fourth quarter of 2001.

We are unable to predict the direction of future interest rate changes. Should interest rates increase during 2003, we could see an increase in the cost of our existing deposit accounts and in obtaining new funds. However, approximately 59% of the Company's certificates of deposit accounts and borrowed funds do not reprice or mature during the next year. As a result, the average cost of our interest-bearing liabilities may not immediately reflect the full effect of an increasing interest-rate environment. Also, in an increasing interest rate environment, mortgage loans and mortgage-backed securities with lower rates do not usually prepay as quickly. In a rising interest rate environment, this could result in our cost of funds increasing more than the yield on our interest-earning assets.

The Company's operating results can also be affected by national and local economic conditions. During 2002, the nation's economy was generally considered to be expanding slowly. World events, particularly the "War on Terror" and the unsettled situation in the Middle East (primarily the situation with Iraq), slowed the economic recovery. The local area economy has been further hurt by the September 11, 2001 attacks on New York City's financial district, in particular, the destruction of the World Trade Center buildings. The Bank does not have a significant amount of mortgages or other loans to borrowers located in the area that was destroyed or damaged in the attacks of September 11, 2001. In addition, job growth was limited during 2002. These economic conditions can result in borrowers defaulting on their loans, or withdrawing their funds on deposit at the Bank to meet their financial obligations. While we have not seen a significant increase in delinquent loans, and have seen an increase in deposits, we cannot predict the effect of these economic conditions on the Company's financial condition or operating results.

▶ CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

December 31,	2002	2001
	<i>(Dollars in thousands, except share data)</i>	
▶ Assets		
Cash and due from banks	\$ 29,119	\$ 20,008
Federal funds sold	18,500	18,500
Securities available for sale:		
Mortgage-backed securities	319,255	243,058
Other securities	39,729	62,481
Loans	1,176,141	1,073,782
Less: Allowance for loan losses	(6,581)	(6,585)
Net loans	1,169,560	1,067,197
Interest and dividends receivable	8,409	7,945
Real estate owned, net	—	93
Bank premises and equipment, net	5,389	5,565
Federal Home Loan Bank of New York stock	22,213	25,422
Goodwill	3,905	3,905
Other assets	36,879	33,355
Total assets	\$1,652,958	\$1,487,529
▶ Liabilities		
Due to depositors:		
Non-interest bearing	\$ 35,287	\$ 28,594
Interest-bearing	966,726	789,923
Mortgagors' escrow deposits	9,812	10,065
Borrowed funds, including securities sold under agreements to repurchase of \$113,900 and \$113,150 at December 31, 2002 and 2001, respectively	493,164	513,435
Other liabilities	16,583	12,125
Total liabilities	1,521,572	1,354,142
Commitments and contingencies (Note 14)		
▶ Stockholders' Equity		
Preferred stock, (\$0.01 par value, authorized 5,000,000 shares; none issued)	—	—
Common stock, (\$0.01 par value, authorized 40,000,000 shares; 13,852,063 shares issued; 12,598,343 and 13,487,784 shares outstanding at December 31, 2002 and 2001, respectively)	139	139
Additional paid-in capital	47,208	45,280
Treasury stock, at average cost (1,253,720 and 364,279 shares at December 31, 2002 and 2001, respectively)	(21,733)	(5,750)
Unearned compensation	(7,825)	(7,766)
Retained earnings	109,208	99,641
Accumulated other comprehensive income, net of taxes	4,389	1,843
Total stockholders' equity	131,386	133,387
Total liabilities and stockholders' equity	\$1,652,958	\$1,487,529

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

▶ CONSOLIDATED STATEMENTS OF INCOME

<i>For the years ended December 31,</i>	2002	2001	2000
	<i>(In thousands, except per share data)</i>		
▶ Interest and dividend income			
Interest and fees on loans	\$ 90,501	\$ 84,369	\$76,780
Interest and dividends on securities:			
Interest	15,613	15,943	19,214
Dividends	165	255	272
Other interest income	627	1,332	675
Total interest and dividend income	106,906	101,899	96,941
▶ Interest expense			
Deposits	28,204	29,711	27,473
Other interest expense	26,360	29,991	29,575
Total interest expense	54,564	59,702	57,048
Net interest income	52,342	42,197	39,893
Provision for loan losses	—	—	—
Net interest income after provision for loan losses	52,342	42,197	39,893
▶ Non-interest income			
Other fee income	2,896	2,261	2,053
Net gain (loss) on sales of securities and loans	(4,158)	321	(651)
Other income	2,771	3,476	2,456
Total non-interest income	1,509	6,058	3,858
▶ Non-interest expense			
Salaries and employee benefits	13,921	12,679	12,254
Occupancy and equipment	2,749	2,368	2,222
Professional services	2,759	2,291	2,245
Data processing	1,566	1,313	1,309
Depreciation and amortization of premises and equipment	1,035	1,065	1,085
Other operating	5,591	4,741	4,682
Total non-interest expense	27,621	24,457	23,797
Income before income taxes	26,230	23,798	19,954
▶ Provision for income taxes			
Federal	8,247	7,245	6,195
State and local	1,720	1,624	1,337
Total provision for income taxes	9,967	8,869	7,532
Net income	\$ 16,263	\$ 14,929	\$12,422
Basic earnings per share	\$ 1.40	\$ 1.22	\$ 0.99
Diluted earnings per share	\$ 1.34	\$ 1.17	\$ 0.97

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

▶ CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the years ended December 31,

	2002	2001	2000
	<i>(In thousands, except share data)</i>		
▶ Common Stock			
Balance, beginning of year	\$ 139	\$ 114	\$ 114
Stock dividend (4,617,270 shares, 2,120,885 shares funded from Treasury)	—	25	—
Balance, end of year	<u>\$ 139</u>	<u>\$ 139</u>	<u>\$ 114</u>
▶ Additional Paid-In Capital			
Balance, beginning of year	\$ 45,280	\$ 76,396	\$ 75,952
Stock dividend	—	(33,169)	—
Award of shares released from Employee Benefit Trust (35,341, 32,930 and 49,480 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	416	376	257
Restricted stock awards (69,075, 78,675 and 6,900 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	146	391	3
Stock options exercised (8,250 shares for the year ended December 31, 2001)	—	5	—
Tax benefit of unearned compensation	1,366	1,281	184
Balance, end of year	<u>\$ 47,208</u>	<u>\$ 45,280</u>	<u>\$ 76,396</u>
▶ Treasury Stock			
Balance, beginning of year	\$ (5,750)	\$(31,755)	\$(25,308)
Purchases of common shares outstanding (1,202,450, 639,950 and 475,516 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	(21,196)	(10,694)	(6,797)
Stock dividend	—	33,142	—
Restricted stock award forfeitures (2,180, 1,400 and 1,500 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	(28)	(26)	(22)
Restricted stock awards (69,075, 52,950 and 9,600 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	1,140	821	148
Repurchase of restricted stock awards (13,553, 23,757 and 23,234 shares for the years ended December 31, 2002, 2001 and 2000, respectively) to satisfy tax obligations	(260)	(519)	(333)
Stock options exercised (259,667, 210,750, and 36,600 shares for the years ended December 31, 2002, 2001, and 2000, respectively)	4,361	3,281	557
Balance, end of year	<u>\$ (21,733)</u>	<u>\$ (5,750)</u>	<u>\$ (31,755)</u>
▶ Unearned Compensation			
Balance, beginning of year	\$ (7,766)	\$ (7,781)	\$ (9,142)
Release of shares from Employee Benefit Trust (87,679, 76,641 and 69,176 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	448	391	354
Restricted stock awards (69,075, 78,675 and 14,400 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	(1,286)	(1,212)	(145)
Restricted stock award forfeitures (2,180, 2,100 and 2,250 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	28	26	22
Restricted stock award expense	751	810	1,130
Balance, end of year	<u>\$ (7,825)</u>	<u>\$ (7,766)</u>	<u>\$ (7,781)</u>

Continued

▶ **CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
(continued)

<i>For the years ended December 31,</i>	2002	2001	2000
	<i>(In thousands, except share data)</i>		
▶ Retained Earnings			
Balance, beginning of year	\$ 99,641	\$ 89,896	\$ 81,056
Net income	16,263	14,929	12,422
Stock options exercised (259,667, 246,475 and 54,900 shares for the years ended December 31, 2002, 2001 and 2000, respectively)	(2,458)	(1,362)	(159)
Restricted stock awards (7,500 shares for the year ended December 31, 2000)	—	—	(6)
Cash dividends declared and paid	(4,238)	(3,822)	(3,417)
Balance, end of year	\$109,208	\$ 99,641	\$ 89,896
▶ Accumulated Other Comprehensive Income, Net of Taxes			
Balance, beginning of year	\$ 1,843	\$ (133)	\$ (4,496)
Adjustment required to recognize minimum pension liability, net of taxes of approximately \$221	(254)	—	—
Change in net unrealized gain (loss), net of taxes of approximately \$(347), \$(1,719) and \$(3,434) for the years ended December 31, 2002, 2001 and 2000, respectively, on securities available for sale	408	2,035	3,902
Less: Reclassification adjustment for losses (gains) included in net income, net of taxes of approximately \$(2,038), \$35 and \$(283) for the years ended December 31, 2002, 2001 and 2000, respectively	2,392	(59)	461
Balance, end of year	\$ 4,389	\$1,843	\$(133)
Total stockholders' equity	\$131,386	\$133,387	\$126,737
▶ Comprehensive Income			
Net income	\$ 16,263	\$ 14,929	\$ 12,422
Other comprehensive income, net of tax:			
Minimum pension liability	(254)	—	—
Unrealized gains (losses) on securities	2,800	1,976	4,363
Comprehensive income	\$ 18,809	\$ 16,905	\$ 16,785

