Waterstone Financial, Inc.
Form 10-Q
October 27, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

T Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2017

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 001-36271

WATERSTONE FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Maryland	90-1026709
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
11200 W. Plank Court Wauwatosa, Wisconsin	53226
(Address of principal executive offices)	(Zip Code)

(414) 761-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes T 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes T No

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

Large accelerated filer	Accelerated filer T	Non-accelerated filer	Smaller reporting company
Emerging growth company		(Do not check if smaller reporting 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.

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

Yes No T

The number of shares outstanding of the issuer's common stock, $0.01 par value per share, was 29,489,346 at October 26, 2017.

WATERSTONE FINANCIAL, INC.

10-Q INDEX

	Page No.
PART I. FINANCIAL INFORMATION	3
	-
Item l. Financial Statements	3
Consolidated Statements of Financial Condition as of September 30, 2017 (unaudited) and December 31, 2016	3
Consolidated Statements of Income for the three and nine months ended September 30, 2017 and 2016 (unaudited)	4
Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2017 and 2016 (unaudited)	5
Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2017 and 2016 (unaudited)	6
Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016 (unaudited)	7
Notes to Consolidated Financial Statements (unaudited)	8 - 35
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	36 - 56
Item 3. Quantitative and Qualitative Disclosures about Market Risk	57
Item 4. Controls and Procedures	57
PART II. OTHER INFORMATION	58
Item 1. Legal Proceedings	58
Item 1A. Risk Factors	58
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	58
Item 3. Defaults Upon Senior Securities	59
Item 4. Mine Safety Disclosures	59
Item 5. Other Information	59
Item 6. Exhibits	59
Signatures	59

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	(Unaudited) September 30, 2017	December 31, 2016
	(Dollars In Thousands, except share and per share data)	
Assets		
Cash	$39,308	$7,878
Federal funds sold	34,916	26,828
Interest-earning deposits in other financial institutions and other short term investments	18,367	12,511
Cash and cash equivalents	92,591	47,217
Securities available for sale (at fair value)	200,840	226,795
Loans held for sale (at fair value)	175,137	225,248
Loans receivable	1,261,160	1,177,884
Less: Allowance for loan losses	14,063	16,029
Loans receivable, net	1,247,097	1,161,855
Office properties and equipment, net	22,889	23,655
Federal Home Loan Bank stock (at cost)	18,450	13,275
Cash surrender value of life insurance	65,665	61,509
Real estate owned, net	4,568	6,118
Prepaid expenses and other assets	26,891	24,947
Total assets	$1,854,128	$1,790,619
Liabilities and Shareholders' Equity		
Liabilities:		
Demand deposits	$123,133	$120,371
Money market and savings deposits	148,607	162,456
Time deposits	685,033	666,584
Total deposits	956,773	949,411
Borrowings	435,503	387,155
Advance payments by borrowers for taxes	25,107	4,716
Other liabilities	24,815	38,647
Total liabilities	1,442,198	1,379,929
Shareholders' equity:		
Preferred stock (par value $.01 per share)		
Authorized - 50,000,000 shares in 2017 and in 2016, no shares issued	-	-
Common stock (par value $.01 per share)		
Authorized - 100,000,000 shares in 2017 and in 2016		
Issued - 29,483,346 in 2017 and 29,430,123 in 2016		
Outstanding - 29,483,346 in 2017 and 29,430,123 in 2016	295	294
Additional paid-in capital	325,753	322,934
Retained earnings	183,578	184,565

Unearned ESOP shares	(19,288)	(20,178)
Accumulated other comprehensive income (loss), net of taxes	328	(378)
Cost of shares repurchased (6,030,900 shares at September 30, 2017 and 5,908,150 shares at December 31, 2016)	(78,736)	(76,547)
Total shareholders' equity	411,930	410,690
Total liabilities and shareholders' equity	$1,854,128	$1,790,619

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In Thousands, except per share amounts)			
Interest income:				
Loans	$15,855	$14,754	$45,078	$42,611
Mortgage-related securities	647	743	2,021	2,371
Debt securities, federal funds sold and short-term investments	951	833	2,680	2,692
Total interest income	17,453	16,330	49,779	47,674
Interest expense:				
Deposits	1,981	1,923	5,614	5,477
Borrowings	2,439	3,082	6,756	10,724
Total interest expense	4,420	5,005	12,370	16,201
Net interest income	13,033	11,325	37,409	31,473
Provision for loan losses	20	135	(1,166)	340
Net interest income after provision for loan losses	13,013	11,190	38,575	31,133
Noninterest income:				
Service charges on loans and deposits	300	789	1,148	1,742
Increase in cash surrender value of life insurance	688	734	1,476	1,446
Loss on sale of securities	-	-	(107)	-
Mortgage banking income	31,863	35,552	92,774	91,146
Other	203	337	941	874
Total noninterest income	33,054	37,412	96,232	95,208
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	26,153	27,573	73,732	70,968
Occupancy, office furniture, and equipment	2,533	2,319	7,587	7,074
Advertising	821	661	2,414	1,974
Data processing	623	616	1,854	1,897
Communications	394	374	1,170	1,088
Professional fees	629	474	1,953	1,486
Real estate owned	(20)	37	258	344
FDIC insurance premiums	129	140	366	500
Other	3,054	3,347	10,227	9,663
Total noninterest expenses	34,316	35,541	99,561	94,994
Income before income taxes	11,751	13,061	35,246	31,347
Income tax expense	4,362	5,556	12,397	12,214
Net income	$7,389	$7,505	$22,849	$19,133
Income per share:				
Basic	$0.27	$0.28	$0.83	$0.71
Diluted	$0.26	$0.27	$0.82	$0.70
Weighted average shares outstanding:				
Basic	27,532	27,043	27,449	26,976
Diluted	27,953	27,429	27,927	27,283

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In Thousands)			
Net income	$7,389	$7,505	$22,849	$19,133
Other comprehensive income (loss), net of tax:				
Net unrealized holding gain (loss) on available for sale securities:				
Net unrealized holding gain (loss) arising during the period, net of tax (expense) benefit of ($59), $385, ($416), ($1,341), respectively	91	(596)	641	2,079
Reclassification adjustment for net loss included in net income during the period, net of tax benefit of $0, $0, ($42), $0, respectively	-	-	65	-
Total other comprehensive income (loss)	91	(596)	706	2,079
Comprehensive income	$7,480	$6,909	$23,555	$21,212

