

SI Financial Group, Inc.
Form 10-Q
August 08, 2017

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

FORM 10-Q
 QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the Quarterly Period Ended June 30, 2017

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

For the Transition Period from _____ to _____

Commission File Number: 0-54241

SI FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Maryland 80-0643149
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

803 Main Street, Willimantic, Connecticut 06226
(Address of principal executive offices) (Zip Code)

(860) 423-4581
(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange

Act. o

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

Yes No

As of August 4, 2017, there were 12,231,845 shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

SI FINANCIAL GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts / Unaudited)

	June 30, 2017	December 31, 2016
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	\$15,412	\$ 18,225
Interest-bearing	79,890	54,961
Total cash and cash equivalents	95,302	73,186
Available for sale securities, at fair value	175,270	159,367
Loans held for sale	1,588	1,393
Loans receivable (net of allowance for loan losses of \$12,147 at June 30, 2017 and \$11,820 at December 31, 2016)	1,227,741	1,220,323
Federal Home Loan Bank stock, at cost	12,231	12,162
Federal Reserve Bank stock, at cost	3,631	3,624
Bank-owned life insurance	21,555	21,293
Premises and equipment, net	19,805	19,884
Goodwill and other intangibles	17,193	17,494
Accrued interest receivable	4,526	4,435
Deferred tax asset, net	9,507	9,658
Other real estate owned, net	1,043	1,466
Other assets	7,108	6,605
Total assets	\$1,596,500	\$1,550,890
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	\$216,919	\$ 201,598
Interest-bearing	983,877	929,087
Total deposits	1,200,796	1,130,685
Mortgagors' and investors' escrow accounts	4,884	4,388
Federal Home Loan Bank advances	187,102	217,759
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	26,448	25,083
Total liabilities	1,427,478	1,386,163
Shareholders' Equity:		
Preferred stock (\$.01 par value; 1,000,000 shares authorized; none issued)	—	—
Common stock (\$.01 par value; 35,000,000 shares authorized; 12,226,345 and 12,212,904 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively)	122	122
Additional paid-in-capital	126,168	125,628
Unallocated common shares held by ESOP	(2,928)	(3,168)
Unearned restricted shares	(260)	(341)
Retained earnings	46,446	43,167

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Accumulated other comprehensive loss	(526)	(681)
Total shareholders' equity	169,022		164,727	
Total liabilities and shareholders' equity	\$1,596,500		\$1,550,890	

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Amounts / Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Interest and dividend income:				
Loans, including fees	\$12,282	\$11,506	\$24,432	\$23,077
Securities:				
Taxable interest	831	907	1,574	1,746
Tax-exempt interest	14	14	28	28
Dividends	177	171	354	333
Other	194	77	312	133
Total interest and dividend income	13,498	12,675	26,700	25,317
Interest expense:				
Deposits	1,883	1,655	3,633	3,204
Federal Home Loan Bank advances	875	816	1,775	1,690
Subordinated debt and other borrowings	59	48	113	93
Total interest expense	2,817	2,519	5,521	4,987
Net interest income	10,681	10,156	21,179	20,330
Provision for loan losses	170	582	330	893
Net interest income after provision for loan losses	10,511	9,574	20,849	19,437
Noninterest income:				
Service fees	1,758	1,569	3,442	3,213
Wealth management fees	192	302	519	601
Increase in cash surrender value of bank-owned life insurance	132	136	262	277
Mortgage banking	466	399	621	669
Net gain on fair value of derivatives	—	16	—	15
Net loss on disposal of equipment	—	(35)	—	(36)
Other	1,091	199	1,304	549
Total noninterest income	3,639	2,586	6,148	5,288
Noninterest expenses:				
Salaries and employee benefits	5,225	4,643	10,433	9,821
Occupancy and equipment	1,700	1,703	3,476	3,446
Computer and electronic banking services	1,290	1,476	2,670	2,944
Outside professional services	392	379	793	1,014
Marketing and advertising	217	238	407	451
Supplies	128	121	262	289
FDIC deposit insurance and regulatory assessments	218	253	412	525
Core deposit intangible amortization	151	150	301	301
Other real estate owned operations	257	69	367	125
Other	445	548	1,244	930

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Total noninterest expenses	10,023	9,580	20,365	19,846
Income before income tax provision	4,127	2,580	6,632	4,879
Income tax provision	1,285	852	2,071	1,610
Net income	\$2,842	\$1,728	\$4,561	\$3,269
Earnings per share:				
Basic	\$0.24	\$0.15	\$0.39	\$0.28
Diluted	\$0.24	\$0.15	\$0.38	\$0.28

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (In Thousands / Unaudited)

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2017	2016	2017	2016
Net income	\$2,842	\$1,728	\$4,561	\$3,269
Other comprehensive income, net of tax:				
Net unrealized holding gains on 125 available for sale securities	125	310	155	1,356
Other comprehensive income	125	310	155	1,356
Comprehensive income	\$2,967	\$2,038	\$4,716	\$4,625

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2017
(In Thousands, Except Share Data / Unaudited)

	Common Stock		Additional Paid-in Capital	Unallocated		Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Dollars		Common Shares Held by ESOP	Unearned Restricted Shares			
Balance at December 31, 2016	12,212,904	\$ 122	\$125,628	\$ (3,168)	\$ (341)	\$43,167	\$ (681)	\$ 164,727
Comprehensive income	—	—	—	—	—	4,561	155	4,716
Cash dividends declared (\$0.10 per share)	—	—	—	—	—	(1,185)	—	(1,185)
Equity incentive plans compensation	—	—	178	—	81	—	—	259
Allocation of 24,318 ESOP shares	—	—	121	240	—	—	—	361
Stock options exercised	33,544	—	444	—	—	—	—	444
Common shares repurchased	(20,103)	—	(203)	—	—	(97)	—	(300)
Balance at June 30, 2017	12,226,345	\$ 122	\$126,168	\$ (2,928)	\$ (260)	\$46,446	\$ (526)	\$ 169,022

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands / Unaudited)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$4,561	\$3,269
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	330	893
Employee stock ownership plan expense	361	336
Equity incentive plan expense	259	461
Excess tax benefit from share-based compensation	—	(8)
Amortization of investment premiums and discounts, net	519	384
Amortization of loan premiums and discounts, net	588	736
Depreciation and amortization of premises and equipment	1,101	1,234
Amortization of core deposit intangible	301	301
Net gain on fair value of derivatives	—	(15)
Deferred income tax provision (benefit)	72	(81)
Loans originated for sale	(23,019)	(19,198)
Proceeds from sale of loans held for sale	23,127	16,073
Net gain on sales of loans held for sale	(466)	(532)
Net loss on disposal of equipment	—	36
Net loss on sales or write-downs of other real estate owned	392	2
Increase in cash surrender value of bank-owned life insurance	(262)	(277)
Change in operating assets and liabilities:		
Accrued interest receivable	(91)	59
Other assets	(340)	(40)
Accrued expenses and other liabilities	1,365	(1,440)
Net cash provided by operating activities	8,798	2,193
Cash flows from investing activities:		
Purchases of available for sale securities	(32,053)	(24,401)
Proceeds from maturities of and principal repayments on available for sale securities	15,865	13,070
Purchases of Federal Home Loan Bank stock	(69)	—
Purchases of Federal Reserve Bank stock	(7)	(3)
Redemption of Federal Home Loan Bank stock	—	504
Loan principal originations, net	10,811	21,503
Purchases of loans	(19,276)	(11,858)
Proceeds from sales of other real estate owned	160	270
Purchases of premises and equipment	(1,022)	(542)
Proceeds from bank-owned life insurance	—	1,201
Net cash used in investing activities	(25,591)	(256)

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Concluded)
(In Thousands / Unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Cash flows from financing activities:		
Net increase in deposits	70,111	58,815
Net increase in mortgagors' and investors' escrow accounts	496	627
Proceeds from Federal Home Loan Bank advances	14,500	3,000
Repayments of Federal Home Loan Bank advances	(45,157)	(29,681)
Excess tax benefit from share-based compensation	—	8
Cash dividends on common stock	(1,185)	(945)
Stock options exercised	281	37
Common shares repurchased	(137)	(37)
Net cash provided by financing activities	38,909	31,824
Net change in cash and cash equivalents	22,116	33,761
Cash and cash equivalents at beginning of period	73,186	40,778
Cash and cash equivalents at end of period	\$95,302	\$74,539
Supplemental cash flow information:		
Interest paid	\$5,534	\$5,015
Income taxes paid, net	4,270	1,450
Transfer of loans to other real estate owned	129	350
Stock options exercised by net-share settlement	163	—

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016 AND DECEMBER 31, 2016

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

SI Financial Group, Inc. (the “Company”) is the holding company for Savings Institute Bank and Trust Company (the “Bank”). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its 24 offices in eastern Connecticut and Rhode Island. Its primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans and consumer loans. In addition, life insurance and annuities are offered to individuals and businesses through the Bank’s offices. The Company does not conduct any material business other than owning all of the stock of the Bank and making payments on the subordinated debentures held by the Company.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, the Bank, and the Bank’s wholly-owned subsidiaries, SI Mortgage Company and SI Realty Company, Inc. All significant intercompany accounts and transactions have been eliminated.