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

▶ CONSOLIDATED STATEMENTS OF CASH FLOW

For the years ended December 31,

	2002	2001	2000
		<i>(In thousands)</i>	
▶ Operating Activities			
Net income.....	\$ 16,263	\$ 14,929	\$ 12,422
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses.....	—	—	—
Provision for losses on real estate owned.....	—	4	—
Depreciation and amortization of bank premises and equipment.....	1,035	1,065	1,085
Amortization of goodwill.....	—	367	366
Impairment writedown of investment security.....	4,429	—	—
Net (gain) loss on sales of securities.....	1	(94)	744
Net gain on sales of loans.....	(272)	(227)	(93)
Net gain on sales of real estate owned.....	(4)	(15)	(199)
Amortization of unearned premium, net of accretion of unearned discount.....	2,988	1,215	1,142
Amortization of deferred income.....	(174)	(309)	(544)
Deferred income tax (benefit) provision.....	(859)	132	7
Deferred compensation.....	523	469	232
Net decrease in other assets and liabilities.....	(428)	(3,912)	(2,709)
Unearned compensation.....	1,615	1,577	1,741
Net cash provided by operating activities.....	25,117	15,201	14,194
▶ Investing Activities			
Purchases of bank premises and equipment.....	(859)	(319)	(1,194)
Net redemptions (purchases) of Federal Home Loan Bank shares.....	3,209	(490)	(2,340)
Purchase of Bank Owned Life Insurance.....	—	—	(20,000)
Purchases of securities available for sale.....	(262,506)	(189,858)	(28,667)
Proceeds from sales and calls of securities available for sale.....	39,022	39,395	28,735
Proceeds from maturities and prepayments of securities available for sale.....	168,133	102,953	36,130
Net originations and repayments of loans.....	(92,100)	(79,840)	(94,312)
Purchases of loans.....	(10,183)	(887)	(15,783)
Proceeds from sales of real estate owned.....	97	106	567
Net cash used in investing activities.....	(155,187)	(128,940)	(96,864)
▶ Financing Activities			
Net increase in non-interest bearing deposits.....	6,693	7,681	423
Net increase in interest-bearing deposits.....	176,803	128,778	25,717
Net increase (decrease) in mortgagors' escrow deposits.....	(253)	2,312	(3,270)
Net decrease in short-term borrowed funds.....	—	(14,232)	(5,768)
Proceeds from long-term borrowings.....	90,000	123,000	159,150
Repayment of long-term borrowings.....	(110,271)	(104,172)	(96,374)
Purchases of treasury stock, net.....	(19,553)	(9,291)	(6,732)
Cash dividends paid.....	(4,238)	(3,822)	(3,417)
Net cash provided by financing activities.....	139,181	130,254	69,729
Net increase (decrease) in cash and cash equivalents.....	9,111	16,515	(12,941)
Cash and cash equivalents, beginning of year.....	38,508	21,993	34,934
Cash and cash equivalents, end of year.....	\$ 47,619	\$ 38,508	\$ 21,993
▶ Supplemental Cash Flow Disclosure			
Interest paid.....	\$ 54,479	\$ 59,937	\$ 56,227
Income taxes paid.....	9,273	7,615	7,849
Non-cash activities:			
Loans originated as the result of real estate sales.....	—	—	191
Loans transferred through the foreclosure of a related mortgage loan to real estate owned.....	—	119	235

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

▶ NOTES TO CONSOLIDATED FINANCIAL STATEMENTS*For the years ended December 31, 2002, 2001 and 2000***▶ 1. NATURE OF OPERATIONS**

Flushing Financial Corporation (the “Holding Company”), a Delaware business corporation, is a savings and loan holding company organized at the direction of its subsidiary, Flushing Savings Bank, FSB (the “Bank”), in connection with the Bank’s conversion from a mutual to capital stock form of organization. The Holding Company and its direct and indirect wholly-owned subsidiaries, the Bank, Flushing Financial Capital Trust I, Flushing Preferred Funding Corporation, Flushing Service Corporation and FSB Properties, Incorporated are collectively herein referred to as the “Company.”

The Company’s principal business is attracting retail deposits from the general public and investing those deposits together with funds generated from operations and borrowings, primarily in (1) originations and purchases of one-to-four family residential mortgage loans (focusing on mixed-use properties—properties that contain both residential dwelling units and commercial units), multi-family income-producing property loans, and commercial real estate loans; (2) mortgage loan surrogates such as mortgage-backed securities and; (3) U.S. government and federal agency securities, corporate fixed-income securities and other marketable securities. To a lesser extent, the Company originates certain other loans, including construction loans, Small Business Administration loans and other small business loans. The Bank conducts its business through ten full-service banking offices, five of which are located in Queens County, two in Nassau County, one in Kings County (Brooklyn), one in Bronx County and one in New York County (Manhattan), New York.

▶ 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Company follow generally accepted accounting principles (“GAAP”) and general practices applicable to the banking industry. The policies which materially affect the determination of the Company’s financial position, results of operations and cash flows are summarized below.

Principles of consolidation:

The accompanying consolidated financial statements include the accounts of Flushing Financial Corporation and its direct and indirect wholly-owned subsidiaries, the Bank, Flushing Financial Capital Trust I (“FFCTI”), Flushing Preferred Funding Corporation (“FPFC”), Flushing Service

Corporation (“FSC”) and FSB Properties, Incorporated (“Properties”). FFCTI is a special purpose business trust formed to issue capital securities. FPFC is a real estate investment trust formed to hold a portion of the Bank’s mortgage loans to facilitate access to capital markets. FSC was formed to market insurance products and mutual funds. Properties is an inactive subsidiary whose purpose was to manage real estate properties and joint ventures. All significant intercompany accounts and transactions have been eliminated in consolidation.

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 reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Cash and cash equivalents:

For the purpose of reporting cash flows, the Company defines cash and due from banks, overnight interest-earning deposits and federal funds sold with original maturities of 90 days or less as cash and cash equivalents.

Securities available for sale:

Securities are classified as available for sale when management intends to hold the securities for an indefinite period of time or when the securities may be utilized for tactical asset/liability purposes and may be sold from time to time to effectively manage interest rate exposure and resultant prepayment risk and liquidity needs. Premiums and discounts are amortized or accreted, respectively, using the level-yield method. Realized gains and losses on the sales of securities are determined using the specific identification method. Unrealized gains and losses (other than unrealized losses considered other than temporary which are recognized in the Consolidated Statements of Income) on securities available for sale are excluded from earnings and reported as accumulated other comprehensive income, net of taxes.

Loans:

Loans are carried at amortized cost. Interest on loans is recognized on the accrual basis. The accrual of income on loans is discontinued when certain factors, such as contractual delinquency of ninety days or more, indicate reasonable doubt as to the timely collectibility of such income. Interest previously recognized on non-accrual

loans is reversed against interest income at the time the loan is placed on non-accrual status. A non-accrual loan can be returned to accrual status after the loan meets certain criteria. Subsequent cash payments received on non-accrual loans that do not meet the criteria are applied first as a reduction of principal until all principal is recovered and then subsequently to interest.

The portion of loan origination fees that exceeds the direct costs of underwriting and closing loans is deferred. The deferred fees received in connection with a loan are recognized as an adjustment of the loan's yield over the shorter of the repricing period or the contractual life of the related loan by the interest method, which results in a constant rate of return. The direct costs of underwriting and closing loans that exceed loan origination fees, and premiums on loans purchased, are deferred and amortized to income over the life of the loans using the level-yield method.

Allowance for loan losses:

The Company maintains an allowance for loan losses at an amount, which, in management's judgment, is adequate to absorb estimated losses on existing loans. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectibility 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 the Company's historical loss experience, recent trends in losses, collection policies and collection experience, trends in the volume of non-performing loans, changes in the composition and volume of the gross loan portfolio, and local and national economic conditions. The Board of Directors reviews and approves management's evaluation of the adequacy of the allowance for loan losses on a quarterly basis.

A loan is considered impaired when, based upon current information, the Company 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, as a practical expedient, 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 the cash basis. The Company reviews all non-accrual loans for impairment.

Real estate owned:

Real estate owned consists of property acquired by foreclosure. These properties are carried at the lower of carrying amount or fair value (which is based on appraised value with certain adjustments) less estimated costs to sell (hereinafter defined as fair value). This determination is made on an individual asset basis. If the fair value is less than the carrying amount, the deficiency is recognized as a valuation allowance. Further decreases to fair value will be recorded in this valuation allowance through a provision for losses on real estate owned. The Company utilizes estimates of fair value to determine the amount of its valuation allowance. Actual values may differ from those estimates.