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Cost of Shares Repurchased	Total Shareholders' Equity
	(Dollars In Thousands, except per share amounts)							
Balances at December 31, 2015	29,407	$ $294	$ 317,022	$ 168,089	$ (21,365)	$ 582	$ (72,692)	$ 391,930
Comprehensive income:								
Net income	-	-	-	19,133	-	-	-	19,133
Other comprehensive income	-	-	-	-	-	2,079	-	2,079
Total comprehensive income								21,212
ESOP shares committed to be released to Plan participants	-	-	278	-	890	-	-	1,168
Cash dividend, $0.21 per share	-	-	-	(5,762)	-	-	-	(5,762)
Stock compensation activity, net of tax	263	3	3,434	-	-	-	-	3,437
Stock compensation expense	-	-	1,430	-	-	-	-	1,430
Repurchase of common stock returned to authorized but unissued	(284)	(3)	-	-	-	-	(3,855)	(3,858)
Balances at September 30, 2016	29,386	$ $294	$ 322,164	$ 181,460	$ (20,475)	$ 2,661	$ (76,547)	$ 409,557
Balances at December 31, 2016	29,430	$ $294	$ 322,934	$ 184,565	$ (20,178)	$ (378)	$ (76,547)	$ 410,690
Comprehensive income:								
Net income	-	-	-	22,849	-	-	-	22,849
Other comprehensive income	-	-	-	-	-	706	-	706
Total comprehensive income								23,555

ESOP shares committed to be released to Plan participants	-	-	572	-	890	-	-	1,462
Cash dividend, $0.86 per share	-	-	-	(23,836)	-	-	-	(23,836)
Stock based compensation activity	176	2	820	-	-	-	-	822
Stock compensation expense	-	-	1,427	-	-	-	-	1,427
Repurchase of common stock returned to authorized but unissued	(123)	(1)	-	-	-	-	(2,189)	(2,190)
Balances at September 30, 2017	29,483	$ $295	$ 325,753	$ 183,578	$ (19,288)	$ 328	$ (78,736)	$ 411,930

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended September 30,	
	2017	2016
	(In Thousands)	
Operating activities:		
Net income	$22,849	$19,133
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	(1,166)	340
Provision for depreciation	1,549	2,061
Stock based compensation	1,427	1,430
Net amortization of premium/discount on debt and mortgage related securities	524	749
Amortization of unearned ESOP shares	1,462	1,168
Amortization and impairment of mortgage servicing rights	71	513
Gain on sale of loans held for sale	(94,219)	(93,481)
Loans originated for sale	(1,881,351)	(1,756,454)
Proceeds on sales of loans originated for sale	2,025,682	1,788,685
Increase in accrued interest receivable	(294)	(204)
Increase in cash surrender value of life insurance	(1,476)	(1,446)
Increase (decrease) in accrued interest on deposits and borrowings	2	(615)
Increase in other liabilities	336	5,893
Increase in accrued tax receivable	(2,088)	(172)
Loss on sale of securities	107	-
Net gain related to real estate owned	(11)	(123)
Gain on sale of mortgage servicing rights	(308)	-
Other	440	(3,784)
Net cash provided by (used in) operating activities	73,536	(36,307)
Investing activities:		
Net increase in loans receivable	(85,685)	(41,096)
Net change in FHLB stock	(5,175)	6,900
Purchases of:		
Debt securities	(6,140)	(4,140)
Mortgage related securities	(6,940)	(5,236)
Premises and equipment, net	(939)	(925)
Bank owned life insurance	(2,680)	(10,180)
Proceeds from:		
Principal repayments on mortgage-related securities	25,177	29,689
Maturities of debt securities	13,941	6,620
Sale of debt securities	448	-
Sales of real estate owned	3,104	5,304
Net cash used in investing activities	(64,889)	(13,064)
Financing activities:		
Net increase in deposits	7,362	62,288
Net change in short term borrowings	(7,652)	56,780
Repayment of long term debt	(69,000)	(220,000)

Proceeds from long term debt	125,000	100,000
Net change in advance payments by borrowers for taxes	6,021	9,405
Cash dividends on common stock	(23,636)	(4,832)
Purchase of common stock returned to authorized but unissued	(2,190)	(3,858)
Proceeds from stock option exercises	822	3,437
Net cash provided by financing activities	36,727	3,220
Increase (decrease) in cash and cash equivalents	45,374	(46,151)
Cash and cash equivalents at beginning of period	47,217	100,471
Cash and cash equivalents at end of period	$92,591	$54,320
Supplemental information:		
Cash paid or credited during the period for:		
Income tax payments	$14,141	$11,009
Interest payments	12,368	16,816
Noncash activities:		
Loans receivable transferred to real estate owned	1,609	3,442
Dividends declared but not paid in other liabilities	3,877	2,322

See Accompanying Notes to Unaudited Consolidated Financial Statements.

Note 1 — Basis of Presentation

The unaudited interim consolidated financial statements include the accounts of Waterstone Financial, Inc. (the "Company") and the Company's subsidiaries.

WaterStone Bank SSB (the "Bank") is a community bank that has served the banking needs of its customers since 1921. WaterStone Bank also has an active mortgage banking subsidiary, Waterstone Mortgage Corporation.

WaterStone Bank conducts its community banking business from 11 banking offices located in Milwaukee, Washington and Waukesha Counties, Wisconsin, as well as a loan production office in Minneapolis, Minnesota. WaterStone Bank's principal lending activity is originating one- to four-family, multi-family residential real estate, and commercial real estate loans for retention in its portfolio. WaterStone Bank also offers home equity loans and lines of credit, construction and land loans, and commercial business loans, and consumer loans. WaterStone Bank funds its loan production primarily with retail deposits and Federal Home Loan Bank advances. Our deposit offerings include: certificates of deposit, money market savings accounts, transaction deposit accounts, non-interest bearing demand accounts and individual retirement accounts. Our investment securities portfolio is comprised principally of mortgage-backed securities, government-sponsored enterprise bonds and municipal obligations.

WaterStone Bank's mortgage banking operations are conducted through its wholly-owned subsidiary, Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originates single-family residential real estate loans for sale into the secondary market. Waterstone Mortgage Corporation utilizes lines of credit provided by WaterStone Bank as a primary source of funds, and also utilizes a line of credit with another financial institution as needed.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information, Rule 10-01 of Regulation S-X and the instructions to Form 10-Q. The financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position, results of operations, changes in shareholders' equity, and cash flows of the Company for the periods presented.