Basis of Financial Statement Presentation

The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, the instructions to Form 10-Q and Rule 10.01 of Regulation S-X of the Securities and Exchange Commission and general practices within the banking industry. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of June 30, 2017 and for the three and six months ended June 30, 2017 and 2016 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and the accompanying notes for the year ended December 31, 2016 contained in the Company’s Annual Report on Form 10-K.

In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the periods covered herein. The results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the operating results for the year ending December 31, 2017 or for any other period.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the date of the balance sheets and reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred income taxes and the impairment of long-lived assets.

Reclassifications

Amounts in the Company's prior year consolidated financial statements are reclassified to conform to the current year presentation. Such reclassifications had no effect on net income.

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016 AND DECEMBER 31, 2016

Loans Receivable

Loans receivable are stated at current unpaid principal balances, net of the allowance for loan losses and deferred loan origination fees and costs. Management has the ability and intent to hold its loans receivable for the foreseeable future or until maturity or pay-off.

A loan is impaired when, based on current information and events, it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis for residential and commercial mortgage loans and commercial business loans by either the present value of 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. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not typically identify individual consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring ("TDR") agreement.

Troubled Debt Restructurings

The Company periodically may agree to modify the contractual terms of loans due to the borrower's financial condition. When a loan is modified and concessions have been made to the original contractual terms that would not otherwise be considered for a borrower with similar risk characteristics, such as reductions of interest rates, deferral of interest or principal payments, or maturity extensions due to the borrower's financial condition, the modification is considered a TDR. Modified terms are dependent upon the financial position and needs of the individual borrower. If the modification agreement is violated, the loan is handled by the Company's Collections Department for resolution, which may result in foreclosure.

Management considers all nonaccrual loans, with the exception of certain consumer loans, to be impaired. Also, all TDRs are initially classified as impaired and follow the Company's nonaccrual policy. However, if the loan was current prior to modification, nonaccrual status would not be required. If the loan was on nonaccrual prior to modification or if the payment amount significantly increases, the loan will remain on nonaccrual for a period of at least six months. Loans qualify for return to accrual status once the borrower has demonstrated the willingness and the ability to perform in accordance with the restructured terms of the loan agreement for a period of not less than six consecutive months. In most cases, loan payments less than 90 days past due are considered minor collection delays and the related loans are generally not considered impaired.

Impaired classification may be removed after a year following the restructure if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar risk characteristics at the time of restructuring.

Allowance for Loan Losses

The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loan losses are charged against the allowance for loan losses when management believes the

uncollectibility of the principal loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received.

Management's judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic

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SI FINANCIAL GROUP, INC.

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JUNE 30, 2017 AND 2016 AND DECEMBER 31, 2016

and real estate market conditions, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, historical loan loss experience, the amount and trends of nonperforming loans, delinquencies, classified assets and loan charge-offs and evaluations of loans and other relevant factors.

The allowance for loan losses consists of the following key elements:

Specific allowance for identified impaired loans. For loans identified as impaired, an allowance is established when the present value of expected cash flows, or observable market price of the loan or fair value of the collateral if the loan is collateral dependent, of the impaired loan is lower than the carrying value of that loan. In the determination of the allowance for loan losses, management may obtain independent appraisals for significant properties, when necessary.

General valuation allowance. The general component represents a valuation allowance on the remainder of the loan portfolio, after excluding impaired loans. For this portion of the allowance, loans are segregated by category and assigned an allowance percentage based on historical loan loss experience adjusted for qualitative factors stratified by the following loan segments: residential one- to four-family, multi-family and commercial real estate, construction, commercial business and consumer. Management uses a rolling average of historical losses based on the time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off and recovery practices; changes in national, regional and local economic and business conditions and developments that affect the collectibility of the portfolio, including the condition of various market segments; changes in the size and composition of the loan portfolio and in the terms of the loans; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due loans, the volume of nonaccrual loans and the volume and severity of adversely classified or graded loans; changes in the quality of the loan review system; changes in the underlying collateral for collateral-dependent loans; the existence and effect of any concentrations of credit and changes in the level of such concentrations; the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the portfolio.

The qualitative factors are determined based on the following various risk characteristics for each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential – One to Four Family – The Bank primarily originates conventional loans with loan-to-value ratios less than 95% and generally originates loans with loan-to-value ratios in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

Multi-family and Commercial – Loans in this segment are originated to acquire, develop, improve or refinance multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The underlying cash flows generated by the properties

can be impacted by the economy as evidenced by increased vacancy rates. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. Management continually monitors the cash flows of these loans.

• Construction – This segment includes loans to individuals and, to a lesser extent, builders to finance the construction of residential dwellings. The Bank also originates construction loans for commercial

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development projects. Upon the completion of construction, the loan generally converts to a permanent mortgage loan. Credit risk is affected by cost overruns, whether estimates of the sale price of the property are correct, time to sell at an adequate price and market conditions.

Commercial Business – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy and reduced viability of the industry in which the customer operates will have a negative impact on the credit quality in this segment. The Bank provides loans to investors in the time share industry, which are secured by consumer receivables, and provides loans for capital improvements to condominium associations, which are secured by the assigned rights to levy special assessments to condominium owners. Additionally, the Bank purchases loans primarily out of our market area from a company specializing in medical loan originations, which are secured by medical equipment.

Consumer – Loans in this segment primarily include home equity lines of credit (representing both first and second liens), indirect automobile loans and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles, as well as unsecured loans. Consumer loan collections depend on the borrower's continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

In computing the allowance for loan losses, we do not assign a general valuation allowance to the Small Business Administration ("SBA") and United States Department of Agriculture ("USDA") loans that we purchase as such loans are fully guaranteed. These loans are included in commercial business loans.

The majority of the Company's loans are collateralized by real estate located in eastern Connecticut and Rhode Island. To a lesser extent, certain commercial real estate loans are secured by collateral located outside of our primary market area with concentrations in Massachusetts and New Hampshire. Accordingly, the collateral value of a substantial portion of the Company's loan portfolio and real estate acquired through foreclosure is susceptible to changes in local market conditions.

Although management believes it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and the Company's results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while management believes it has established the allowance for loan losses in conformity with GAAP, our regulators, in reviewing the loan portfolio, may request us to increase our allowance for loan losses based on judgments different from ours. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate or increases may be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations.

Interest and Fees on Loans

Interest on loans is accrued and included in net interest income based on contractual rates applied to principal amounts outstanding. Accrual of interest is discontinued when loan payments are 90 days or more past due, based on contractual terms, or when, in the judgment of management, collectibility of the loan or loan interest becomes uncertain. Subsequent recognition of income occurs only to the extent payment is received subject to management's

assessment of the collectibility of the remaining interest and principal. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt and the borrower has made regular payments in accordance with the terms of the loan over a period of at least six months. Interest collected on nonaccrual loans is recognized only to the extent cash payments are

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016 AND DECEMBER 31, 2016

received, and may be recorded as a reduction to principal if the collectibility of the principal balance of the loan is unlikely.

Loan origination fees, direct loan origination costs and loan purchase premiums are deferred, and the net amount is recognized as an adjustment of the related loan's yield utilizing the interest method over the contractual life of the loan. In addition, discounts related to fair value adjustments for loans receivable acquired in a business combination or asset purchase are accreted into earnings over the contractual term as an adjustment of the related loan's yield. The Company periodically evaluates the cash flows expected to be collected for loans acquired with deteriorated credit quality. Changes in the expected cash flows compared to the expected cash flows as of the date of acquisition may impact the accretable yield or result in a charge to the provision for loan losses to the extent of a shortfall.

Common Share Repurchases

The Company is chartered in Maryland. Maryland law does not provide for treasury shares, rather shares repurchased by the Company constitute authorized but unissued shares. GAAP states that accounting for treasury stock shall conform to state law. Therefore, the cost of shares repurchased by the Company is allocated to common stock, additional paid-in capital and retained earnings balances.