Bank premises and equipment:

Bank premises and equipment are stated at cost, less depreciation accumulated on a straight-line basis over the estimated useful lives of the related assets (3 to 40 years). Leasehold improvements are amortized on a straight-line basis over the terms of the related leases or the lives of the assets, whichever is shorter.

Federal Home Loan Bank Stock:

In connection with the Bank's borrowings from the Federal Home Loan Bank of New York ("FHLB-NY"), the Bank is required to purchase shares of FHLB-NY non-marketable capital stock at par. Such shares are redeemed by FHLB-NY at par with reductions in the Bank's borrowing levels. The Bank carries this investment at historical cost.

Securities sold under agreements to repurchase:

Securities sold under agreements to repurchase are accounted for as collateralized financing and are carried at amounts at which the securities will be subsequently reacquired as specified in the respective agreements.

Goodwill:

Goodwill, prior to January 1, 2002, was amortized using the straight-line method over fifteen years. The Company had periodically reviewed its goodwill for possible impairment. Upon the adoption of SFAS No. 142 on January 1, 2002, the company no longer amortizes goodwill, but rather performs annual tests for impairment as of the end of each year.

▶ NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the years ended December 31, 2002, 2001 and 2000

Stock Compensation Plans:

Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," establishes a fair value based method of accounting for employee stock compensation plans. Under this method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." The Company has elected to continue with the accounting methodology in Opinion No. 25. As a result, pro forma disclosures of net income and earnings per share and other disclosures, as if the fair value based method of accounting had been applied, are provided in the notes to the consolidated financial statements.

Earnings per share:

Basic earnings per share for the years ended December 31, 2002, 2001 and 2000 was computed by dividing net income by the total weighted average number of common shares outstanding, including only the vested portion of restricted stock awards. Diluted earnings per share includes the additional dilutive effect of stock options outstanding and the unvested portions of restricted stock awards during the period. The shares held in the Company's Employee Benefit Trust are not included in shares outstanding for purposes of calculating earnings per share.

Earnings per share has been computed based on the following for the years ended December 31:

	2002	2001	2000
	<i>(Amounts in thousands, except per share data)</i>		
Net income	\$16,263	\$14,929	\$12,422
Divided by:			
Weighted average common shares outstanding	11,600	12,267	12,565
Weighted average common stock equivalents	514	504	227
Total weighted average common shares outstanding & common stock equivalents ...	12,114	12,771	12,792
Basic earnings per share	\$ 1.40	\$ 1.22	\$ 0.99
Diluted earnings per share	\$ 1.34	\$ 1.17	\$ 0.97

Common stock equivalents that are antidilutive are not included in the computation of diluted earnings per share. Options to purchase 274,400 shares at \$18.70, 255,600 shares at \$16.18, and 290,550 shares at \$10.38 were not included in the computation of diluted earnings per share for 2002, 2001 and 2000, respectively. Unvested restricted stock awards of 68,875 shares at \$18.62, 62,925 shares at \$16.27, and 110,400 shares at \$10.37 were not included in the computation of diluted earnings per share for 2002, 2001 and 2000, respectively.

▶ 3. LOANS

The composition of loans is as follows at December 31:

	2002	2001
	<i>(In thousands)</i>	
One-to-four family residential—		
conventional	\$ 262,944	\$ 351,992
One-to-four family residential—		
mixed-use properties	170,499	109,809
Multi-family residential	452,663	369,651
Commercial real estate	257,054	214,410
Co-operative apartments	5,205	6,601
Construction	17,827	13,807
Small Business Administration	4,301	3,911
Consumer and other	4,185	2,814
Gross loans	1,174,678	1,072,995
Unearned loan fees and deferred costs, net	1,463	787
Total loans	\$1,176,141	\$1,073,782

The total amount of loans on non-accrual status, and loans classified as impaired, at December 31, 2002, 2001 and 2000 was \$3,592,000, \$2,320,000 and \$1,618,000, respectively. The portion of the allowance for loan losses allocated to impaired loans was \$340,000 (5.2%), \$541,000 (8.2%) and \$257,000 (3.8%) at December 31, 2002, 2001 and 2000, respectively. The portion of the impaired loan amount above 100% of the loan-to-value ratio is charged off. The average balance of impaired loans was \$2,681,000, \$2,105,000 and \$1,692,000 for 2002, 2001 and 2000, respectively.

The following is a summary of interest foregone on non-accrual loans for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Interest income that would have been recognized had the loans performed in accordance with their original terms	\$298	\$193	\$141
Less: Interest income included in the results of operations.....	76	76	62
Foregone interest	\$222	\$117	\$79

The following are changes in the allowance for loan losses for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Balance, beginning of year	\$6,585	\$6,721	\$6,818
Provision for loan losses	—	—	—
Charge-offs	(12)	(149)	(99)
Recoveries	8	13	2
Balance, end of year.....	\$6,581	\$6,585	\$6,721

▶ 4. REAL ESTATE OWNED

The following are changes in the allowance for losses on real estate owned for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Balance, beginning of year	\$ —	\$ —	\$ —
Provision.....	—	4	—
Reduction due to sales of real estate owned.....	—	(4)	—
Balance, end of year.....	\$ —	\$ —	\$ —

▶ 5. BANK PREMISES AND EQUIPMENT, NET

Bank premises and equipment are as follows at December 31:

	2002	2001
	<i>(In thousands)</i>	
Land	\$ 801	\$ 801
Building and leasehold improvements.....	4,214	4,231
Equipment and furniture	9,595	9,162
Total	14,610	14,194
Less: Accumulated depreciation and amortization	9,221	8,629
Bank premises and equipment, net.....	\$ 5,389	\$ 5,565

▶ 6. DEBT AND EQUITY SECURITIES

Investments in equity securities that have readily determinable fair values and all investments in debt securities 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 years ended December 31, 2002, 2001 and 2000. Securities available for sale are recorded at estimated fair value based on dealer quotations where available. Actual values may differ from estimates provided by outside dealers. Securities classified as held-to-maturity would be stated at cost, adjusted for amortization of premium and accretion of discount using the level-yield method.

The amortized cost and estimated fair value of the Company's securities, classified as available for sale at December 31, 2002 are as follows:

	Amortized Cost	Estimated Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
	<i>(In thousands)</i>			
U.S. Treasury securities and government agencies.....	\$ 15,376	\$ 15,609	\$ 233	\$ —
Corporate debt securities.....	1,700	2,252	552	—
Mutual funds.....	19,535	19,412	99	222
Other.....	1,853	2,456	645	42
Total other securities.....	38,464	39,729	1,529	264
GNMA.....	94,302	97,529	3,227	—
FNMA.....	114,103	116,983	2,882	2
FHLMC	46,468	47,153	691	6
REMIC and CMO	57,049	57,590	619	78
Total mortgage-backed securities.....	311,922	319,255	7,419	86
Total securities available for sale	\$350,386	\$358,984	\$8,948	\$350

▶ **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

For the years ended December 31, 2002, 2001 and 2000

The amortized cost and estimated fair value of the Company's securities, classified as available for sale at December 31, 2002, by contractual maturity, are shown below. 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	Estimated Fair Value
<i>(In thousands)</i>		
Due in one year or less.....	\$ 20,513	\$ 21,033
Due after one year through five years.....	1,975	2,528
Due after five years through ten years.....	10,282	10,462
Due after ten years.....	5,694	5,706
Total other securities.....	38,464	39,729
Mortgage-backed securities.....	311,922	319,255
Total securities available for sale.....	\$350,386	\$358,984

The amortized cost and estimated fair value of the Company's securities classified as available for sale at December 31, 2001 were as follows:

	Amortized Cost	Estimated Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
<i>(In thousands)</i>				
Corporate debt securities.....	\$ 32,884	\$ 32,985	\$ 123	\$ 22
Public utility debt securities.....	8,042	8,132	90	—
Mutual funds.....	18,899	18,867	32	64
Other.....	1,884	2,497	614	1
Total other securities.....	61,709	62,481	859	87
GNMA.....	132,678	134,125	1,560	113
FNMA.....	50,895	51,359	591	127
FHLMC.....	20,552	20,810	273	15
REMIC and CMO.....	36,292	36,764	500	28
Total mortgage-backed securities.....	240,417	243,058	2,924	283
Total securities available for sale.....	\$302,126	\$305,539	\$3,783	\$370

For the year ended December 31, 2002, gross gains of \$423,000 and losses of \$424,000 were realized on sales of securities available for sale. In addition, an impairment writedown of \$4,429,000 was recorded during the year ended December 31, 2002. For the year ended December 31, 2001, gross gains of \$179,000 and losses of \$85,000 were realized on sales of securities available for sale. For the year ended December 31, 2000, gross gains of \$205,000 and losses of \$949,000 were realized on sales of securities available for sale.

▶ **7. DEPOSITS**

Total deposits at December 31, 2002 and 2001, and the weighted average rate on deposits at December 31, 2002, are as follows:

	2002	2001	Weighted Average Rate 2002
<i>(Dollars in thousands)</i>			
Interest-bearing deposits:			
Certificate of deposit accounts.....	\$ 543,330	\$467,172	3.96%
Passbook savings accounts.....	213,572	195,855	1.00
Money market accounts.....	170,029	93,789	2.31
NOW accounts.....	39,795	33,107	0.75
Total interest-bearing deposits.....	966,726	789,923	
Non-interest bearing deposits:			
Demand accounts.....	35,287	28,594	
Total due to depositors.....	1,002,013	818,517	
Mortgagors' escrow deposits.....	9,812	10,065	0.38
Total deposits.....	\$1,011,825	\$828,582	

The aggregate amount of time deposits with denominations of \$100,000 or more was \$100,926,000 and \$75,175,000 at December 31, 2002 and 2001, respectively.