The accompanying unaudited consolidated financial statements and related notes should be read in conjunction with the Company's December 31, 2016 Annual Report on Form 10-K. Operating results for the nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017 or for any other period.

The preparation of the unaudited consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the allowance for loan losses, deferred income taxes and real estate owned. Actual results could differ from those estimates.

Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications did not result in any changes to previously reported net income or shareholders' equity.

Impact of Recent Accounting Pronouncements

Accounting Standards Codification (ASC) Topic 606 "Revenue from Contracts with Customers." New authoritative accounting guidance under ASC Topic 606, "Revenue from Contracts with Customers" amended prior guidance to

require an entity to 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 and to provide clarification on identifying performance obligations and licensing implementation guidance. The new authoritative guidance was initially effective for reporting periods after January 1, 2017 but was deferred to January 1, 2018. The Company's revenue is comprised of interest and non-interest revenue. The guidance does not apply to revenue associated with financial instruments, including loans and securities. The Company is substantially complete with its overall assessment of revenue streams and reviewing of related contracts potentially affected by the guidance, including asset management fees, deposit related fees, and other non-interest related fees. The Company's assessment suggests that adoption of this guidance should not materially change the method in which we currently recognize revenue for these revenue streams. In addition, the Company is evaluating the guidance's expanded disclosure requirements. The Company plans to adopt ASC 606 on January 1, 2018 utilizing the modified retrospective approach with a cumulative effect adjustment to opening retained earnings, if such adjustment is deemed to be material.

ASC Topic 825 "Financial Instruments." New authoritative accounting guidance under ASC Topic 825, "Financial Instruments" amended prior guidance to require equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. The new guidance simplifies the impairment assessment of equity investments without readily determinable fair values, requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from changes in the instrument-specific credit risk when the entity has selected the fair value option for financial instruments and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset. The new authoritative guidance will be effective for reporting periods after January 1, 2018 and is not expected to have a material impact on the Company's statements of operations or financial condition.

ASC Topic 842 "Leases." New authoritative accounting guidance under ASC Topic 842, "Leases" amended prior guidance to require lessees to recognize the assets and liabilities arising from all leases on the balance sheet. The new authoritative guidance defines a lease as a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. In addition, the qualifications for a sale and leaseback transaction have been amended. The new authoritative guidance also requires qualitative and quantitative disclosures 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 new authoritative guidance will be effective for reporting periods after January 1, 2019. The Company is evaluating the new guidance and its impact on the Company's statements of operations and financial condition.

ASC Topic 718 "Compensation - Stock Compensation." New authoritative accounting guidance under ASC Topic 718, "Compensation - Stock Compensation" amended prior guidance on several aspects, including the income tax consequences, classification of awards as either equity or liability, and classification on the statement of cash flows. The new authoritative guidance allows for all excess tax benefits and tax deficiencies to be recognized as income tax benefit or expense in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. For earnings per share, anticipated excess tax benefits will not be included in assumed proceeds when applying the treasury method for computing dilutive shares. For the statement of cash flows, excess tax benefits should be classified along with other income tax cash flows as an operating activity, and cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. The new authoritative guidance also allows an entity to make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. In addition, the threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates in the applicable jurisdictions. The Company adopted this standard on January 1, 2017. See Note 9 for the impact on the Company's statement of operations.

ASC Topic 326 "Financial Instruments - Credit Losses." New authoritative accounting guidance under ASC Topic 326, "Financial Instruments - Credit Losses" amended the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information for credit loss estimates. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The new authoritative guidance also requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected (net of the allowance for credit losses). In addition, the credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses rather than a write-down. The new authoritative guidance will be effective for reporting periods after January 1, 2020. The Company is evaluating the new guidance and its impact on the Company's statements of operations and financial condition.

ASC Topic 310 "Receivables - Nonrefundable Fees and Other Costs." New authoritative accounting guidance under ASC Topic 310 "Receivables - Nonrefundable Fees and Other Costs" amends prior guidance by shortening the amortization period for certain callable debt securities held at a premium requiring the premium to be amortized to the earliest call date. The new authoritative guidance will be effective for reporting periods after January 1, 2019 with early adoption permitted. The Company is evaluating the new guidance and its impact on the Company's statements of operations and financial condition.

Note 2— Securities Available for Sale

The amortized cost and fair values of the Company's investment in securities available for sale follow:

	September 30, 2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$61,692	$ 631	$ (105)	$62,218
Collateralized mortgage obligations:				
Government sponsored enterprise issued	54,949	56	(345)	54,660
Mortgage-related securities	116,641	687	(450)	116,878
Government sponsored enterprise bonds	2,500	-	(1)	2,499
Municipal securities	64,100	1,578	(16)	65,662
Other debt securities	15,005	61	(492)	14,574
Debt securities	81,605	1,639	(509)	82,735
Certificates of deposit	1,225	3	(1)	1,227
	$199,471	$ 2,329	$ (960)	$200,840

	December 31, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$72,858	$ 798	$ (243)	$73,413
Collateralized mortgage obligations:				
Government sponsored enterprise issued	62,297	70	(365)	62,002
Mortgage-related securities	135,155	868	(608)	135,415
Government sponsored enterprise bonds	2,500	4	(1)	2,503
Municipal securities	70,311	685	(300)	70,696
Other debt securities	17,399	154	(603)	16,950
Debt securities	90,210	843	(904)	90,149
Certificates of deposit	1,225	7	(1)	1,231
	$226,590	$ 1,718	$ (1,513)	$226,795

The Company's mortgage-backed securities and collateralized mortgage obligations issued by government sponsored enterprises are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. At September 30, 2017, $25.6 million of the Company's mortgage related securities were pledged as collateral to secure repurchase agreement obligations of the Company. As of September 30, 2017, $2.7 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities. At December 31, 2016, $93.2 million of the Company's government sponsored enterprise bonds and $2.4 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities, respectively.