Recent Accounting Pronouncements

Revenue from Contracts with Customers (Topic 606): In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance that improves the revenue recognition requirements for contracts with customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve the core principle, a company should apply a five step approach to revenue recognition. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or entered into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. Accordingly, the guidance does not apply to, among other things, the following: receivables (i.e. loans), debt and equity investments, equity method investments, joint ventures, derivatives and hedging, financial instruments and transfers and servicing. As significantly all of the Company's revenues are excluded from the scope of the guidance, adoption is not expected to have a material impact on the Company's consolidated financial statements. In August 2015, the FASB delayed the effective date for this guidance for one year to fiscal years beginning after December 15, 2017.

Financial Instruments (Subtopic 825-10): In January 2016, the FASB issued guidance addressing certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Targeted improvements to GAAP include the requirement for equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income and the elimination of the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost. The amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

Leases (Topic 842): In February 2016, the FASB issued amended guidance to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. An entity that elects

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to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. It is expected that assets and liabilities will increase based on the present value of remaining lease payments for leases in place at the adoption date; however, based on the current level of long-term leases in place, this is not expected to be material to the Company's consolidated financial statements.

Compensation - Stock Compensation (Topic 718): In March 2016, the FASB issued guidance to simplify the accounting for share-based payment transactions, including the income tax consequences of such transactions. Under the provisions of the update, the income tax consequences of excess tax benefits and deficiencies should be recognized in income tax expense in the reporting period in which the awards vest. Currently, excess tax benefits or deficiencies impact shareholders' equity directly to the extent there is a cumulative excess tax benefit. In the event that a tax deficiency has occurred during the reporting period and a cumulative tax benefit does not exist, the tax deficiency is recognized in income tax expense under current GAAP. The update also provides entities may continue to estimate forfeitures in accounting for stock based compensation or recognize them as they occur. The provisions of this update became effective for interim and annual periods beginning after December 15, 2016. The adoption of this guidance on January 1, 2017 did not have a material impact on Company's consolidated financial statements.

Financial Instruments - Credit Losses (Topic 326): In June 2016, the FASB issued guidance that significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. The update will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to (1) financial assets subject to credit losses and measured at amortized cost and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments and financial guarantees. The CECL model does not apply to available for sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to current accounting guidance, except that losses will be recognized as allowances rather than reductions in the amortized cost of the securities. The update also simplifies the accounting model for purchased credit-impaired debt securities and loans. Disclosure requirements under the update have been expanded to include the entity's assumptions, models and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by year of origination. The update is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual periods beginning after December 15, 2018. The update requires a modified retrospective transition under which a cumulative effect to equity will be recognized in the period of adoption. Management has developed a focus team that is reviewing and monitoring additional developments and accounting guidance to determine the impact to the Company's consolidated financial statements. Management began evaluating the models and related requirements and is developing an implementation plan.

Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230): In August 2016, the FASB issued guidance to reduce the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This update provides guidance on eight specific cash flow

issues. The update is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The amendments in this update should be applied using a retrospective transition method to each period presented. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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Business Combinations - Clarifying the Definition of a Business (Topic 805): In January 2017, the FASB issued guidance to clarify the definition of a business. The amendments in this update provide a screen to determine when an integrated set of assets and activities (collectively referred to as a "set") is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. The amendments in this update are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The amendments in this update should be applied prospectively on or after the effective date. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

Intangibles - Goodwill and Other - Simplifying the Test for Goodwill Impairment (Topic 350): In January, 2017, the FASB issued guidance aimed at simplifying the subsequent measurement of goodwill. Under these amendments, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from tax deductible goodwill on the carrying amount of a reporting unit when measuring the goodwill impairment loss, if applicable. The Board also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. Therefore, the same impairment assessment applies to all reporting units. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendments in this update should be applied on a prospective basis and are effective for annual and goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): In March 2017, the FASB issued guidance shortening the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. The amendments in this update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

Compensation - Stock Compensation (Topic 718): In May 2017, the FASB issued guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all of the following are met: 1) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; 2) the vesting conditions of the modified award are the same as the vesting conditions of the original award

immediately before the original award is modified; and 3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted. The amendments in this update should be applied prospectively to an award modified on or after the adoption date.

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The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

NOTE 2. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period. Unvested restricted shares are considered outstanding in the computation of basic earnings per share since the shares participate in dividends and the rights to the dividends are non-forfeitable. Diluted earnings per share is computed in a manner similar to basic earnings per share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. The Company's common stock equivalents relate solely to stock options. Repurchased common shares and unallocated common shares held by the Bank's ESOP are not deemed outstanding for earnings per share calculations.

Anti-dilutive shares are common stock equivalents with weighted average exercise prices in excess of the weighted average market value for the periods presented, and are not considered in diluted earnings per share calculations. The Company had anti-dilutive common shares outstanding of 130,000 for the three and six months ended June 30, 2017 and 157,391 and 151,391 for the three and six months ended June 30, 2016, respectively.

The computation of earnings per share is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in Thousands, Except Per Share Amounts)			
Net income	\$2,842	\$ 1,728	\$4,561	\$ 3,269
Weighted average common shares outstanding:				
Basic	11,847,905	10,803,156	11,838,075	11,796,099
Effect of dilutive stock options	92,734	58,813	89,893	59,386
Diluted	11,940,639	10,861,969	11,927,968	11,855,485
Earnings per share:				
Basic	\$0.24	\$ 0.15	\$0.39	\$ 0.28
Diluted	\$0.24	\$ 0.15	\$0.38	\$ 0.28

NOTE 3. SECURITIES

Available for Sale Securities

The amortized cost, gross unrealized gains and losses and fair values of available for sale securities at June 30, 2017 and December 31, 2016 are as follows:

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June 30, 2017			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In Thousands)			
Debt securities:			
U.S.			
Government agency obligations	\$ 42	\$ (608)	\$ 72,218
Government-sponsored enterprises	77	(2)	9,310
Mortgage-backed securities: ⁽¹⁾			
Agency residential	392	(762)	88,369
Non-agency residential	—	(5)	79
Collateralized debt obligation	10	—	1,107
Obligations of state and political subdivisions	—	—	1,000
Tax-exempt securities	58	—	3,187
Total available for sale securities	\$ 579	\$ (1,377)	\$ 175,270

⁽¹⁾ Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises (“GSEs”). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by any of the GSEs or the U.S. Government.

December 31, 2016			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In Thousands)			
Debt securities:			
U.S. Government	\$ 132	\$ (730)	\$ 64,296

and agency obligations				
Government-sponsored enterprises	11,267	97	—	11,364
Mortgage-backed securities: ⁽¹⁾				
Agency				
- residential	78,843	475	(1,016)	78,302
Non-agency				
- residential	93	—	(6)	87
Collateralized debt obligation	157	—	—	1,157
Obligations of state and political subdivisions	1,000	—	—	1,000
Tax-exempt securities	3,145	22	(6)	3,161
Total available for sale securities	\$ 160,399	\$ 726	\$ (1,758)	\$ 159,367

⁽¹⁾ Agency securities refer to debt obligations issued or guaranteed by government corporations or GSEs. Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by any of the GSEs or the U.S. Government.

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The amortized cost and fair value of debt securities by contractual maturities at June 30, 2017 are presented below. Maturities are based on the final contractual payment dates and do not reflect the impact of potential prepayments or early redemptions. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	Amortized Cost	Fair Value
	(In Thousands)	
Within 1 year	\$13,481	\$13,485
After 1 but within 5 years	21,640	21,665
After 5 but within 10 years	7,575	7,486
After 10 years	44,549	44,186
	87,245	86,822
Mortgage-backed securities	88,823	88,448
Total debt securities	\$176,068	\$175,270

There were no sales of available for sale securities for the three and six months ended June 30, 2017 and 2016.

The following tables present information pertaining to securities with gross unrealized losses at June 30, 2017 and December 31, 2016, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2017	(In Thousands)					
U.S. Government and agency obligations	\$25,603	\$ 102	\$26,982	\$ 506	\$52,585	\$ 608
Government sponsored enterprises	299	2	—	—	299	2
Mortgage-backed securities:						
Agency - residential	51,795	522	12,558	240	64,353	762
Non-agency - residential	—	—	79	5	79	5
Total	\$77,697	\$ 626	\$39,619	\$ 751	\$117,316	\$ 1,377

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016	(In Thousands)					
U.S. Government and agency obligations	\$21,531	\$ 227	\$19,272	\$ 503	\$40,803	\$ 730
Mortgage-backed securities:						
Agency - residential	49,961	756	9,585	260	59,546	1,016
Non-agency - residential	—	—	87	6	87	6

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Tax-exempt securities	1,121	6	—	—	1,121	6
Total	\$72,613	\$ 989	\$28,944	\$ 769	\$101,557	\$ 1,758

At June 30, 2017, 60 debt securities with gross unrealized losses had an aggregate depreciation of 1.16% of the Company's amortized cost basis. The unrealized losses are primarily related to the Company's U.S. Government and agency obligations and agency mortgage-backed securities. There were no investments deemed other-than-temporarily impaired for the three and six months ended June 30, 2017 and 2016. The following summarizes, by

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security type, the basis for management's determination during the preparation of the financial statements of whether the applicable investments within the Company's securities portfolio were not other-than-temporarily impaired at June 30, 2017.