Interest expense on deposits is summarized as follows for the years ended December 31:

	2002	2001	2000
		<i>(In thousands)</i>	
Certificate of deposit accounts	\$21,640	\$23,062	\$21,488
Passbook savings accounts	3,147	3,767	3,931
Money market accounts	3,039	2,309	1,438
NOW accounts	321	504	530
Total due to depositors	28,147	29,642	27,387
Mortgagors' escrow deposits	57	69	86
Total interest expense on deposits	\$28,204	\$29,711	\$27,473

▶ 8. BORROWED FUNDS

Borrowed funds are summarized as follows at December 31:

	2002		2001	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	<i>(Dollars in thousands)</i>			
Repurchase agreements—fixed rate:				
Due in 2002	\$ —	—%	\$ 9,250	6.01%
Due in 2005	10,900	6.36	10,900	6.36
Due in 2006	18,000	4.96	18,000	4.96
Due in 2007	60,000	5.25	50,000	5.64
Due in 2009	25,000	5.52	25,000	5.52
Total repurchase agreements	113,900	5.37	113,150	5.60
FHLB-NY advances—adjustable rate:				
Due in 2002	—	—	25,000	1.95
Due in 2003	25,000	5.50	25,000	5.50
Due in 2004	50,000	2.54	50,000	3.15
Due in 2007	20,000	3.15	—	—
Total FHLB-NY advances—adjustable rate	95,000	3.45	100,000	3.44
FHLB-NY advances—fixed rate:				
Due in 2002	—	—	76,000	5.93
Due in 2003	85,000	6.12	85,000	6.12
Due in 2004	49,000	5.33	49,000	5.33
Due in 2006	35,000	4.93	25,000	4.99
Due in 2007	25,000	6.15	25,000	6.15
Due in 2008	30,000	3.85	—	—
Due in 2010	40,000	7.30	40,000	7.30
Due in 2011	264	7.34	285	7.34
Total FHLB-NY advances—fixed rate	264,264	5.74	300,285	6.01
Total FHLB-NY advances	359,264	5.13	400,285	5.37
Other borrowings—adjustable rate:				
Due in 2032	20,000	5.43	—	—
Total borrowings	\$493,164	5.20%	\$513,435	5.42%

▶ NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the years ended December 31, 2002, 2001 and 2000

As part of the Company's strategy to finance investment opportunities and manage its cost of funds, the Company enters into repurchase agreements with broker-dealers and the FHLB-NY. These agreements are recorded as financing transactions and the obligations to repurchase are reflected as a liability in the consolidated financial statements. The securities underlying the agreements were delivered to the broker-dealers or the FHLB-NY who arranged the transaction. The securities remain registered in the name of the Company and are returned upon the maturity of the agreement. The Company retains the right of substitution of collateral throughout the terms of the agreements. All the repurchase agreements are collateralized by mortgage-backed securities. Information relating to these agreements at or for the years ended December 31 is as follows:

	2002	2001
	<i>(Dollars in thousands)</i>	
Book value of collateral	\$111,634	\$119,011
Estimated fair value of collateral	111,634	119,011
Average balance of outstanding agreements during the year	108,514	156,640
Maximum balance of outstanding agreements at a month end during the year	113,900	182,226
Average interest rate of outstanding agreements during the year	5.58%	5.71%

Pursuant to a blanket collateral agreement with the FHLB-NY, advances are secured by all of the Bank's stock in the FHLB-NY, certain qualifying mortgage loans, mortgage-backed and mortgage-related securities, and other securities not otherwise pledged in an amount at least equal to 110% of the advances outstanding.

The Holding Company also has a trust formed under the laws of the State of Delaware for the purpose of issuing capital and common securities and investing the proceeds thereof in junior subordinated debentures of the Holding Company. On July 11, 2002, FFCTI issued \$20.0 million of floating rate capital securities. The capital securities have a maturity date of October 7, 2032, are callable at par in 5 years and every quarter thereafter, and pay cumulative cash distributions at a floating per annum rate of interest, reset quarterly, equal to 3.65% over 3-month LIBOR,

with an initial rate of 5.51387%. The rate was 5.425% at December 31, 2002. A rate cap of 12.50% is effective through October 7, 2007. The Holding Company has guaranteed the payment of FFCTI's obligations under these capital securities.

▶ 9. INCOME TAXES

Flushing Financial Corporation files consolidated Federal and combined New York State and New York City income tax returns with its subsidiaries, with the exception of FFCTI and FPFC, which file separate Federal, New York State and New York City income tax returns as a trust and real estate investment trust, respectively. A deferred tax liability is recognized on all taxable temporary differences and a deferred tax asset is recognized on all deductible temporary differences and operating losses and tax credit carryforwards. A valuation allowance is recognized to reduce the potential deferred tax asset if it is "more likely than not" that all or some portion of that potential deferred tax asset will not be realized. The Company must also take into account changes in tax laws or rates when valuing the deferred income tax amounts it carries on its Consolidated Statements of Financial Condition.

The Company's annual tax liability for New York State and New York City was the greater of a tax based on "entire net income," "alternative entire net income," "taxable assets" or a minimum tax. For each of the years ended December 31, 2002, 2001 and 2000, the Company's state and city tax was based on "alternative entire net income."

Income tax provisions (benefits) are summarized as follows for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Federal:			
Current	\$9,174	\$7,350	\$6,387
Deferred	(927)	(105)	(192)
Total federal tax provision	8,247	7,245	6,195
State and Local:			
Current	1,652	1,387	1,138
Deferred	68	237	199
Total state and local tax provision	1,720	1,624	1,337
Total income tax provision	\$9,967	\$8,869	\$7,532

The income tax provision in the Consolidated Statements of Income has been provided at effective rates of 38.0%, 37.3% and 37.7% for the years ended December 31, 2002, 2001 and 2000, respectively. The effective rates differ from the statutory federal income tax rate as follows for the years ended December 31:

	2002		2001		2000	
	<i>(Dollars in thousands)</i>					
Taxes at federal statutory rate	\$9,181	35.0%	\$8,329	35.0%	\$6,984	35.0%
Increase (reduction) in taxes resulting from:						
State & local income tax, net of Federal income tax benefit	1,118	4.3	1,056	4.5	869	4.3
Other	(332)	(1.3)	(516)	(2.2)	(321)	(1.6)
Taxes at effective rate	\$9,967	38.0%	\$8,869	37.3%	\$7,532	37.7%

The components of the income taxes attributable to income from operations and changes in equity are as follows for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Income from operations	\$ 9,967	\$ 8,869	\$ 7,532
Equity:			
Change in fair value of securities available for sale ...	2,385	1,684	3,717
Adjustment required to recognize minimum pension liability	(221)	—	—
Compensation expense for tax purposes in excess of that recognized for financial reporting purposes	(1,366)	(1,281)	(184)
Total	\$10,765	\$ 9,272	\$ 11,065

The components of the net deferred tax asset are as follows at December 31:

	2002	2001
	<i>(In thousands)</i>	
Deferred tax asset:		
Postretirement benefits	\$ 1,923	\$ 3,117
Impairment writedown	1,849	—
Allowance for loan losses	206	—
Minimum pension liability	221	—
Other	237	907
Deferred tax asset	4,436	4,024
Deferred tax liabilities:		
Unrealized gains on securities available for sale	3,955	1,570
Allowance for loan losses	—	545
Depreciation	64	192
Other	14	9
Deferred tax liability	4,033	2,316
Net deferred tax asset included in other assets	\$ 403	\$ 1,708

The Company has recorded a net deferred tax asset of \$403,000. This represents the anticipated net federal, state and local tax benefits expected to be realized in future years upon the utilization of the underlying tax attributes comprising this balance. The Company has reported taxable income for federal, state, and local tax purposes in each of the past three years. In management's opinion, in view of the Company's previous, current and projected future earnings trend, it is more likely than not that the net deferred tax asset will be fully realized. Accordingly, no valuation allowance was deemed necessary for the net deferred tax asset at December 31, 2002.

▶ 10. BENEFIT PLANS

Defined Contribution Plans:

The Company maintains a profit-sharing plan and the Bank maintains a 401(k) plan. Both plans are tax-qualified defined contribution plans which cover substantially all employees. Annual contributions are at the discretion of the Company's Board of Directors, but not to exceed the maximum amount allowable under the Internal Revenue Code. Currently, annual matching contributions under the Bank's 401(k) plan equal 50% of the employee's contributions, up to a maximum of 3% of the employee's compensation. Contributions to the profit-sharing plan are determined at the end of each year. Contributions by the Bank into the 401(k) plan vest 20% per year over a five-year period beginning after the employee has completed one year of service. Contributions into the profit-sharing plan vest 20% per year over the employee's first five years of service. Compensation expense recorded by the Company for these plans amounted to \$679,000, \$619,000 and \$581,000 for the years ended December 31, 2002, 2001 and 2000, respectively.