The amortized cost and fair values of investment securities by contractual maturity at September 30, 2017 are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Debt and other securities		
Due within one year	$11,214	$11,207
Due after one year through five years	20,919	21,116
Due after five years through ten years	36,891	38,178
Due after ten years	13,806	13,461
Mortgage-related securities	116,641	116,878
	$199,471	$200,840

Gross unrealized losses on securities available for sale and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows:

	September 30, 2017					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(In Thousands)					
Mortgage-backed securities	$8,547	$ (42)	$3,553	$ (63)	$12,100	$ (105)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	33,229	(313)	2,188	(32)	35,417	(345)
Government sponsored enterprise bonds	2,499	(1)	-	-	2,499	(1)
Municipal securities	10,301	(15)	101	(1)	10,402	(16)
Other debt securities	-	-	9,508	(492)	9,508	(492)
Certificates of deposit	489	(1)	-	-	489	(1)
	$55,065	$ (372)	$15,350	$ (588)	$70,415	$ (960)

	December 31, 2016					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(In Thousands)					
Mortgage-backed securities	$23,433	$ (222)	$1,068	$ (21)	$24,501	$ (243)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	39,395	(365)	-	-	39,395	(365)
Government sponsored enterprise bonds	2,000	(1)	-	-	2,000	(1)
Municipal securities	32,141	(300)	-	-	32,141	(300)
Other debt securities	-	-	9,397	(603)	9,397	(603)
Certificates of deposit	489	(1)	-	-	489	(1)
	$97,458	$ (889)	$10,465	$ (624)	$107,923	$ (1,513)

The Company reviews the investment securities portfolio on a quarterly basis to monitor its exposure to other-than-temporary impairment. In evaluating whether a security's decline in market value is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, the financial

condition of the issuer and the underlying obligors, quality of credit enhancements, volatility of the fair value of the security, the expected recovery period of the security and ratings agency evaluations. In addition, the Company may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds and the value of any underlying collateral.

The following table presents the change in other-than-temporary credit related impairment charges on securities available for sale for which a portion of the other-than-temporary impairments related to other factors was recognized in other comprehensive loss.

	(In Thousands)
Credit-related impairments on securities as of December 31, 2015	$ 117
Credit-related impairments related to securities for which an other- than-temporary impairment was not previously recognized	-
Decrease in credit-related impairments related to securities for which an other-than-temporary impairment was previously recognized	(23)
Credit-related impairments on securities as of December 31, 2016	94
Credit-related impairments related to securities for which an other- than-temporary impairment was not previously recognized	-
Increase in credit-related impairments related to securities for which an other-than-temporary impairment was previously recognized	-
Credit-related impairments on securities as of September 30, 2017	$ 94

As of September 30, 2017, the Company held one municipal security that had previously been deemed to be other-than-temporarily impaired. The security was issued by a tax incremental district in a municipality located in Wisconsin. During the year ended December 31, 2012, the Company received audited financial statements with respect to the municipal issuer that called into question the ability of the underlying taxing district that issued the security to operate as a going concern. During the year ended December 31, 2012, the Company's analysis of this security resulted in $77,000 in credit losses charged to earnings with respect to this municipal security. An additional $17,000 credit loss was charged to earnings during the year ended December 31, 2014 with respect to this security as a sale occurred at a discounted price. As of September 30, 2017, this security had an amortized cost of $116,000 and total life-to-date impairment of $94,000.

As of September 30, 2017, the Company had four mortgage-backed securities, two government sponsored enterprise issued securities, one municipal bond security, and one other debt security which had been in an unrealized loss position for twelve months or longer. These securities were determined not to be other-than-temporarily impaired as of September 30, 2017. The Company has determined that the decline in fair value of these securities is primarily attributable to an increase in market interest rates compared to the stated rates on these securities and is not attributable to credit deterioration. As the Company does not intend to sell nor is it more likely than not that it will be required to sell these securities before recovery of the amortized cost basis, these securities are not considered other-than-temporarily impaired.

Deterioration of general economic market conditions could result in the recognition of future other than temporary impairment losses within the investment portfolio and such amounts could be material to our consolidated financial statements.

During the nine months ended September 30, 2017, proceeds from the sale of securities totaled $448,000 and resulted in losses totaling $107,000. The $107,000 included in loss on sale of available for sale securities in the consolidated statements of income during the nine months ended September 30, 2017 was reclassified from accumulated other comprehensive income. There were no sales of securities during the nine months ended September 30, 2016.

Note 3 - Loans Receivable

Loans receivable at September 30, 2017 and December 31, 2016 are summarized as follows:

	September 30, 2017	December 31, 2016
	(In Thousands)	
Mortgage loans:		
Residential real estate:		
One- to four-family	$427,195	$392,817
Multi-family	580,134	558,592
Home equity	21,606	21,778
Construction and land	16,451	18,179
Commercial real estate	181,328	159,401
Consumer	266	319
Commercial loans	34,180	26,798
	$1,261,160	$1,177,884

The Company provides several types of loans to its customers, including residential, construction, commercial and consumer loans. Significant loan concentrations are considered to exist for a financial institution when there are amounts loaned to one borrower or to multiple borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. While the Company's credit risks are geographically concentrated in the Milwaukee metropolitan area, there are no concentrations with individual or groups of related borrowers.

Qualifying loans receivable totaling $950.7 million and $911.9 million at September 30, 2017 and December 31, 2016, respectively, are pledged as collateral against $410.0 million and $295.0 million in outstanding Federal Home Loan Bank of Chicago (FHLBC) advances under a blanket security agreement at September 30, 2017 and December 31, 2016.

Certain of the Company's executive officers, directors, employees, and their related interests have loans with the Bank. As of September 30, 2017 and December 31, 2016, loans aggregating approximately $4.7 million and $5.1 million, respectively, were outstanding to such parties. None of these loans were considered impaired as of September 30, 2017 or December 31, 2016.

As of September 30, 2017 and December 31, 2016, there were no loans 90 or more days past due and still accruing interest.