U.S. Government and Agency Obligations and Mortgage-backed Securities - Agency - Residential. The unrealized losses on the Company's U.S. Government and agency obligations and mortgage-backed agency-residential securities related primarily to a widening of the rate spread to comparable treasury securities. The Company does not expect these securities to settle at a price less than the par value of the securities.

Mortgage-backed Securities - Non-Agency - Residential. The unrealized losses on the Company's non-agency-residential mortgage-backed securities relate to one investment which has been evaluated by management and no potential credit loss was identified.

NOTE 4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loan Portfolio

The composition of the Company's loan portfolio at June 30, 2017 and December 31, 2016 is as follows:

	June 30, 2017	December 31, 2016
(In Thousands)		
Real estate loans:		
Residential		
-		
1 to 4 family	\$408,717	\$417,064
Multi-family and commercial construction	88,692	421,668
Total real estate loans	497,409	838,732
Commercial business loans:		
	102,640	116,383

SBA and USDA guaranteed Time share	48,907	51,083
Condominium association	26,207	23,531
Medical loans	26,787	27,180
Other	92,906	79,524
Total commercial business loans	297,447	297,701
Consumer loans:		
Home equity	54,895	55,228
Indirect automobile	213	501
Other	1,689	1,687
Total consumer loans	56,797	57,416
Total loans	1,237,491	1,229,875
Deferred loan origination costs, net of fees	2,397	2,268
Allowance for loan losses	(12,147)	(11,820)
Loans receivable, net	\$1,227,741	\$ 1,220,323

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The Company purchased commercial loans totaling \$19.3 million during the six months ended June 30, 2017. For the twelve months ended December 31, 2016, the Company purchased commercial loans totaling \$37.7 million.

Allowance for Loan Losses

Changes in the allowance for loan losses for the three and six months ended June 30, 2017 and 2016 are as follows:

	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
Three Months Ended June 30, 2017	(In Thousands)					
Balance at beginning of period	\$ 1,189	\$ 6,139	\$ 541	\$ 3,397	\$ 734	\$12,000
Provision (credit) for loan losses	14	91	21	46	(2)	170
Loans charged-off	(22)	—	—	(14)	(1)	(37)
Recoveries of loans previously charged-off	—	—	—	10	4	14
Balance at end of period	\$ 1,181	\$ 6,230	\$ 562	\$ 3,439	\$ 735	\$12,147
Six Months Ended June 30, 2017	(In Thousands)					
Balance at beginning of period	\$ 1,149	\$ 5,724	\$ 952	\$ 3,266	\$ 729	\$11,820
Provision (credit) for loan losses	51	506	(390)	162	1	330
Loans charged-off	(22)	—	—	(14)	(1)	(37)
Recoveries of loans previously charged-off	3	—	—	25	6	34
Balance at end of period	\$ 1,181	\$ 6,230	\$ 562	\$ 3,439	\$ 735	\$12,147

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Three Months Ended June 30, 2016	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	\$1,033	\$ 5,202	\$ 573	\$ 2,674	\$ 651	\$10,133
Provision for loan losses	54	109	225	22	172	582
Loans charged-off	(61)	—	—	(35)	(117)	(213)
Recoveries of loans previously charged-off	—	109	—	32	—	141
Balance at end of period	\$1,026	\$ 5,420	\$ 798	\$ 2,693	\$ 706	\$10,643

Six Months Ended June 30, 2016	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	\$1,036	\$ 5,033	\$ 516	\$ 2,625	\$ 653	\$9,863
Provision for loan losses	44	302	282	92	173	893
Loans charged-off	(82)	(24)	—	(68)	(120)	(294)
Recoveries of loans previously charged-off	28	109	—	44	—	181
Balance at end of period	\$1,026	\$ 5,420	\$ 798	\$ 2,693	\$ 706	\$10,643

Further information pertaining to the allowance for loan losses at June 30, 2017 and December 31, 2016 is as follows:

June 30, 2017	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Allowance for loans individually evaluated and deemed to be impaired	\$320	\$ 260	\$ —	\$ 1	\$ 53	\$634
Allowance for loans individually or collectively evaluated and not deemed to be impaired	861	5,970	562	3,438	682	11,513
Allowance for loans acquired with deteriorated credit quality	—	—	—	—	—	—
Total loan loss allowance	\$1,181	\$ 6,230	\$ 562	\$ 3,439	\$ 735	\$12,147
Loans individually evaluated and deemed to be impaired	\$5,568	\$ 6,978	\$ —	\$ 797	\$ 364	\$13,707
Loans individually or collectively evaluated and not deemed to be impaired	402,761	439,373	25,838	296,650	56,433	1,221,055
Amount of loans acquired with deteriorated credit quality	388	2,341	—	—	—	2,729

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Total loans	\$408,717	\$ 448,692	\$ 25,838	\$ 297,447	\$ 56,797	\$1,237,491
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December 31, 2016	Residential - 1 to 4 Family (In Thousands)	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
Allowance for loans individually evaluated and deemed to be impaired	\$ 306	\$ 240	\$ —	\$ 95	\$ 52	\$ 693
Allowance for loans individually or collectively evaluated and not deemed to be impaired	843	5,484	952	3,171	677	11,127
Allowance for loans acquired with deteriorated credit quality	—	—	—	—	—	—
Total loan loss allowance	\$ 1,149	\$ 5,724	\$ 952	\$ 3,266	\$ 729	\$ 11,820
Loans individually evaluated and deemed to be impaired	\$ 6,450	\$ 7,257	\$ —	\$ 607	\$ 453	\$ 14,767
Loans individually or collectively evaluated and not deemed to be impaired	410,221	411,637	36,026	297,094	56,963	1,211,941
Amount of loans acquired with deteriorated credit quality	393	2,774	—	—	—	3,167
Total loans	\$ 417,064	\$ 421,668	\$ 36,026	\$ 297,701	\$ 57,416	\$ 1,229,875

Past Due Loans

The following represents an aging of loans at June 30, 2017 and December 31, 2016:

Real Estate: Residential	90 Days Past Due	60-89 Days Past Due	30 Days Past Due	Total 30 Days or More Past Due	Current	Total Loans
(In Thousands)						
-						
1 to 4 family	\$ 51	\$ 294	\$ 1,446	\$ 1,791	\$ 406,926	\$ 408,717
Multi-family and				27	448,665	448,692

commercial					
Construction	—	—	25,838	25,838	
Commercial					
Business:					
SBA					
and					
USDA	577	—	577	102,063	102,640
guaranteed					
Time					
share	—	—	—	48,907	48,907
Condominium					
association	—	—	—	26,207	26,207
Medical					
loans	14	—	14	26,773	26,787
Other	—	313	324	92,582	92,906
Consumer:					
Home					
equity	261	—	179	440	54,455
Indirect					
automobile	5	—	5	208	213
Other	—	—	1	1,688	1,689
\$329	\$ 885	\$ 1,965	\$ 3,179	\$ 1,234,312	\$ 1,237,491

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	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total 30 Days or More Past Due	Current	Total Loans
(In Thousands)						
Real Estate: Residential						
-						
1 to 4 family	\$4,781	\$1,128	\$1,547	\$7,456	\$409,608	\$417,064
Multi-family						
2-5	250	351	3,353	418,315	421,668	
commercial Construction					36,026	36,026
Commercial Business:						
SBA and USDA			1,628	114,755	116,383	
guaranteed Time share					51,083	51,083
Condominium association					23,531	23,531
Medical loans					27,180	27,180
Other		593	1,024	78,500	79,524	
Consumer:						
Home equity		179	361	54,867	55,228	
Indirect automobile			9	492	501	
Other	2	5	11	1,676	1,687	
\$0.187	\$1,380	\$2,675	\$13,842	\$1,216,033	\$1,229,875	

The Company did not have any loans that were past due 90 days or more and still accruing interest at June 30, 2017 or December 31, 2016.