▶ **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

For the years ended December 31, 2002, 2001 and 2000

Employee Benefit Trust:

An Employee Benefit Trust (“EBT”) has been established to assist the Company in funding its benefit plan obligations. In connection with the Bank’s conversion, the EBT borrowed \$7,928,000 from the Company and used \$7,000 of cash received from the Bank to purchase 1,552,500 shares of the common stock of the Company. The loan will be repaid principally from the Company’s discretionary contributions to the EBT and dividend payments received on common stock held by the EBT, or may be forgiven by the Company, over a period of 30 years. At December 31, 2002 the loan had an outstanding balance of \$5,465,000, bearing a fixed interest rate of 6.22% per annum. The loan obligation of the EBT is considered unearned compensation and, as such, is recorded as a reduction of the Company’s stockholders’ equity. Both the loan obligation and the unearned compensation are reduced by the amount of loan repayments made by the EBT or forgiven by the Company. Shares purchased with the loan proceeds are held in a suspense account for contribution to specified benefit plans as the loan is repaid or forgiven. Shares released from the suspense account are used solely for funding matching contributions under the Bank’s 401(k) plan and contributions to the Company’s profit-sharing plan. Since annual contributions are discretionary with the Company or dependent upon employee contributions, compensation payable under the EBT cannot be estimated. For the years ended December 31, 2002, 2001 and 2000, the Company funded \$597,000, \$545,000 and \$511,000, respectively, of employer contributions to the 401(k) and profit sharing plans from the EBT.

The shares held in the suspense account are pledged as collateral and are reported as unallocated EBT shares in stockholders’ equity. As shares are released from the suspense account, the Company reports compensation expense equal to the current market price of the shares, and the shares become outstanding for earnings per share computations. The EBT shares are as follows at December 31:

	2002	2001
Shares owned by Employee Benefit Trust, beginning balance	1,246,237	1,279,167
Shares released and allocated	35,341	32,930
Shares owned by Employee Benefit Trust, ending balance	<u>1,210,896</u>	1,246,237
Market value of unallocated shares...	<u>\$19,832,055</u>	\$22,183,019

Restricted Stock Plan:

The 1996 Restricted Stock Incentive Plan (“Restricted Stock Plan”) became effective on May 21, 1996 after adoption by the Board of Directors and approval by stockholders. The aggregate number of shares of common stock which may be issued under the Restricted Stock Plan, as amended, may not exceed 817,125 shares to employees, and may not exceed 262,875 shares to outside directors, for a total of 1,080,000 shares. Lapsed, forfeited or canceled awards and shares withheld from an award to satisfy tax obligations will not count against these limits, and will be available for subsequent grants. The shares distributed under the Restricted Stock Plan may be shares held in treasury or authorized but unissued shares. The following table summarizes certain activity for the Restricted Stock Plan, after giving effect to the three-for-two common stock split distributed in the form of a stock dividend on August 30, 2001, for the years ended December 31:

	2002	2001	2000
Shares available for future Restricted Stock Awards at beginning of year	331,849	238,203	215,502
Shares authorized for Restricted Stock Awards	—	135,000	—
Restricted Stock Awards	(69,075)	(78,675)	(14,400)
Restricted shares repurchased to satisfy tax obligations	13,553	35,221	34,851
Forfeitures	2,180	2,100	2,250
Shares available for future Restricted Stock Awards at end of year	<u>278,507</u>	331,849	238,203

The Board of Directors has discretion to determine the vesting period of all grants to employees. All grants that have been awarded to employees vest 20% per year over a five-year period. Initial grants to outside directors vest 20% per year over a five-year period, while subsequent annual grants to outside directors vest one-third per year over a three-year period. All grants have full vesting in the event of death, disability, retirement or a change in control. Total restricted stock award expense in 2002, 2001 and 2000 was \$751,000, \$810,000 and \$1,130,000, respectively.

Stock Option Plan:

The 1996 Stock Option Incentive Plan ("Stock Option Plan") became effective on May 21, 1996 after adoption by the Board of Directors and approval by stockholders. The Stock Option Plan provides for the grant of incentive stock options intended to comply with the requirements of Section 422 of the Internal Revenue Code, nonstatutory stock options, and limited stock appreciation rights granted in tandem with such options. The aggregate number of shares of common stock which may be issued under the Stock Option Plan, as amended, with respect to options granted to employees may not exceed 2,115,937 shares, and with respect to options granted to outside directors may not exceed 814,687 shares, for a total of 2,930,624 shares. Lapsed, forfeited or canceled options will not count against these limits and will be available for subsequent grants. However, the cancellation of an option upon exercise of a related stock appreciation right will count against these limits. Options with respect to more than 168,750 shares of common stock may not be granted to any employee in any calendar year. The shares distributed under the Stock Option Plan may be shares held in treasury or authorized but unissued shares. The Board of Directors has discretion to determine the vesting period of all grants to employees. All grants that have been awarded to employees vest 20% per year over a five-year period. Initial grants to outside directors vest 20% per year over a five-year period, while subsequent annual grants to outside

directors vest one-third per year over a three-year period. All grants have full vesting in the event of death, disability, retirement or a change in control. The following table summarizes certain information regarding the Stock Option Plan after giving effect to the three-for-two common stock split distributed in the form of a stock dividend on August 30, 2001.

	Shares Underlying Options	Weighted Average Exercise Price
Balance outstanding		
December 31, 1999	1,902,821	\$ 7.79
Granted	28,800	\$10.05
Exercised	(54,900)	\$ 7.22
Forfeited	(36,900)	\$ 9.71
Balance outstanding		
December 31, 2000	1,839,821	\$ 7.80
Granted	348,600	\$15.01
Exercised	(254,725)	\$ 7.56
Forfeited	(5,700)	\$13.40
Balance outstanding		
December 31, 2001	1,927,996	\$ 9.12
Granted	275,000	\$18.70
Exercised	(259,667)	\$ 7.33
Forfeited	(4,860)	\$13.23
Balance Outstanding		
December 31, 2002	1,938,469	\$10.71
Shares available for future stock option awards at December 31, 2002	287,076	

The following table summarizes information about the Stock Option Plan at December 31, 2002:

Exercise Prices	Options Outstanding		Options Exercisable	
	Number Outstanding at 12/31/02	Weighted Average Remaining Contractual Life	Number Exercisable at 12/31/02	Weighted Average Exercise Price
\$ 7.22	966,209	3.4 Years	966,209	\$ 7.22
\$ 8.00-\$11.00.....	339,810	6.1 Years	224,700	\$ 9.62
\$11.01-\$14.00.....	103,950	7.7 Years	28,350	\$11.83
\$14.01-\$17.00.....	254,100	8.5 Years	62,700	\$16.13
\$17.01-\$20.00.....	274,400	9.5 Years	—	—
\$ 7.22-\$20.00.....	1,938,469	5.6 Years	1,281,959	\$ 8.18

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the years ended December 31, 2002, 2001 and 2000

As permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company has chosen to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations in accounting for its Stock Option Plan. Accordingly, no compensation cost has been recognized for options granted under the Stock Option Plan. Had compensation cost for the Company's Stock Option Plan been determined based on the fair value at the grant dates, consistent with the method prescribed by SFAS No. 123, the Company's net income and earnings per share would have been as indicated in the table below. However, the present impact of SFAS No. 123 may not be representative of the effect on income in future years because the options vest over several years and additional option grants may be made each year.

	2002	2001	2000
	<i>(Dollars in thousands, except per share data)</i>		
Net income:			
As reported	\$16,263	\$14,929	\$12,422
Pro forma	\$15,751	\$14,219	\$11,655
Diluted earnings per share:			
As reported	\$ 1.34	\$ 1.17	\$ 0.97
Pro forma	\$ 1.30	\$ 1.11	\$ 0.91

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The weighted average assumptions used for grants made in 2002, 2001 and 2000 are as follows:

	2002 Grants	2001 Grants	2000 Grants
Dividend yield	1.93%	2.13%	2.65%
Expected volatility	29.33%	27.49%	24.37%
Risk-free interest rate	4.76%	5.27%	6.08%
Expected option life	7 Years	7 Years	7 Years

Pension Plans:

The Bank has a defined benefit pension plan covering substantially all of its employees (the "Retirement Plan"). The benefits are based on years of service and the employee's compensation during the three consecutive years out of the final ten years of service that produces the highest average. The Bank's funding policy is to contribute annually the maximum amount that can be deducted for federal income tax purposes. Contributions are intended to provide not only for the benefits attributed to service to date but also for those expected to be earned in the future. The Bank's Retirement Plan invests in diversified equity and fixed-income funds, which are independently managed by a third party.