An analysis of past due loans receivable as of September 30, 2017 and December 31, 2016 follows:

	As of September 30, 2017					
	1-59 Days Past Due [(1)]	60-89 Days Past Due [(2)]	90 Days or Greater	Total Past Due	Current [(3)]	Total Loans
	(In Thousands)					
Mortgage loans:						
Residential real estate:						
One- to four-family	$1,859	$192	$4,161	$6,212	$420,983	$427,195
Multi-family	332	-	407	739	579,395	580,134
Home equity	220	-	91	311	21,295	21,606

Construction and land	-	-	37	37	16,414	16,451
Commercial real estate	1,270	156	181	1,607	179,721	181,328
Consumer	-	-	-	-	266	266
Commercial loans	23	-	26	49	34,131	34,180
Total	$3,704	$348	$4,903	$8,955	$1,252,205	$1,261,160

	As of December 31, 2016					
	1-59 Days Past Due [1]	60-89 Days Past Due [2]	90 Days or Greater	Total Past Due	Current [3]	Total Loans
	(In Thousands)					
Mortgage loans:						
Residential real estate:						
One- to four-family	$2,403	$ 7	$4,623	$7,033	$385,784	$392,817
Multi-family	376	-	401	777	557,815	558,592
Home equity	82	-	35	117	21,661	21,778
Construction and land	-	-	-	-	18,179	18,179
Commercial real estate	-	-	203	203	159,198	159,401
Consumer	-	-	-	-	319	319
Commercial loans	42	-	27	69	26,729	26,798
Total	$2,903	$ 7	$5,289	$8,199	$1,169,685	$1,177,884

(1) Includes $96,000 and $148,000 at September 30, 2017 and December 31, 2016, respectively, which are on non-accrual status.
(2) Includes $24,000 and $- at September 30, 2017 and December 31, 2016, respectively, which are on non-accrual status.
(3) Includes $2.0 million and $4.4 million at September 30, 2017 and December 31, 2016, respectively, which are on non-accrual status.

A summary of the activity for the nine months ended September 30, 2017 and 2016 in the allowance for loan losses follows:

	One- to Four-Family	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
Nine months ended September 30, 2017								
Balance at beginning of period	$7,164	$ 4,809	$ 364	$ 1,016	$ 1,951	$ 12	$ 713	$16,029
Provision (credit) for loan losses	(249)	(396)	8	(283)	(170)	(2)	(74)	(1,166)
Charge-offs	(1,092)	(92)	-	(14)	(6)	-	-	(1,204)
Recoveries	200	102	21	80	1	-	-	404
Balance at end of period	$6,023	$ 4,423	$ 393	$ 799	$ 1,776	$ 10	$ 639	$14,063
Nine months ended September 30, 2016								
Balance at beginning of period	$7,763	$5,000	$433	$904	$1,680	$9	$396	$16,185
Provision (credit) for loan losses	141	23	(25)	(123)	33	3	288	340
Charge-offs	(801)	(488)	(62)	(3)	-	-	-	(1,354)
Recoveries	246	134	24	58	-	-	-	462
Balance at end of period	$7,349	$4,669	$370	$836	$1,713	$12	$684	$15,633

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of September 30, 2017 follows:

	One- to Four- Family	Multi- Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
Allowance related to loans individually evaluated for impairment	$198	$-	$77	$ -	$ 38	$ -	$ -	$313
Allowance related to loans collectively evaluated for impairment	5,825	4,423	316	799	1,738	10	639	13,750
Balance at end of period	$6,023	$4,423	$393	$ 799	$ 1,776	$ 10	$ 639	$14,063
Loans individually evaluated for impairment	$8,456	$833	$302	$ 37	$ 472	$ -	$ 26	$10,126
Loans collectively evaluated for impairment	418,739	579,301	21,304	16,414	180,856	266	34,154	1,251,034
Total gross loans	$427,195	$580,134	$21,606	$ 16,451	$ 181,328	$ 266	$ 34,180	$1,261,160

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of December 31, 2016 follows:

	One- to Four-Family	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
Allowance related to loans individually evaluated for impairment	$499	$-	$79	$ -	$ 83	$ -	$ 1	$662
Allowance related to loans collectively evaluated for impairment	6,665	4,809	285	1,016	1,868	12	712	15,367
Balance at end of period	$7,164	$4,809	$364	$ 1,016	$ 1,951	$ 12	$ 713	$16,029
Loans individually evaluated for impairment	$10,920	$3,941	$442	$ -	$ 718	$ -	$ 41	$16,062
Loans collectively evaluated for impairment	381,897	554,651	21,336	18,179	158,683	319	26,757	1,161,822
Total gross loans	$392,817	$558,592	$21,778	$ 18,179	$ 159,401	$ 319	$ 26,798	$1,177,884

The following table presents information relating to the Company's internal risk ratings of its loans receivable as of September 30, 2017 and December 31, 2016:

	One to Four-Family	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
At September 30, 2017								
Substandard	$8,899	$ 833	$272	$ 37	$ 1,062	$ -	$ 1,595	$12,698
Watch	7,348	498	199	-	456	-	761	9,262
Pass	410,948	578,803	21,135	16,414	179,810	266	31,824	1,239,200
	$427,195	$ 580,134	$21,606	$ 16,451	$ 181,328	$ 266	$ 34,180	$1,261,160
At December 31, 2016								
Substandard	$12,845	$ 1,427	$428	$ -	$ 717	$ -	$ 41	$15,458
Watch	10,509	3,975	149	436	1,389	-	3,671	20,129
Pass	369,463	553,190	21,201	17,743	157,295	319	23,086	1,142,297
	$392,817	$ 558,592	$21,778	$ 18,179	$ 159,401	$ 319	$ 26,798	$1,177,884

Factors that are important to managing overall credit quality include sound loan underwriting and administration, systematic monitoring of existing loans and commitments, effective loan review on an ongoing basis, early identification of potential problems, an allowance for loan losses, and sound non-accrual and charge-off policies. Our

underwriting policies require an officers' loan committee review and approval of all loans in excess of $500,000. In addition, we utilize an independent loan review function for all loans. Our ability to manage credit risk depends in large part on our ability to properly identify and manage problem loans. To do so, we maintain a loan review system under which our credit management personnel review non-owner occupied one- to four-family, multi-family, construction and land, commercial real estate and commercial loans that individually, or as part of an overall borrower relationship exceed $1.0 million in potential exposure. Loans meeting these criteria are reviewed on an annual basis, or more frequently, if the loan renewal is less than one year. With respect to this review process, management has determined that pass loans include loans that exhibit acceptable financial statements, cash flow and leverage. Watch loans have potential weaknesses that deserve management's attention, and if left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the credit. Substandard loans are considered inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged. These loans generally have a well-defined weakness that may jeopardize liquidation of the debt and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Finally, a loan is considered to be impaired when it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Management has determined that all non-accrual loans and loans modified under troubled debt restructurings meet the definition of an impaired loan.

The Company's procedures dictate that an updated valuation must be obtained with respect to underlying collateral at the time a loan is deemed impaired. Updated valuations may also be obtained upon transfer from loans receivable to real estate owned based upon the age of the prior appraisal, changes in market conditions or known changes to the physical condition of the property.