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Impaired and Nonaccrual Loans

The following is a summary of impaired loans and nonaccrual loans at June 30, 2017 and December 31, 2016:

Recorded Investment	Unpaid Principal Balance	Related Allowance	Nonaccrual Loans
------------------------	--------------------------------	----------------------	---------------------

(In Thousands)

Impaired loans without valuation allowance:			
Real Estate: Residential			
- 1 to 4 family Multi-family and commercial Commercial Business:			
Medical loans	28	—	14
Other	756	—	744
Consumer:			
Home equity	185	—	85
Other	—	—	4
Total impaired loans without valuation allowance	9,234	—	3,779
Impaired loans with valuation			

allowance:				
Real Estate: Residential				
-				
1 to 4 family Multi-family	2,344	2,344	320	623
and commercial	1,838	3,838	260	95
Commercial business	27	27	1	27
-				
Other Consumer				
- Home equity Total impaired loans with valuation allowance	179	277	53	179
Total impaired loans with valuation allowance	6,388	6,486	634	924
Total impaired loans	\$15,602	\$15,770	\$ 634	\$ 4,703

(1) Includes loans acquired with deteriorated credit quality from the Newport Federal Savings Bank ("Newport") merger and performing troubled debt restructurings. Some loans acquired with deteriorated credit quality have not been included as a result of sustained performance. These loans amounted to \$814,000 at June 30, 2017.

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	Impaired Loans ⁽¹⁾			
December 31, 2016	Unpaid Principal Balance	Related Allowance	Nonaccrual Loans	

(In Thousands)

Impaired loans without valuation allowance:				
Real Estate: Residential				
-				
1 to 4 family	\$3,960	\$4,013	\$ —	\$ 2,753
Multi-family	1,807	5,807	—	885
commercial business	512	512	—	498
-				
Other Consumer				
- Home equity Consumer	174	174	—	174
- Indirect automobile	—	—	—	6
Total impaired loans without valuation allowance	10,453	10,506	—	4,316

Impaired loans with

valuation allowance:				
Real Estate: Residential				
-				
1 to 4 family Multi-family	2,489	2,489	306	672
and commercial	1,789	3,789	240	171
Commercial business	95	95	95	95
- Other Consumer				
- Home equity Total impaired loans with valuation allowance	280	378	52	179
Total impaired loans with valuation allowance	6,653	6,751	693	1,117
Total impaired loans	\$ 7,106	\$ 7,129	\$ 693	\$ 1,296

(1) Includes loans acquired with deteriorated credit quality from the Newport merger and performing troubled debt restructurings. Some loans acquired with deteriorated credit quality have not been included as a result of sustained performance. These loans amounted to \$828,000 at December 31, 2016.

The Company reviews and establishes, if necessary, an allowance for certain impaired loans for the amount by which the present value of expected cash flows (or observable market price of loan or fair value of the collateral if the loan is collateral dependent) are lower than the carrying value of the loan. At June 30, 2017 and December 31, 2016, the Company concluded that certain impaired loans required no valuation allowance as a result of management's measurement of impairment. No additional funds are advanced to those borrowers whose loans are deemed impaired without prior approval of the Loan Committee or the Board of Directors.

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Additional information related to impaired loans is as follows:

	Three Months Ended June 30, 2017			Six Months Ended June 30, 2017		
	Average Interest Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Interest Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Real Estate:						
Residential - 1 to 4 family	\$5,985	\$ 31	\$ 3	\$6,188	\$ 70	\$ 9
Multi-family and commercial	8,016	102	—	8,858	226	11
Commercial business:						
Medical loans	7	—	—	3	—	—
Other	1,415	36	27	1,118	44	27
Consumer:						
Home equity	381	1	—	422	3	1
Other	5	—	—	—	—	—
Total	\$15,809	\$ 170	\$ 30	\$16,591	\$ 343	\$ 48

	Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
	Average Interest Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Interest Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Real Estate:						
Residential - 1 to 4 family	\$5,736	\$ 27	\$ —	\$5,930	\$ 51	\$ —
Multi-family and commercial	8,762	64	—	7,738	148	—
Commercial business - Other	680	—	—	637	—	—
Consumer - Home equity	327	1	—	222	2	1
Total	\$15,505	\$ 92	\$ —	\$14,527	\$ 201	\$ 1

Credit Quality Information

The Company utilizes an eight-grade internal loan rating system for all loans in the portfolio, with the exception of its purchased SBA and USDA commercial business loans that are fully guaranteed by the U.S. government, as follows:

o Pass (Ratings 1-4): Loans in these categories are considered low to average risk.

o Special Mention (Rating 5): Loans in this category are starting to show signs of potential weakness and are being closely monitored by management.

o Substandard (Rating 6): Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the

Company will sustain some loss if the weakness is not corrected.

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Doubtful (Rating 7): Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

Loss (Rating 8): Loans in this category are considered uncollectible and of such little value that their continuance as assets is not warranted.

Management periodically reviews the ratings described above and the Company's internal audit function reviews components of the credit files, including the assigned risk ratings, of certain commercial loans as part of its loan review.

The following tables present the Company's loans by risk rating at June 30, 2017 and December 31, 2016:

June 30, 2017	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In Thousands)						
Real Estate:							
Residential - 1 to 4 family	\$—	\$400,139	\$1,534	\$7,044	\$—	—	—\$408,717
Multi-family and commercial	—	424,819	13,121	10,752	—	—	448,692
Construction	—	25,838	—	—	—	—	25,838
Total real estate loans	—	850,796	14,655	17,796	—	—	883,247
Commercial Business:							
SBA and USDA guaranteed	102,640	—	—	—	—	—	102,640
Time share	—	48,907	—	—	—	—	48,907
Condominium association	—	26,207	—	—	—	—	26,207
Medical loans	—	26,773	—	14	—	—	26,787
Other	—	86,725	3,857	2,324	—	—	92,906
Total commercial business loans	102,640	188,612	3,857	2,338	—	—	297,447
Consumer:							
Home equity	—	54,413	37	445	—	—	54,895
Indirect automobile	—	213	—	—	—	—	213
Other	—	1,570	115	4	—	—	1,689
Total consumer loans	—	56,196	152	449	—	—	56,797
Total loans	\$102,640	\$1,095,604	\$18,664	\$20,583	\$—	—	—\$1,237,491

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December 31, 2016	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In Thousands)						
Real Estate:							
Residential - 1 to 4 family	\$—	\$408,237	\$ 1,174	\$ 7,653	\$ —	—	—\$417,064
Multi-family and commercial	—	393,225	14,018	14,425	—	—	421,668
Construction	—	36,026	—	—	—	—	36,026
Total real estate loans	—	837,488	15,192	22,078	—	—	874,758
Commercial Business:							
SBA and USDA guaranteed	116,383	—	—	—	—	—	116,383
Time share	—	51,083	—	—	—	—	51,083
Condominium association	—	23,531	—	—	—	—	23,531
Medical loans	—	27,180	—	—	—	—	27,180
Other	—	73,474	3,741	2,309	—	—	79,524
Total commercial business loans	116,383	175,268	3,741	2,309	—	—	297,701
Consumer:							
Home equity	—	54,683	46	499	—	—	55,228
Indirect automobile	—	501	—	—	—	—	501
Other	—	1,681	—	6	—	—	1,687
Total consumer loans	—	56,865	46	505	—	—	57,416
Total loans	\$116,383	\$1,069,621	\$ 18,979	\$ 24,892	\$ —	—	—\$1,229,875

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The following tables provide information on loans modified as TDRs during the three and six months ended June 30, 2017 and 2016. During the modification process, there were no loan charge-offs or principal reductions for the loans included in the table below.

	Three Months Ended June 30, 2017			2016		
	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)
	(Dollars in Thousands)					
Residential - 1 to 4 family	—	\$ —	\$ —	1	\$ 57	\$ —
Multi-family and commercial	2	239	54	3	2,688	234
Commercial business - other	—	—	—	3	865	—
Total	2	\$ 239	\$ 54	7	\$ 3,610	\$ 234

	Six Months Ended June 30, 2017			2016		
	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)
	(Dollars in Thousands)					
Residential - 1 to 4 family	—	\$ —	\$ —	2	\$ 143	\$ —
Multi-family and commercial	2	239	54	4	4,128	234
Commercial business - other	1	293	—	3	865	—
Total	3	\$ 532	\$ 54	9	\$ 5,136	\$ 234

The following table provides the recorded investment, by type of modification, during the three and six months ended June 30, 2017 and 2016 for modified loans identified as TDRs.

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	2017	2016	2017	2016
Principal deferrals	\$ —	\$ —	\$ —	\$ 86
Combination of rate and	3,382	239	3,382	

maturity

(1)

Maturity	228	293	1,668
only			
Total	\$3,610	\$532	\$5,136

(1) Terms include combination of interest rate adjustments and extensions of maturity.