The components of the net pension expense are as follows for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Service cost	\$ 452	\$ 396	\$ 350
Interest cost	695	683	621
Amortization of past service liability	(24)	(24)	(25)
Amortization of unrecognized gain	—	(116)	(48)
Expected return on plan assets	(947)	(986)	(823)
Net pension expense (benefit)	\$ 176	\$ (47)	\$ 75

The following table sets forth, for the Retirement Plan, the change in benefit obligation and assets, and for the Company, the amounts recognized in the Consolidated Statements of Financial Condition at December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Change in benefit obligation:			
Benefit obligation at beginning of year	\$ 9,927	\$ 8,671	\$ 7,998
Service cost	452	396	350
Interest cost	695	683	621
Actuarial loss	738	594	94
Benefits paid	(495)	(417)	(392)
Plan amendments	12	—	—
Benefit obligation at end of year	11,329	9,927	8,671
Change in plan assets:			
Market value of assets at beginning of year	9,215	11,155	9,871
Actual return on plan assets	(1,136)	(1,523)	1,676
Employer contributions	2,528	—	—
Benefits paid	(495)	(417)	(392)
Market value of plan assets at end of year	10,112	9,215	11,155
Funded status	(1,217)	(712)	2,484
Unrecognized net loss (gain) from past experience different from that assumed and effects of changes in assumptions	3,638	805	(2,414)
Prior service cost not yet recognized in periodic pension cost	(37)	(62)	(86)
Prepaid (accrued) pension cost included in other assets/liabilities	\$ 2,384	\$ 31	\$ (16)

Assumptions used to develop periodic pension amounts were:

	2002	2001	2000
Weighted average discount rate	6.50%	7.25%	8.00%
Rate of increase in future compensation levels	4.00%	4.50%	5.50%
Expected long-term rate of return on assets	8.50%	9.00%	9.00%

The Bank has an Outside Director Retirement Plan (the "Directors' Plan"), which provides benefits to each outside director who has at least five years of service as an outside director (including service as a director or trustee of the Bank or any predecessor) and whose years of service as an outside director plus age equal or exceed 55. Benefits are also payable to an outside director whose status as an outside director terminates because of death or disability or who is an outside director upon a change of control (as defined in the Directors' Plan). An eligible director will be paid an annual retirement benefit equal to the last annual retainer paid, plus fees paid to such director for attendance at Board meetings during the twelve-month period prior to retirement. Such benefit will be paid in equal monthly installments for the lesser of the number of months such director served as an outside director or 120 months. In the event of a termination of Board service due to a change of control, an outside director who has completed at least two years of service as an outside director will receive a cash lump sum payment equal to 120 months of benefit, and an outside director with less than two years service will receive a cash lump sum payment equal to a number of months of benefit equal to the number of months of his service as an outside director. In the event of the director's death, the surviving spouse will receive the equivalent benefit. No benefits will be payable to a director who is removed for cause. The Holding Company has guaranteed the payment of benefits under the Directors' Plan. Upon adopting the Directors' Plan, the Bank elected to immediately recognize the effect of adopting the Directors' Plan. Subsequent plan amendments are amortized as a past service liability.

The components of the net pension expense for the Directors' Plan are as follows for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Service cost	\$ 38	\$ 27	\$ 20
Interest cost	32	11	8
Amortization of unrecognized loss	14	—	—
Amortization of past service liability	119	119	109
Net pension expense	\$203	\$157	\$137

The following table sets forth, for the Directors' Plan, the change in benefit obligation and assets, and for the Company, the amounts recognized in the Consolidated Statements of Financial Condition at December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Change in benefit obligation:			
Benefit obligation at beginning of year	\$ 2,508	\$ 2,043	\$ 1,913
Service cost	38	27	20
Interest cost	32	11	8
Actuarial (gain) loss	—	465	(24)
Benefits paid	(60)	(38)	(22)
Plan amendments	—	—	148
Benefit obligation at end of year	2,518	2,508	2,043
Change in plan assets:			
Market value of assets at beginning of year	—	—	—
Employer contributions	60	38	22
Benefits paid	(60)	(38)	(22)
Market value of assets at end of year	—	—	—
Funded status	(2,518)	(2,508)	(2,043)
Unrecognized net loss from past experience different from that assumed and effects of changes in assumptions	475	489	15
Prior service cost not yet recognized in periodic pension cost	663	782	901
Adjustment required to recognize minimum liability	(1,123)	—	—
Accrued pension cost included in other liabilities	\$(2,503)	\$(1,237)	\$(1,127)

For the years ended December 31, 2002, 2001 and 2000, the weighted average discount rate used in determining the actuarial present value of the projected benefit obligation was 6.50%, 7.25% and 8.00%, respectively. The level of future retainers and meeting fees was projected to remain constant.

▶ NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the years ended December 31, 2002, 2001 and 2000

▶ 11. POSTRETIREMENT BENEFITS OTHER THAN PENSION

The Company sponsors two postretirement benefit plans that cover all retirees who were full-time permanent employees with at least five years of service and their spouses. One plan provides medical benefits through a 50% cost sharing arrangement. Effective January 1, 2000, the spouses of future retirees will be required to pay 100% of the premiums for their coverage. The other plan provides life insurance benefits and is noncontributory. Under these programs, eligible retirees receive lifetime medical and life insurance coverage for themselves and lifetime medical coverage for their spouses. The Company reserves the right to amend or terminate these plans at its discretion.

Comprehensive medical plan benefits equal the lesser of the normal plan benefit or the total amount not paid by Medicare. Life insurance benefits for retirees are based on annual compensation and age at retirement. As of December 31, 2002, the Bank has not funded these plans.

The following table sets forth, for the postretirement plans, the change in benefit obligation and assets, and for the Company, the amounts recognized in the Consolidated Statements of Financial Condition at December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Change in benefit obligation:			
Benefit obligation at beginning of year	\$2,164	\$ 2,227	\$ 2,407
Service cost	98	79	82
Actuarial (gain) loss	1,131	(222)	(69)
Plan amendments.....	—	—	(265)
Interest cost.....	153	174	171
Benefits paid	(123)	(94)	(99)
Benefit obligation at end of year.....	3,423	2,164	2,227
Change in plan assets:			
Market value of assets at beginning of year	—	—	—
Employer contributions.....	123	94	99
Benefits paid	(123)	(94)	(99)
Market value of assets at end of year.....	—	—	—
Funded status.....	(3,423)	(2,164)	(2,227)
Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions.....	1,118	(13)	208
Prior service cost not yet recognized in periodic expense...	(397)	(527)	(658)
Accrued postretirement cost included in other liabilities.....	\$(2,702)	\$(2,704)	\$(2,677)

Assumptions used in determining the actuarial present value of the accumulated postretirement benefit obligations at December 31 are as follows:

	2002	2001	2000
Rate of return on plan assets	NA	NA	NA
Discount rate	6.50%	7.25%	8.00%
Rate of increase in health care costs:			
Initial.....	9.00%	9.00%	6.50%
Ultimate (year 2008)	4.50%	4.50%	5.00%
Annual rate of salary increases.....	4.50%	5.50%	5.00%

The health care cost trend rate assumptions have a significant effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 2002 by \$327,000 and the aggregate of the service and interest cost components of net periodic postretirement benefit costs for the year then ended by \$26,000.

The resulting net periodic postretirement benefit expense consisted of the following components for the years ended December 31:

	2002	2001	2000
	<i>(In thousands)</i>		
Service cost	\$ 98	\$ 79	\$ 82
Interest cost	153	174	171
Amortization of unrecognized loss	—	—	4
Amortization of past service liability	(130)	(131)	(124)
Net postretirement benefit expense.....	\$ 121	\$ 122	\$ 133

▶ 12. STOCKHOLDERS' EQUITY

Dividend Restrictions:

In connection with the Bank's conversion from mutual to stock form in November 1995, a special liquidation account was established at the time of conversion, in accordance with the requirements of the Office of Thrift Supervision ("OTS"), which was equal to its capital as of June 30, 1995. The liquidation account is reduced as and to the extent that eligible account holders have reduced their qualifying deposits. Subsequent increases in deposits do not restore an eligible account holder's interest in the liquidation account. In the event of a complete liquidation of the Bank, each eligible account holder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the current adjusted qualifying balances for accounts then held. As of December 31, 2002, the Bank's liquidation account was \$6.2 million and was presented within retained earnings.

In addition to the restriction described above, Federal banking regulations place certain restrictions on dividends paid by the Bank to the Holding Company. The total amount of dividends which may be paid at any date is generally limited to the net income of the Bank for the current year and prior two years, less any dividends previously paid from those earnings. As of December 31, 2002, the Bank had \$19.6 million in retained earnings available to distribute to the Holding Company in the form of cash dividends.

In addition, dividends paid by the Bank to the Holding Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

Stock Split:

The Company declared a three-for-two stock split which was distributed on August 30, 2001 in the form of a stock

dividend. This dividend was not paid on shares held in treasury. Shares issued and outstanding for prior years have been restated to reflect this three-for-two stock split. Treasury share amounts have not been restated for prior years as the stock dividend was not paid on these shares.

Treasury Stock Transactions:

During 2002, the Holding Company repurchased 1,202,450 shares of its outstanding common stock on the open market under its stock repurchase programs. During 2001, 2,120,885 shares of Treasury Stock were used to pay the stock dividend discussed above. At December 31, 2002, the Company had 1,253,720 shares of Treasury Stock which, among other things, could be used to award grants under the Company's Restricted Stock Plan and to satisfy obligations under the Stock Option Plan. Treasury stock is being accounted for using the average cost method.