Estimated fair values are reduced to account for sales commissions, broker fees, unpaid property taxes and additional selling expenses to arrive at an estimated net realizable value. The adjustment factor is based upon the Company's actual experience with respect to sales of real estate owned over the prior two years. In situations in which we are placing reliance on an appraisal that is more than one year old, an additional adjustment factor is applied to account for downward market pressure since the date of appraisal. The additional adjustment factor is based upon relevant sales data available for our general operating market as well as company-specific historical net realizable values as compared to the most recent appraisal prior to disposition.

With respect to multi-family income-producing real estate, appraisals are reviewed and estimated collateral values are adjusted by updating significant appraisal assumptions to reflect current real estate market conditions. Significant assumptions reviewed and updated include the capitalization rate, rental income and operating expenses. These adjusted assumptions are based upon recent appraisals received on similar properties as well as on actual experience related to real estate owned and currently under Company management.

The following tables present data on impaired loans at September 30, 2017 and December 31, 2016.

	As of or for the Nine Months Ended September 30, 2017					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
	(In Thousands)					
Total Impaired with Reserve						
One- to four-family	$1,568	$1,568	$ 198	$ -	$ 1,595	$ 57
Multi-family	-	-	-	-	-	-
Home equity	159	159	77	-	165	10
Construction and land	-	-	-	-	-	-
Commercial real estate	38	447	38	409	45	-
Consumer	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
	1,765	2,174	313	409	1,805	67
Total Impaired with no Reserve						
One- to four-family	6,888	8,385	-	1,497	7,409	251
Multi-family	833	1,699	-	866	834	63
Home equity	143	143	-	-	147	4
Construction and land	37	51	-	14	45	-
Commercial real estate	434	434	-	-	436	11
Consumer	-	-	-	-	-	-
Commercial	26	26	-	-	26	-
	8,361	10,738	-	2,377	8,897	329
Total Impaired						
One- to four-family	8,456	9,953	198	1,497	9,004	308
Multi-family	833	1,699	-	866	834	63
Home equity	302	302	77	-	312	14
Construction and land	37	51	-	14	45	-
Commercial real estate	472	881	38	409	481	11
Consumer	-	-	-	-	-	-

Commercial	26	26	-	-	26	-
	$10,126	$12,912	$ 313	$ 2,786	$ 10,702	$ 396

	As of or for the Year Ended December 31, 2016					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
	(In Thousands)					
Total Impaired with Reserve						
One- to four-family	$3,007	$3,007	$ 499	$ -	$ 3,063	$ 88
Multi-family	-	-	-	-	-	-
Home equity	188	188	79	-	198	15
Construction and land	-	-	-	-	-	-
Commercial real estate	280	689	83	409	295	15
Consumer	-	-	-	-	-	-
Commercial	1	1	1	-	2	-
	3,476	3,885	662	409	3,558	118
Total Impaired with no Reserve						
One- to four-family	7,913	9,245	-	1,332	8,150	401
Multi-family	3,941	4,952	-	1,011	4,005	230
Home equity	254	254	-	-	258	9
Construction and land	-	-	-	-	-	-
Commercial real estate	438	438	-	-	442	13
Consumer	-	-	-	-	-	-
Commercial	40	40	-	-	46	2
	12,586	14,929	-	2,343	12,901	655
Total Impaired						
One- to four-family	10,920	12,252	499	1,332	11,213	489
Multi-family	3,941	4,952	-	1,011	4,005	230
Home equity	442	442	79	-	456	24
Construction and land	-	-	-	-	-	-
Commercial real estate	718	1,127	83	409	737	28
Consumer	-	-	-	-	-	-
Commercial	41	41	1	-	48	2
	$16,062	$18,814	$ 662	$ 2,752	$ 16,459	$ 773

The difference between a loan's recorded investment and the unpaid principal balance represents a partial charge-off resulting from a confirmed loss when the value of the collateral securing the loan is below the loan balance and management's assessment that the full collection of the loan balance is not likely.

When a loan is considered impaired, interest payments received are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

The determination as to whether an allowance is required with respect to impaired loans is based upon an analysis of the value of the underlying collateral and/or the borrower's intent and ability to make all principal and interest payments in accordance with contractual terms. The evaluation process is subject to the use of significant estimates and actual results could differ from estimates. This analysis is primarily based upon third party appraisals and/or a discounted cash flow analysis. In those cases in which no allowance has been provided for an impaired loan, the Company has determined that the estimated value of the underlying collateral exceeds the remaining outstanding balance of the loan. Of the total $8.4 million of impaired loans as of September 30, 2017 for which no allowance has

been provided, $2.4 million in net charge-offs have been recorded to reduce the unpaid principal balance to an amount that is commensurate with the loans' net realizable value, using the estimated fair value of the underlying collateral. To the extent that further deterioration in property values continues, the Company may have to reevaluate the sufficiency of the collateral servicing these impaired loans resulting in additional provisions to the allowance for loans losses or charge-offs.

At September 30, 2017, total impaired loans included $5.2 million of troubled debt restructurings. Troubled debt restructurings involve granting concessions to a borrower experiencing financial difficulty by modifying the terms of the loan in an effort to avoid foreclosure. The vast majority of debt restructurings include a modification of terms to allow for an interest only payment and/or reduction in interest rate. The restructured terms are typically in place for six to twelve months. At December 31, 2016, total impaired loans included $10.1 million of troubled debt restructurings.

The following presents data on troubled debt restructurings:

	As of September 30, 2017					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
One- to four-family	$2,747	2	$1,204	7	$3,951	9
Multi-family	-	-	833	3	833	3
Home Equity	48	1	-	-	48	1
Commercial real estate	291	1	37	1	328	2
	$3,086	4	$2,074	11	$5,160	15

	As of December 31, 2016					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
One- to four-family	$3,296	3	$2,399	34	$5,695	37
Multi-family	2,514	1	1,427	5	3,941	6
Home equity	49	1	97	1	146	2
Commercial real estate	295	1	60	1	355	2
	$6,154	6	$3,983	41	$10,137	47

At September 30, 2017, $5.2 million in loans had been modified in troubled debt restructurings and $2.1 million of these loans were included in the non-accrual loan total. The remaining $3.1 million, while meeting the internal requirements for modification in a troubled debt restructuring, were current with respect to payments under their original loan terms at the time of the restructuring and, therefore, continued to be included with accruing loans. Provided these loans perform in accordance with the modified terms, they will continue to be accounted for on an accrual basis.