During the three and six months ended June 30, 2017, there was one TDR totaling \$2,000 in payment default within twelve months of restructure. There were two commercial loans totaling \$330,000 that were modified as TDRs that were in payment default within twelve months of restructure for the three and six months ended June 30, 2016.

As of June 30, 2017, the Company held \$1.5 million in consumer mortgage loans collateralized by residential real estate properties that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

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Loans Acquired with Deteriorated Credit Quality

The following is a summary of loans acquired with evidence of credit deterioration from Newport as of June 30, 2017 and December 31, 2016.

	Contractual Required Payments Receivable (In Thousands)	Cash Expected To Be Collected (In Thousands)	Non-Accrutable Discount	Accrutable Yield	Loans Receivable	
Balance at December 31, 2016	\$3,522	\$ 3,167	\$ 355	\$ 154	\$ 3,013	
Additions	—	77	(77) 77	—	
Collections	(67) (67) —	(12) (55)
Dispositions	(503) (448) (55) —	(448)
Balance at June 30, 2017	\$2,952	\$ 2,729	\$ 223	\$ 219	\$ 2,510	

NOTE 5. PREMISES AND EQUIPMENT

Premises and equipment at June 30, 2017 and December 31, 2016 are summarized as follows:

	June 30, 2017	December 31, 2016	
	(In Thousands)		
Land	\$4,746	\$ 4,746	
Buildings	13,673	13,623	
Leasehold improvements	11,578	10,731	
Furniture and equipment	12,563	12,405	
Construction in process	—	580	
	42,560	42,085	
Accumulated depreciation and amortization	(22,755) (22,201)
Premises and equipment, net	\$19,805	\$ 19,884	

At December 31, 2016, construction in process related to the construction, design and site costs associated with a new branch location.

NOTE 6. OTHER COMPREHENSIVE INCOME

Accounting principles generally require recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of shareholders' equity on the balance sheet, such items, along with net income, are components of comprehensive income.

Components of other comprehensive income and related tax effects are as follows:

Six Months Ended June 30, 2017	
Before Tax	Net of Effects Tax

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	Amount	Amount
Securities:	(In Thousands)	
Unrealized holding gains on available for sale securities	\$234	\$ (79) \$ 155
Other comprehensive income	\$234	\$ (79) \$ 155

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The components of accumulated other comprehensive loss included in shareholders' equity are as follows:

	June 30, 2017		
	Before Tax Amount	Tax Effects	Net of Tax Amount
	(In Thousands)		
Net unrealized losses on available for sale securities	\$ (798)	\$ 272	\$ (526)
Accumulated other comprehensive loss	\$ (798)	\$ 272	\$ (526)
	December 31, 2016		
	Before Tax Amount	Tax Effects	Net of Tax Amount
	(In Thousands)		
Net unrealized losses on available for sale securities	\$ (1,032)	\$ 351	\$ (681)
Accumulated other comprehensive loss	\$ (1,032)	\$ 351	\$ (681)

NOTE 7. REGULATORY CAPITAL

The Company and the Bank are subject to regulatory capital requirements promulgated by federal bank regulatory agencies. Failure by the Company or the Bank to meet minimum capital requirements could result in certain mandatory and discretionary actions by regulators that could have a material adverse effect on our consolidated financial statements. Under Basel III capital requirements, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation require the Company and the Bank to maintain certain minimum capital amounts and ratios. Federal bank regulators require the Company and the Bank to maintain minimum ratios of core capital to adjusted average assets, common equity tier 1 capital to risk-weighted assets, tier 1 capital to risk-weighted assets and total risk-based capital to risk-weighted assets. At June 30, 2017, the Company and the Bank met all the capital adequacy requirements to which they were subject and were "well capitalized" under the regulatory requirements. Management believes no conditions or events have occurred since June 30, 2017 that would materially adversely change the Company's and the Bank's capital classifications.

Effective January 1, 2016, Basel III implemented a requirement for all banking organizations to maintain a capital conservation buffer exclusively composed of common equity Tier 1 capital in an amount greater than 2.5% of total risk-weighted assets to avoid being subject to limitations on capital distributions, stock repurchases and discretionary bonus payments to executive officers. The capital conservation buffer increases the three risk-based capital ratios and will be phased in over a multi-year schedule with full compliance in 2019. Management believes the Company and the Bank's capital level will remain characterized as "well-capitalized" under the new rules. The Company and Bank's regulatory capital amounts and ratios at June 30, 2017 and December 31, 2016, compared to the FDIC's requirements

for classification as a well capitalized institution and for minimum capital adequacy, were as follows:

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	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2017	(Dollars in Thousands)					
Common Equity Tier 1 Capital:						
Company	\$ 154,179	15.07%	\$ 46,049	4.50%	\$ 66,515	6.50%
Bank	145,826	14.27	45,983	4.50	66,420	6.50
Tier 1 Capital to Risk Weighted Assets:						
Company	162,179	15.85	61,399	6.00	81,865	8.00
Bank	145,826	14.27	61,310	6.00	81,747	8.00
Total Capital to Risk Weighted Assets:						
Company	174,764	17.08	81,866	8.00	102,332	10.00
Bank	158,411	15.50	81,747	8.00	102,184	10.00
Tier 1 Capital to Average Assets:						
Company	162,179	10.31	62,947	4.00	78,684	5.00
Bank	145,826	9.32	62,593	4.00	78,241	5.00
December 31, 2016	(Dollars in Thousands)					
Common Equity Tier 1 Capital:						
Company	\$ 150,915	15.08%	\$ 45,028	4.50%	\$ 65,041	6.50%
Bank	141,673	14.17	44,978	4.50	64,968	6.50
Tier 1 Capital to Risk Weighted Assets:						
Company	158,915	15.88	60,037	6.00	80,050	8.00
Bank	141,673	14.17	59,970	6.00	79,960	8.00
Total Capital to Risk Weighted Assets:						
Company	171,187	17.11	80,050	8.00	100,062	10.00
Bank	153,945	15.40	79,960	8.00	99,950	10.00
Tier 1 Capital to Average Assets:						
Company	158,915	10.50	60,562	4.00	75,702	5.00
Bank	141,673	9.41	60,248	4.00	75,310	5.00

NOTE 8. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Hierarchy

The Company groups its assets and liabilities in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Transfers between levels are recognized at the end of a reporting period, if applicable.

Valuation is based on quoted prices in active markets for identical assets or liabilities. Level 1 assets and Level liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations 1: are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

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Level 2: Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include assets or liabilities whose value is determined using unobservable inputs to pricing models, discounted cash flow methodologies, or similar techniques, as well as assets or liabilities for which the determination of fair value requires significant management judgment or estimation.

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of assets and liabilities is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various assets and liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the assets and liabilities.

The following methods and assumptions were used by the Company in estimating fair value disclosures of its financial instruments:

- Cash and cash equivalents. The carrying amounts of cash and cash equivalents approximate the fair values based on the short-term nature of the assets.

Securities available for sale. Included in the available for sale category are debt securities. The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market. Securities measured at fair value in Level 2 are based on pricing models that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. The Company utilizes a nationally-recognized third-party pricing service to estimate fair value measurements for the majority of its portfolio. The pricing service evaluates each asset class based on relevant market information considering observable data, but these prices do not represent binding quotes. The fair value prices on all investments are reviewed for reasonableness by management. Securities measured at fair value in Level 3 include one collateralized debt obligation that was backed by a trust preferred security issued by banks and insurance companies. Management determined that an orderly and active market for this security and similar securities did not exist based on a significant reduction in trading volume and widening spreads relative to historical levels. The Company estimates future cash flows discounted using a rate management believes is representative of current market conditions. Factors in determining the discount rate include the current level of deferrals and/or defaults, changes in credit rating and the financial condition of the debtors within the underlying securities, broker quotes for securities with similar structure and credit risk, interest rate movements and pricing for new issuances.

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Federal Home Loan Bank stock. The carrying value of Federal Home Loan Bank ("FHLB") stock approximates fair value based on the redemption provisions of the FHLB.

Federal Reserve Bank stock. The carrying value of Federal Reserve Bank ("FRB") stock approximates fair value based on the redemption provisions of the FRB.

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Loans held for sale. The fair value of loans held for sale is estimated using quoted market prices.

Loans receivable. For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of fixed-rate loans are estimated by discounting the future cash flows using the rates at the end of the period in which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Accrued interest receivable. The carrying amount of accrued interest approximates fair value.