▶ 13. REGULATORY CAPITAL

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") imposes a number of mandatory supervisory measures on banks and thrift institutions. Among other matters, FDICIA established five capital zones or classifications (well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized). Such classifications are used by the OTS and other bank regulatory agencies to determine matters ranging from each institution's semi-annual FDIC deposit insurance premium assessments, to approvals of applications authorizing institutions to grow their asset size or otherwise expand business activities. Under OTS capital regulations, the Bank is required to comply with each of three separate capital adequacy standards. As of December 31, 2002, the Bank continues to be categorized as "well-capitalized" by the OTS under the prompt corrective action regulations and continues to exceed all regulatory capital requirements. Set forth below is a summary of the Bank's compliance with OTS capital standards.

	December 31, 2002		December 31, 2001	
	Amount	Percent of Assets	Amount	Percent of Assets
<i>(Dollars in thousands)</i>				
Tangible capital:				
Capital level.....	\$125,656	7.74%	\$107,811	7.32%
Requirement.....	24,344	1.50%	22,081	1.50%
Excess.....	\$101,312	6.24%	\$ 85,730	5.82%
Core (Tier I) capital:				
Capital level.....	\$125,656	7.74%	\$107,811	7.32%
Requirement.....	48,687	3.00%	44,162	3.00%
Excess.....	\$ 76,969	4.74%	\$ 63,649	4.32%
Total risk-based capital:				
Capital level.....	\$132,237	14.27%	\$114,396	13.58%
Requirement.....	74,151	8.00%	67,395	8.00%
Excess.....	\$ 58,086	6.27%	\$ 47,001	5.58%

▶ 14. COMMITMENTS AND CONTINGENCIES

Commitments:

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to

meet the financing needs of its customers. These financial instruments include commitments to extend credit and lines of credit. The instruments involve, to varying degrees, elements of credit and market risks in excess of the amount recognized in the consolidated financial statements.

▶ **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

For the years ended December 31, 2002, 2001 and 2000

The Company's exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for loan commitments and lines of credit is represented by the contractual amounts of these instruments.

Commitments to extend credit (principally real estate mortgages) and lines of credit (principally construction loan and home equity loan lines of credit) amounted to approximately \$53,043,000 and \$17,667,000, respectively, at December 31, 2002. Since generally all of the loan commitments are expected to be drawn upon, the total loan commitments approximate future cash requirements, whereas the amounts of lines of credit may not be indicative of the Company's future cash requirements. The loan commitments generally expire in ninety days, while construction loan lines of credit mature within eighteen months and home equity lines of credit mature within ten years. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

As of December 31, 2002, commitments to extend credit for fixed-rate real estate mortgages amounted to \$16.1 million, with an average interest rate of 7.17%.

Commitments to extend credit are legally binding agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates and require payment of a fee. The Company evaluates each customer's creditworthiness on a case-by-case basis. Collateral held consists primarily of real estate.

FFCTI issued \$20.0 million of floating rate capital securities in July 2002. The Holding Company has guaranteed the payment of FFCTI's obligations under these capital securities.

The Company's minimum annual rental payments for Bank premises due under non-cancelable leases are as follows:

	Minimum Rental
	<i>(in thousands)</i>
Years ending December 31:	
2003	\$ 971
2004	998
2005	968
2006	887
2007	273
Thereafter.....	745
Total minimum payments required.....	<u>\$4,842</u>

The leases have escalation clauses for operating expenses and real estate taxes. Certain lease agreements provide for increases in rental payments based upon increases in the consumer price index. Rent expense under these leases for the years ended December 31, 2002, 2001 and 2000 was approximately \$936,000, \$715,000 and \$643,000, respectively.

Contingencies:

The Company is a defendant in various lawsuits. Management of the Company, after consultation with outside legal counsels, believes that the resolution of these various matters will not result in any material adverse effect on the Company's consolidated financial condition, results of operations or cash flows.

▶ **15. CONCENTRATION OF CREDIT RISK**

The Company's lending is concentrated in one-to-four family residential real estate, multi-family residential real estate and commercial real estate loans to borrowers in the metropolitan New York area. The Company evaluates each customer's creditworthiness on a case-by-case basis under the Company's established underwriting policies. The collateral obtained by the Company generally consists of first liens on one-to-four family and multi-family residential real estate and commercial income producing real estate.

▶ **16. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," requires that the Company disclose the estimated fair values for certain of its financial instruments. Financial instruments include items such as loans, deposits, securities, commitments to lend and other items as defined in SFAS No. 107.

Fair value estimates are supposed to represent estimates of the amounts at which a financial instrument could be exchanged between willing parties in a current transaction other than in a forced liquidation. However, in many instances current exchange prices are not available for many of the Company's financial instruments, since no active market generally exists for a significant portion of the Bank's financial instruments. Accordingly, the Company uses other valuation techniques to estimate fair values of its financial instruments such as discounted cash flow methodologies and other methods allowable under SFAS No. 107.

Fair value estimates are subjective in nature and are dependent on a number of significant assumptions based on management's judgment regarding future expected loss experience, current economic condition, risk characteristics of various financial instruments, and other factors. In addition, SFAS No. 107 allows a wide range of valuation techniques; therefore, it may be difficult to compare the Company's fair value information to independent markets or to other financial institutions' fair value information.

The Company generally holds its earning assets, other than securities available for sale, to maturity and settles its liabilities at maturity. However, fair value estimates are made at a specific point in time and are based on relevant market information. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular instrument. Accordingly, as assumptions change, such as interest rates and prepayments, fair value estimates change and these amounts may not necessarily be realized in an immediate sale.

SFAS No. 107 does not require disclosure about fair value information for items that do not meet the definition of a financial instrument or certain other financial instruments specifically excluded from its requirements. These items include core deposit intangibles and other customer relationships, premises and equipment, leases, income taxes, foreclosed properties and equity.

Further, SFAS No. 107 does not attempt to value future income or business. These items may be material and accordingly, the fair value information presented does not purport to represent, nor should it be construed to represent, the underlying "market" or franchise value of the Company.

The estimated fair value of each material class of financial instruments at December 31, 2002 and 2001 and the related methods and assumptions used to estimate fair value are as follows:

Cash and due from banks, overnight interest-earning deposits and federal funds sold, FHLB-NY stock, interest and dividends receivable, mortgagors' escrow deposits and other liabilities:

The carrying amounts are a reasonable estimate of fair value.

Securities available for sale:

The estimated fair values of securities available for sale are contained in Note 6 of Notes to Consolidated Financial Statements. Fair value is based upon quoted market prices, where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities and adjusted for differences between the quoted instrument and the instrument being valued.

Loans:

The estimated fair value of loans, with carrying amounts of \$1,169,560,000 and \$1,067,197,000 at December 31, 2002 and 2001, respectively, was \$1,207,408,000 and \$1,092,221,000 at December 31, 2002 and 2001, respectively.

Fair value is estimated by discounting the expected future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities.

For non-accruing loans, fair value is generally estimated by discounting management's estimate of future cash flows with a discount rate commensurate with the risk associated with such assets.

Due to depositors:

The estimated fair value of due to depositors, with carrying amounts of \$1,002,013,000 and \$818,517,000 at December 31, 2002 and 2001, respectively, was \$1,018,495,000 and \$831,808,000 at December 31, 2002 and 2001, respectively.

The fair values of demand, passbook savings, NOW and money market deposits are, by definition, equal to the amount payable on demand at the reporting dates (i.e., their carrying value). The fair value of fixed-maturity certificates of deposits are estimated by discounting the expected future cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowed funds:

The estimated fair value of borrowed funds, with carrying amounts of \$493,164,000 and \$513,435,000 at December 31, 2002 and 2001, respectively, was \$524,480,000 and \$527,398,000 at December 31, 2002 and 2001, respectively.

The fair value of borrowed funds is estimated by discounting the contractual cash flows using interest rates in effect for borrowings with similar maturities and collateral requirements.

▶ NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the years ended December 31, 2002, 2001 and 2000

Other financial instruments:

The fair values of commitments to sell, lend or borrow are estimated using the fees currently charged or paid to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties or on the estimated cost to terminate them or otherwise settle with the counterparties at the reporting date. For fixed-rate loan commitments to sell, lend or borrow, fair values also consider the difference between current levels of interest rates and committed rates (where applicable).

At December 31, 2002 and 2001, the fair values of the above financial instruments approximate the recorded amounts of the related fees and were not considered to be material.

▶ 17. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," which is effective for fiscal years beginning after December 15,

2001. The Statement changes the approach to how goodwill and other intangible assets are accounted for subsequent to their recognition. Goodwill and intangible assets that have indefinite useful lives will not be amortized but rather will be tested at least annually for impairment. Intangible assets that have finite useful lives will be amortized over their useful lives. The Statement provides specific guidance on testing intangible assets that will not be amortized for impairment. As of December 31, 2001, the Company had goodwill with a remaining balance of \$3.9 million recorded in connection with its purchase of New York Federal Savings Bank in 1997. Amortization expense for each of the years in the three-year period ended December 31, 2001 was \$0.4 million. Effective January 1, 2002, the Company is no longer recording this amortization expense, but rather is required, at least annually, to test the remaining goodwill for impairment. The impairment test performed in connection with the adoption of this Statement in January 2002, and the subsequent annual impairment test performed in January 2003, did not require an adjustment to the carrying value of the goodwill.