All loans that have been modified in a troubled debt restructuring are considered to be impaired. As such, an analysis has been performed with respect to all of these loans to determine the need for a valuation reserve. When a loan is expected to perform in accordance with the restructured terms and ultimately return to and perform under contract terms, a valuation allowance is established for an amount equal to the excess of the present value of the expected future cash flows under the original contract terms as compared with the modified terms, including an estimated default rate. When there is doubt as to the borrower's ability to perform under the restructured terms or ultimately return to and perform under market terms, a valuation allowance is established equal to the impairment when the carrying amount exceeds fair value of the underlying collateral. As a result of the impairment analysis, a $96,000 valuation allowance has been established as of September 30, 2017 with respect to the $5.2 million in troubled debt restructurings. As of December 31, 2016, a $293,000 valuation allowance had been established with respect to the $10.1 million in troubled debt restructurings.

After a troubled debt restructuring reverts to market terms, a minimum of six consecutive contractual payments must be received prior to consideration for a return to accrual status. If an updated credit department review indicates no other evidence of elevated credit risk, the loan is returned to accrual status at that time.

The following presents troubled debt restructurings by concession type:

	As of September 30, 2017					
	Performing in accordance with modified terms		In Default		Total	
	Amount	Number	Amount	Number	Amount	Number
	(dollars in thousands)					
Interest reduction and principal forbearance	$4,060	9	$-	-	$4,060	9
Principal forbearance	48	1	-	-	48	1
Interest reduction	356	3	696	2	1,052	5
	$4,464	13	$696	2	$5,160	15

	As of December 31, 2016					
	Performing in accordance with modified terms		In Default		Total	
	Amount	Number	Amount	Number	Amount	Number
	(dollars in thousands)					
Interest reduction and principal forbearance	$8,221	22	$761	2	$8,982	24
Principal forbearance	49	1	-	-	49	1
Interest reduction	1,106	22	-	-	1,106	22
	$9,376	45	$761	2	$10,137	47

There were no loans modified as troubled debt restructurings for the three months or nine months ended September 30, 2017. There was one home equity loan with a balance of $64,000 modified as a troubled debt restructuring modified during the three and nine months ended September 30, 2016.

There were no troubled debt restructurings within the past twelve months for which there was a default during the three or nine months ended September 30, 2017 and September 30, 2016.

The following table presents data on non-accrual loans as of September 30, 2017 and December 31, 2016:

	September 30, 2017	December 31, 2016
	(Dollars in Thousands)	
Non-accrual loans:		
Residential		
One- to four-family	$5,709	$ 7,623
Multi-family	833	1,427
Home equity	223	344
Construction and land	37	-
Commercial real estate	181	422
Commercial	26	41
Consumer	-	-
Total non-accrual loans	$7,009	$ 9,857
Total non-accrual loans to total loans receivable	0.56 %	0.84 %
Total non-accrual loans to total assets	0.38 %	0.55 %

Note 4— Real Estate Owned

Real estate owned is summarized as follows:

	September 30, 2017	December 31, 2016
	(In Thousands)	
One- to four-family	$ 1,021	$ 2,141
Multi-family	169	-
Construction and land	4,822	5,082
Commercial real estate	300	300
Total real estate owned	6,312	7,523
Valuation allowance at end of period	(1,744)	(1,405)
Total real estate owned, net	$ 4,568	$ 6,118

The following table presents the activity in the Company's real estate owned:

	Nine months ended September 30,	
	2017	2016
	(In Thousands)	
Real estate owned at beginning of the period	$ 6,118	9,190
Transferred from loans receivable	1,609	3,442
Sales (net of gains / losses)	(2,654)	(4,762)
Write downs	(504)	(416)
Other	(1)	-
Real estate owned at the end of the period	$ 4,568	7,454

Residential one- to four-family mortgage loans that were in the process of foreclosure were $3.0 million and $3.1 million at September 30, 2017 and December 31, 2016, respectively.

Note 5— Mortgage Servicing Rights

The following table presents the activity in the Company's mortgage servicing rights:

	Nine months ended September 30,	
	2017	2016
	(In Thousands)	
Mortgage servicing rights at beginning of the period	$2,260	$1,422
Additions	793	1,486
Amortization	(71)	(412)
Sales	(2,264)	-
Mortgage servicing rights at end of the period	718	2,496
Valuation allowance at end of period	-	(100)
Mortgage servicing rights at end of the period, net	$718	$2,396

During the nine months ended September 30, 2017, $1.88 billion in residential loans were originated for sale. During the same period, sales of loans held for sale totaled $2.03 billion, generating mortgage banking income of $92.8 million. The unpaid principal balance of loans serviced for others was $99.2 million and $318.6 million at September 30, 2017 and December 31, 2016, respectively. These loans are not reflected in the consolidated statements of financial condition.

During the nine months ended September 30, 2017, the Company sold mortgage servicing rights related to $295.1 million in loans receivable with a book value of $2.3 million for $2.6 million resulting in a gain on sale of $308,000. During the nine months ended September 30, 2016, the Company did not sell any mortgage servicing rights.

The following table shows the estimated future amortization expense for mortgage servicing rights for the periods indicated:

Estimate for the period ending December 31:	(In Thousands)
2017	$ 25
2018	106
2019	96
2020	86
2021	76
Thereafter	329
Total	$ 718

Note 6— Deposits

At September 30, 2017 and December 31, 2016, time deposits with balances greater than $250,000 amounted to $43.6 million and $44.5 million, respectively.