Deposits. The fair value of demand deposits, negotiable orders of withdrawal, regular savings, certain money market deposits and mortgagors' and investors' escrow accounts is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities to a schedule of aggregated expected maturities on such deposits.

Federal Home Loan Bank advances. The fair value of the advances is estimated using a discounted cash flow calculation that applies current FHLB interest rates for advances of similar maturity to a schedule of maturities of such advances.

Junior subordinated debt owed to unconsolidated trust. Rates currently available for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

Interest rate swap agreement. The fair value of the Company's interest rate swap is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of the derivative. The pricing analysis is based on observable inputs for the contractual term of the derivative, including the period to maturity, credit component and interest rate curves.

Forward loan sale commitments and derivative loan commitments. Forward loan sale commitments and derivative loan commitments are based on the fair values of the underlying mortgage loans, including the servicing rights for derivative loan commitments, and the probability of such commitments being exercised. Significant management judgment and estimation is required in determining these fair value measurements.

Off-balance sheet instruments. Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present assets and liabilities measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016. The Company had no significant transfers into or out of Levels 1, 2 or 3 during the three and six months ended June 30, 2017.

	June 30, 2017			Total
	Level 1	Level 2	Level 3	
	(In Thousands)			
Assets:				
U.S. Government and agency obligations	\$24,514	\$47,704	\$—	\$72,218
Government-sponsored enterprises	—	9,310	—	9,310
Mortgage-backed securities	—	88,448	—	88,448
Collateralized debt obligation	—	—	1,107	1,107
Obligations of state and political subdivisions	—	1,000	—	1,000
Tax-exempt securities	—	3,187	—	3,187
Forward loan sale commitments and derivative loan commitments	—	—	94	94
Total assets	\$24,514	\$149,649	\$1,201	\$175,364
	December 31, 2016			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Assets:				
U.S. Government and agency obligations	\$21,087	\$43,209	\$—	\$64,296
Government-sponsored enterprises	—	11,364	—	11,364
Mortgage-backed securities	—	78,389	—	78,389
Collateralized debt obligation	—	—	1,157	1,157
Obligations of state and political subdivisions	—	1,000	—	1,000
Tax-exempt securities	—	3,161	—	3,161
Forward loan sale commitments and derivative loan commitments	—	—	136	136
Total assets	\$21,087	\$137,123	\$1,293	\$159,503
Liabilities:				
Forward loan sale commitments and derivative loan commitments	\$—	\$—	\$15	\$15
Interest rate swap agreement	—	2	—	2
Total liabilities	\$—	\$2	\$15	\$17

The following table shows a reconciliation of the beginning and ending balances for Level 3 assets:

Collateralized Debt Obligations	Derivative Loan and Forward Loan Sale
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	Commitments, Net	
	(In Thousands)	
Balance at December 31, 2016	\$1,157	\$ 121
Total realized losses included in net income	—	(27)
Total unrealized losses included in other comprehensive income	(50)	—
Balance at June 30, 2017	\$1,107	\$ 94

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Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may also be required, from time to time, to measure certain other financial assets on a nonrecurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets at June 30, 2017 and December 31, 2016. There were no liabilities measured at fair value on a nonrecurring basis at June 30, 2017 and December 31, 2016.

	At June 30, 2017			At December 31, 2016		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(In Thousands)					
Impaired loans	\$—	\$—	—\$644	\$—	\$—	—\$696
Other real estate owned	—	—	1,043	—	—	1,466
Total assets	\$—	\$—	—\$1,687	\$—	\$—	—\$2,162

The following table summarizes losses resulting from fair value adjustments for assets measured at fair value on a nonrecurring basis.

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	2017	2016	2017	2016
	(In Thousands)			
Impaired loans	\$90	\$167	\$139	\$239
Other real estate owned	181	—	197	8
Total losses	\$271	\$167	\$336	\$247

The Company measures the impairment of loans that are collateral dependent based on the fair value of the collateral (Level 3). The fair value of collateral used by the Company represents the amount expected to be received from the sale of the property, net of selling costs, as determined by an independent, licensed or certified appraiser using observable market data. This data includes information such as selling price of similar properties, expected future cash flows or earnings of the subject property based on current market expectations, and relevant legal, physical and economic factors. The appraised values of collateral are adjusted as necessary by management based on observable inputs for specific properties. Losses applicable to write-downs of impaired loans are based on the appraised market value of the underlying collateral, assuming foreclosure of these loans is imminent, and are recorded through the provision for loan losses.

The amount of other real estate owned represents the carrying value of the collateral based on the appraised value of the underlying collateral less estimated selling costs. The loss on foreclosed assets represents adjustments in the

valuation recorded during the time period indicated and not for losses incurred on sales.

Summary of Fair Values of Financial Instruments

The estimated fair values and related carrying or notional amounts of the Company's financial instruments are presented in the following table. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have

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realized in a sales transaction at June 30, 2017 and December 31, 2016. The estimated fair value amounts at June 30, 2017 and December 31, 2016 have been measured as of each respective date, and have not been re-evaluated or updated for purposes of the consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period-end. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimate, comparisons between the Company's disclosures and those of other banks may not be meaningful.

As of June 30, 2017 and December 31, 2016, the recorded carrying amounts and estimated fair values of the Company's financial instruments are as follows:

	June 30, 2017				Total
	Carrying Amount	Level 1	Level 2	Level 3	
	(In Thousands)				
Financial Assets:					
Cash and cash equivalents	\$95,302	\$95,302	\$ —	—	—\$ 95,302
Available for sale securities	175,270	24,514	149,649	1,107	175,270
Loans held for sale	1,588	—	—	1,605	1,605
Loans receivable, net	1,227,741	—	—	1,223,476	1,223,476
Federal Home Loan Bank stock	12,231	—	—	12,231	12,231
Federal Reserve Bank stock	3,631	—	—	3,631	3,631
Accrued interest receivable	4,526	—	—	4,526	4,526
Financial Liabilities:					
Deposits	1,200,796	—	—	1,203,245	1,203,245
Mortgagors' and investors' escrow accounts	4,884	—	—	4,884	4,884
Federal Home Loan Bank advances	187,102	—	186,917	—	186,917
Junior subordinated debt owed to unconsolidated trust	8,248	—	6,140	—	6,140
On-balance Sheet Derivative Financial Instruments:					
Assets:					
Derivative loan commitments	68	—	—	68	68
Forward loan sale commitments	26	—	—	26	26

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016 AND DECEMBER 31, 2016

	December 31, 2016				
	Carrying Fair Value				
	Amount	Level 1	Level 2	Level 3	Total
	(In Thousands)				
Financial Assets:					
Cash and cash equivalents	\$73,186	\$73,186	\$ —	—	—\$ 73,186
Available for sale securities	159,367	21,087	137,123	1,157	159,367
Loans held for sale	1,393	—	—	1,584	1,584
Loans receivable, net	1,220,323	—	—	1,218,918	1,218,918
Federal Home Loan Bank stock	12,162	—	—	12,162	12,162
Federal Reserve Bank stock	3,624	—	—	3,624	3,624
Accrued interest receivable	4,435	—	—	4,435	4,435
Financial Liabilities:					
Deposits	1,130,685	—	—	1,134,378	1,134,378
Mortgagors' and investors' escrow accounts	4,388	—	—	4,388	4,388
Federal Home Loan Bank advances	217,759	—	217,120	—	217,120
Junior subordinated debt owed to unconsolidated trust	8,248	—	6,043	—	6,043
On-balance Sheet Derivative Financial Instruments:					
Assets:					
Derivative loan commitments	72	—	—	72	72
Forward loan sale commitments	64	—	—	64	64
Liabilities:					
Derivative loan commitments	15	—	—	15	15
Interest rate swap agreement	2	—	2	—	2

NOTE 9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**Derivative Financial Instruments**

The Company had a stand-alone derivative financial instrument in the form of an interest rate swap agreement, which derives its value from underlying interest rates. This transaction involved both credit and market risk. The notional amount was an amount on which calculations, payments and the value of the derivative was based. The notional amount does not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such difference, which represents the fair value of the derivative instrument, was reflected on the Company's balance sheets as other assets and other liabilities. The Company was exposed to credit-related losses in the event of nonperformance by the counterparty to this agreement. The Company controls the credit risk of its financial contract through credit approvals, limits and monitoring procedures and does not expect any counterparty to fail its obligations.

Derivative instruments are generally either negotiated over-the-counter contracts or standardized contracts executed on a recognized exchange. Negotiated over-the-counter derivative contracts are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise prices and maturity.

Derivative Instruments Not Designated As Hedging Instruments

Certain derivative instruments do not meet the requirements to be accounted for as hedging instruments. These undesignated derivative instruments are recognized on the consolidated balance sheets at fair value, with changes in fair value recorded in noninterest income.