▶ 18. QUARTERLY FINANCIAL DATA (UNAUDITED)

Selected unaudited quarterly financial data for the fiscal years ended December 31, 2002 and 2001 is presented below:

	2002				2001			
	4th	3rd	2nd	1st	4th	3rd	2nd	1st
<i>(In thousands, except per share data)</i>								
Quarterly operating data:								
Interest income	\$27,260	\$26,855	\$26,678	\$26,113	\$26,038	\$25,583	\$25,227	\$25,051
Interest expense	13,636	13,732	13,494	13,702	14,501	15,042	15,079	15,080
Net interest income	13,624	13,123	13,184	12,411	11,537	10,541	10,148	9,971
Provision for loan losses	—	—	—	—	—	—	—	—
Other operating income	1,543	1,476	(2,896)	1,386	1,417	1,300	1,618	1,723
Other expense	7,234	6,913	6,973	6,501	6,567	5,939	5,984	5,967
Income before income tax expense	7,933	7,686	3,315	7,296	6,387	5,902	5,782	5,727
Income tax expense	3,014	2,921	1,274	2,758	2,427	2,184	2,140	2,118
Net income	\$ 4,919	\$ 4,765	\$ 2,041	\$ 4,538	\$ 3,960	\$ 3,718	\$ 3,642	\$ 3,609
Basic earnings per share	\$ 0.44	\$ 0.41	\$ 0.17	\$ 0.38	\$ 0.33	\$ 0.30	\$ 0.30	\$ 0.29
Diluted earnings per share	\$ 0.42	\$ 0.39	\$ 0.17	\$ 0.36	\$ 0.31	\$ 0.29	\$ 0.28	\$ 0.28
Dividends per share	\$ 0.090	\$ 0.090	\$ 0.090	\$ 0.090	\$ 0.080	\$ 0.080	\$ 0.073	\$ 0.073
Average common shares outstanding for:								
Basic earnings per share	11,258	11,491	11,689	11,970	12,107	12,316	12,284	12,364
Diluted earnings per share	11,741	12,070	12,308	12,541	12,700	12,882	12,832	12,800

▶ 19. PARENT COMPANY ONLY FINANCIAL INFORMATION

Earnings of the Bank are recognized by the Holding Company using the equity method of accounting. Accordingly, earnings of the Bank are recorded as increases in the Holding Company's investment, any dividends would reduce the Holding Company's investment in the Bank, and any changes in the Bank's unrealized gain or loss on securities available for sale, net of taxes, would increase or decrease, respectively, the Holding Company's investment in the Bank. The condensed financial statements for the Holding Company at and for the years ended December 31, 2002 and 2001 are presented below:

	2002	2001
<i>(In thousands)</i>		
Condensed Statements of Financial Condition		
Assets:		
Cash and due from banks	\$ 9,976	\$ 12,679
Federal funds sold and overnight interest-earning deposit	—	924
Securities available for sale:		
Mortgage-backed securities	—	—
Other securities	6,153	6,263
Interest receivable	30	17
Investment in subsidiaries	134,598	113,232
Other assets	1,821	600
Total assets	\$152,578	\$133,715
Liabilities:		
Other liabilities	\$ 573	\$ 328
Borrowings	20,619	—
Total liabilities	21,192	328
Stockholders' equity:		
Common stock	139	139
Additional paid-in capital	47,208	45,280
Treasury stock	(21,733)	(5,750)
Unearned compensation	(7,825)	(7,766)
Retained earnings	109,208	99,641
Accumulated other comprehensive income, net of taxes	4,389	1,843
Total equity	131,386	133,387
Total liabilities and equity	\$152,578	\$133,715

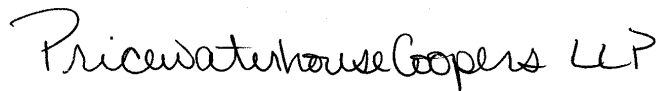
	2002	2001
<i>(In thousands)</i>		
Condensed Statements of Income		
Dividends from the Bank	\$ —	\$ 15,000
Interest income	333	438
Interest expense	(540)	—
Non-interest income	—	—
Other operating expenses	(722)	(609)
Income before taxes and equity in undistributed earnings of subsidiary	(929)	14,829
Income tax benefit	457	127
Income before equity in undistributed earnings of subsidiary	(472)	14,956
Excess of dividends over current year earnings	—	(27)
Equity in undistributed earnings of the Bank	16,735	—
Net income	\$ 16,263	\$ 14,929
<i>(In thousands)</i>		
Condensed Statements of Cash Flow		
Operating activities:		
Net income	\$ 16,263	\$ 14,929
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed earnings of the Bank	(16,735)	27
Net decrease in operating assets and liabilities	(898)	(91)
Amortization of unearned premium, net of accretion of unearned discount	1	8
Unearned compensation, net	1,615	1,577
Net cash provided by operating activities	246	16,450
Investing activities:		
Purchases of securities available for sale	(112)	(709)
Proceeds from sales and calls of securities available for sale	30	1,460
Investment in subsidiary	(619)	—
Net cash (used) provided by investing activities	(701)	751
Financing activities:		
Purchase of treasury stock	(19,553)	(9,289)
Cash dividends paid	(4,238)	(3,824)
Proceeds from long-term borrowings	20,619	—
Net cash used in financing activities	(3,172)	(13,113)
Net increase (decrease) in cash and cash equivalents	(3,627)	4,088
Cash and cash equivalents, beginning of year	13,603	9,515
Cash and cash equivalents, end of year	\$ 9,976	\$ 13,603

▶ REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
Flushing Financial Corporation:

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of income, changes in stockholders' equity, and cash flows present fairly, in all material respects, the financial position of Flushing Financial Corporation and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which

require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.



New York, New York
January 29, 2003

► CORPORATE INFORMATION

EXECUTIVE MANAGEMENT

Gerard P. Tully, Sr.

Chairman of the Board

Michael J. Hegarty

President & Chief Executive Officer

John R. Buran

*Executive Vice President &
Chief Operating Officer*

Monica C. Passick

*Senior Vice President, Treasurer &
Chief Financial Officer*

Henry A. Braun

Senior Vice President

Robert L. Callicutt

Senior Vice President

Francis W. Korzekwinski

Senior Vice President

Anna M. Piacentini

*Senior Vice President &
Corporate Secretary*

BOARD OF DIRECTORS

Gerard P. Tully, Sr.

Chairman

*Real estate development
and management*

Michael J. Hegarty

President & Chief Executive Officer

James D. Bennett

Attorney in Nassau County, New York

Louis C. Grassi

*Managing Partner of Grassi & Co.,
CPAs, P.C.*

Robert A. Marani

*Commercial real estate development
and management*

John O. Mead

*Retired fabric manufacturer
and marketer*

Vincent F. Nicolosi

Attorney in Bayside, New York

Franklin F. Regan, Jr.

Attorney in Flushing, New York

John E. Roe, Sr.

*Chairman of City Underwriting Agency, Inc.
Insurance Brokers*

Michael J. Russo

*Consulting Engineer, President and
Director of Operations for Northeastern
Aviation Corp.*

CORPORATE HEADQUARTERS

Flushing Savings Bank, FSB
144-51 Northern Boulevard
Flushing, New York 11354
718-961-5400

facsimile 718-539-1025

www.flushingsavings.com

RETAIL BRANCH LOCATIONS

Flushing

144-51 Northern Boulevard

159-18 Northern Boulevard

188-08 Hollis Court Boulevard

44-43 Kissena Boulevard

Bayside

61-54 Springfield Boulevard

New Hyde Park

661 Hillside Avenue

In-Store Branch

(Stop & Shop Supermarket)

653 Hillside Avenue

Bay Ridge

7102 Third Avenue

Manhattan

33 Irving Place

Bronx

In-Store Branch

(Stop & Shop Supermarket)

753 Co-Op City Boulevard

MORTGAGE ORIGINATIONS

Flushing Savings Bank, FSB and

New York Federal Division

144-51 Northern Boulevard

718-961-5400

SMALL BUSINESS LENDING

33 Irving Place

212-477-9424

► SHAREHOLDER INFORMATION

ANNUAL MEETING

The Annual Meeting of Shareholders of Flushing Financial Corporation will be held at 2:00 PM, May 20, 2003, at the La Guardia Marriott located at 102-05 Ditmars Boulevard, East Elmhurst, New York 11369

STOCK LISTING

Nasdaq National Market®
Symbol "FFIC"

TRANSFER AGENT AND REGISTRAR

EquiServe Trust Company NA

P. O. Box 43011

Providence, Rhode Island 02940-3011

1-800-426-5523

INDEPENDENT CERTIFIED

PUBLIC ACCOUNTANTS

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1177 Avenue of the Americas

New York, New York 10036

646-471-4000

LEGAL COUNSEL

Hughes Hubbard & Reed LLP

One Battery Park Plaza

New York, New York 10004

212-837-6000

SHAREHOLDER RELATIONS

Van Negriss and Company, Inc.

766 Madison Avenue

New York, New York 10021

212-396-0606

Flushing Financial Corporation

144-51 NORTHERN BLVD.
FLUSHING, NEW YORK 11354