Interest Rate Swap Agreement - In 2012, management entered into an interest rate swap agreement that does not meet the hedge accounting requirements of FASB's "Derivatives and Hedging" standard to manage the Company's exposure to interest rate movements and other identified risks. This agreement terminated on January 11, 2017.

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SI FINANCIAL GROUP, INC.

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At December 31, 2016, information pertaining to the Company's interest rate swap agreement not designated as a hedge was as follows:

	December 31, 2016	
	(Dollars in Thousands)	
Notional amount	\$	15,000
Weighted average fixed pay rate	1.26	%
Weighted average variable receive rate	0.88	%
Weighted average maturity in years	0.0	
Unrealized loss relating to interest rate swap	\$	2

The Company reported a gain in fair value on the interest rate swap not designated as a hedge in noninterest income of \$16,000 and \$15,000 for the three and six months ended June 30, 2016, respectively.

Derivative Loan Commitments - Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Company to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the values of these loan commitments decrease. Conversely, if interest rates decrease, the value of these loan commitments increase.

Forward Loan Sale Commitments - To protect against the price risk inherent in derivative loan commitments, the Company utilizes both "mandatory delivery" and "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the value of loans that would result from the exercise of the derivative loan commitments.

With a "mandatory delivery" contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay a "pair-off" fee, based on then-current market prices, to the investor to compensate the investor for the shortfall.

With a "best efforts" contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g., on the same day the lender

commits to lend funds to a potential borrower).

The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016 AND DECEMBER 31, 2016

Interest Rate Risk Management - Derivative Instruments

The following table presents the fair values of derivative instruments as well as their classification on the consolidated balance sheets at June 30, 2017 and December 31, 2016.

		June 30, 2017	December 31, 2016	
Balance Sheet Location		Estimated Notional Fair Amount Value	Notional Amount	Estimated Fair Value
(In Thousands)				
Derivatives not designated as hedging instruments:				
Interest rate swap	Other Liabilities	\$-\$	—\$15,000	\$ (2)
Derivative loan commitments	Other Assets	6,788	12,607	57
Forward loan sale commitments	Other Assets	4,456	4,049	64

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

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding changes in the Company's financial condition as of June 30, 2017 and December 31, 2016 and the results of operations for the three and six months ended June 30, 2017 and 2016. The information contained in this section should be read in conjunction with the consolidated financial statements and notes thereto appearing in Part I, Item 1 of this document as well as with management's discussion and analysis of financial condition and results of operations and consolidated financial statements included in the Company's 2016 Annual Report on Form 10-K.

This report may contain certain "forward-looking statements" within the meaning of the federal securities laws, which are made in good faith pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally preceded by terms such as "expects," "believes," "anticipates," "intends," "estimates," "projects" and similar expressions. These statements are not historical facts; rather, they are statements based on management's current expectations regarding our business strategies, intended results and future performance.

Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to: changes in interest rates; national and regional economic conditions; legislative and regulatory changes; monetary and fiscal policies of the United States government, including policies of the United States Treasury and the Federal Reserve Board; the quality and composition of the loan and investment portfolios; demand for loan products; deposit flows; competition; demand for financial services in the Company's market area; changes in real estate market values in the Company's market area; and changes in relevant accounting principles and guidelines. Additional factors that may affect the Company's results are discussed in the Company's Annual Report on Form 10-K and in other reports filed with the Securities and Exchange Commission. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims, any obligation to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Critical Accounting Policies

The Company considers accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. The Company considers the determination of allowance for loan losses, deferred income taxes and the impairment of long-lived assets, such as goodwill and other intangibles, to be its critical accounting policies. Additional information about the Company's accounting policies is included in the notes to the Company's consolidated financial statements contained in Part I, Item 1 of this document and in the Company's 2016 Annual Report on Form 10-K.

Impact of New Accounting Standards

Refer to Note 1 of the consolidated financial statements in this report for a discussion of recent accounting pronouncements.

Comparison of Financial Condition at June 30, 2017 and December 31, 2016

Assets:

Summary. Assets increased \$45.6 million, or 2.9%, to \$1.60 billion at June 30, 2017, compared to \$1.55 billion at December 31, 2016, principally due to increases of \$22.1 million in cash and cash equivalents, \$15.9 million in

available for sale securities and \$7.4 million in net loans receivable. Funds from excess deposits contributed to the increase in cash and cash equivalents and available for sale securities.

Loans Receivable, Net. Net loans increased \$7.4 million primarily due to increases of \$27.0 million in multi-family and commercial real estate loans and \$13.4 million in other commercial business loans, offset by decreases of \$13.7 million in SBA and USDA guaranteed loans, \$10.2 million in construction loans and \$8.3 million in residential mortgage loans. Changes in the loan portfolio consisted of the following:

Residential Real Estate. Residential mortgage loans comprised 33.0% of the total loan portfolio at June 30, 2017 and decreased \$8.3 million to \$408.7 million as compared to \$417.1 million at December 31, 2016. Residential mortgage loan originations increased \$10.1 million, or 24.1%, during the six months ended June 30, 2017 over the comparable period in 2016 as a result of increased activity in the housing market.

Multi-family and Commercial Real Estate. Multi-family and commercial real estate loans represented 36.3% of total loans at June 30, 2017 and increased \$27.0 million, or 6.4%, during the first half of 2017, partially due to the conversion of a \$15.3 million commercial construction loan to a permanent commercial real estate loan. Loan originations for multi-family and commercial real estate loans were \$21.0 million, representing a decrease of \$3.8 million, during the first half of 2017 compared to the same period in 2016.

Construction. Construction loans, which include both residential and commercial construction loans, decreased \$10.2 million to \$25.8 million for the first half of 2017 primarily due to the conversion of a \$15.3 million commercial construction loan to a permanent commercial real estate loan.

Commercial Business. Commercial business loans represented 24.0% of total loans at June 30, 2017. Commercial business loans decreased \$254,000, or 0.1%, for the first half of 2017 primarily due to decreases of \$13.7 million in SBA and USDA guaranteed loans and \$2.2 million in timeshare loans, offset by an increase of \$13.4 million in other commercial business loans and \$2.7 million in condominium association loans. Commercial business purchased loans and loan originations increased \$7.4 million and \$21.4 million, respectively, as compared to the same period in 2016. At June 30, 2017, unfunded lines of credit related to time share lending totaled \$27.6 million as a result of focused efforts within the time share industry.

Consumer. Consumer loans represented 4.6% of the Company's total loan portfolio at June 30, 2017. Consumer loans decreased \$619,000 during the first first half of 2017 primarily as a result of decreases of \$333,000 in home equity loans and \$288,000 in indirect automobile loans. Loan originations for consumer loans totaled \$13.8 million, representing an increase of \$734,000, for the first half of 2017 over the comparable period in 2016.

The allowance for loan losses totaled \$12.1 million at June 30, 2017 compared to \$11.8 million at December 31, 2016. The ratio of the allowance for loan losses to total loans increased to 0.98% at June 30, 2017 from 0.96% at December 31, 2016, primarily due to the provision incurred in the period from increases in the commercial real estate loan portfolio, which carries a higher degree of risk (excluding guaranteed SBA and USDA loans) than other loans held in the portfolio, a decrease in SBA and USDA loans, which because of the government guarantee on these loans, does not require a corresponding allowance for loan losses, and \$3,000 of net charge-offs for the period.

The following table provides information with respect to nonperforming assets and TDRs as of the dates indicated.

June 30, 2017 December 31, 2016

Nonaccrual
(Dollars in Thousands)
loans:

Real
estate
loans:
Residential

-
1
\$2,901 \$ 3,425

to
4
family
Multi-family
and
1,056

commercial
Total
real
estate
loans
3,650 4,481

Commercial
business
loans:

Medical
Loans —
700
Other 593

Total
commercial
business
loans
785 593

Consumer
loans:
Home
equity 353

400
Other 6
Total
consumer
loans 359

Total
nonaccrual
loans
5,433

Accruing
loans

past
due
90
days
or

more
 Total
 nonperforming
 4,703 5,433
 loans
 (1)

Other
 real
 estate
 1,043 1,466
 owned,
 net
 (2)

Total
 nonperforming 6,899
 5,746
 assets
 Accruing
 troubled
 9,861 9,982
 debt

restructurings
 Total
 nonperforming
 assets
 and 5,607 \$ 16,881
 troubled
 debt
 restructurings

Allowance
 for
 loan
 losses
 as
 258.28 % 217.56
 a
 percent
 of
 nonperforming
 loans