A summary of the contractual maturities of time deposits at September 30, 2017 is as follows:

	(In Thousands)
Within one year	$ 514,304

More than one to two years	153,213
More than two to three years	13,618
More than three to four years	1,358
More than four through five years	2,540
	$ 685,033

Note 7— Borrowings

Borrowings consist of the following:

		September 30, 2017		December 31, 2016	
		Balance	Weighted Average Rate	Balance	Weighted Average Rate
		(Dollars in Thousands)			
Short term:					
Repurchase agreement		$10,503	3.99 %	$8,155	3.52 %
Federal Home Loan Bank, Chicago advances		55,000	1.25 %	65,000	0.61 %
Long term:					
Federal Home Loan Bank, Chicago advances maturing:					
2017		65,000	3.19 %	65,000	3.19 %
2018		65,000	2.97 %	65,000	2.97 %
2021		100,000	0.78 %	100,000	0.78 %
2027		125,000	1.23 %	-	0.00 %
Repurchase agreements maturing	2017	15,000	2.89 %	84,000	3.96 %
		$435,503	1.81 %	$387,155	2.27 %

The short-term repurchase agreement represents the outstanding portion of a total $35.0 million commitment with one unrelated bank. The short-term repurchase agreement is utilized by Waterstone Mortgage Corporation to finance loans originated for sale. This agreement is secured by the underlying loans being financed. Related interest rates are based upon the note rate associated with the loans being financed. The short-term repurchase agreement had a $10.5 million balance at September 30, 2017 and a $8.2 million balance at December 31, 2016.

The $55.0 million in short-term advances consists of one $35.0 million short-term advance that has a maturity date of March 15, 2018 and a fixed rate of 1.28% and one $20.0 million short-term advance that has a maturity date of October 4, 2017 and a fixed rate of 1.20%.

The $65.0 million in advances due in 2017 consists of three advances with fixed rates ranging from 3.09% to 3.46% callable quarterly until maturity.

The $65.0 million in advances due in 2018 consists of three advances with fixed rates ranging from 2.73% to 3.11% callable quarterly until maturity.

The $100.0 million in advances due in 2021 consists of two advances totaling $50.0 million with fixed rates ranging from 0.67% to 0.73% with a FHLB quarterly call option beginning in June 2018 and one advance for $50.0 million with a fixed rate of 0.85% with a FHLB quarterly call option beginning in September 2018.

The $125.0 million in advances due in 2027 consists of one $50.0 million advance with a fixed rate of 1.24% with a FHLB single call option in May 2019, one $50.0 million advance with a fixed rate of 1.23% with a FHLB single call option in June 2019, and one $25.0 million advance with a fixed rate of 1.23% with a FHLB single call option in August 2019.

The $15.0 million repurchase agreement has a fixed rate of 2.89% callable quarterly until its maturity in 2017. The repurchase agreement is collateralized by securities available for sale with an estimated fair value of $25.6 million at September 30, 2017 and $93.2 million at December 31, 2016.

The Company selects loans that meet underwriting criteria established by the FHLBC as collateral for outstanding advances. The Company's borrowings from the FHLBC are limited to 79% of the carrying value of unencumbered one- to four-family mortgage loans, 75% of the carrying value of home equity loans and 51% of the carrying value of multi-family loans. In addition, these advances were collateralized by FHLBC stock of $18.5 million at September 30, 2017 and $13.3 million at December 31, 2016. In the event of prepayment, the Company is obligated to pay all remaining contractual interest on the advance.

Note 8 – Regulatory Capital

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements, or overall financial performance deemed by the regulators to be inadequate, can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and Bank's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Company's and Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC) issued final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The final rules revise the regulatory capital elements, add a new common equity Tier I capital ratio, increase the minimum Tier 1 capital ratio requirements and implement a new capital conservation buffer. The rules also permit certain banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income. The Company and the Bank have made the election to retain the existing treatment for accumulated other comprehensive income. The final rules took effect for the Company and the Bank on January 1, 2015, subject to a transition period for certain parts of the rules.

The table below includes the new regulatory capital ratio requirements that became effective on January 1, 2015. Beginning in 2016, an additional capital conservation buffer was added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer will be fully phased-in on January 1, 2019 at 2.5%. A banking organization with a conservation buffer of less than 2.5% (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. At September 30, 2017, the ratios for the Company and the Bank are sufficient to meet the fully phased-in conservation buffer.

The actual and required capital amounts and ratios for the Bank as of September 30, 2017 and December 31, 2016 are presented in the table below:

	September 30, 2017							
	Actual		For Capital Adequacy Purposes		Minimum Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars In Thousands)							
Total Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	$425,064	30.70%	$110,755	8.00%	$128,061	9.25%	$N/A	N/A
WaterStone Bank	400,873	28.99%	110,613	8.00%	127,896	9.25%	138,266	10.00%
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	411,001	29.69%	83,066	6.00%	100,372	7.25%	N/A	N/A
WaterStone Bank	386,810	27.98%	82,960	6.00%	100,243	7.25%	110,613	8.00%

Common Equity Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	411,001	29.69%	62,300	4.50%	79,605	5.75%	N/A	N/A
WaterStone Bank	386,810	27.98%	62,220	4.50%	79,503	5.75%	89,873	6.50 %
Tier 1 Capital (to average assets)								
Consolidated Waterstone Financial, Inc.	411,001	21.90%	75,054	4.00%	N/A	N/A	N/A	N/A
WaterStone Bank	386,810	20.67%	74,859	4.00%	N/A	N/A	93,574	5.00 %
State of Wisconsin (to total assets)								
WaterStone Bank	386,810	20.91%	110,989	6.00%	N/A	N/A	N/A	N/A

	December 31, 2016							
	(Dollars In Thousands)							
Total Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	$426,496	32.23%	$105,870	8.00%	$114,141	8.625%	$N/A	N/A
WaterStone Bank	389,602	29.50%	105,641	8.00%	113,895	8.625%	132,052	10.00%
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	410,467	31.02%	79,402	6.00%	87,673	6.625%	N/A	N/A
WaterStone Bank	373,573	28.29%	79,231	6.00%	87,484	6.625%	105,641	8.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	410,467	31.02%	59,552	4.50%	67,823	5.125%	N/A	N/A
WaterStone Bank	373,573	28.29%	59,423	4.50%	67,676	5.125%	85,834	6.50 %
Tier 1 Capital (to average assets)								
Consolidated Waterstone Financial, Inc.	410,467	23.20%	70,760	4.00%	N/A	N/A	N/A	N/A
WaterStone Bank	373,573	21.17%	70,573	4.00%	N/A	N/A	88,216	5.00 %
State of Wisconsin (to total assets)								
WaterStone Bank	373,573	20.90%	107,247	6.00%	N/A	N/A	N/A	N/A

Note 9 – Income Taxes

Income tax expense increased from $12.2 million during the nine months ended September 30, 2016 to $12.4 million for the nine months ended September 30, 2017. This increase was primarily due to the increase in our income before income taxes, which increased from $31.3 million during the nine months ended September 30, 2016 to $35.2 million during the nine months ended September 30, 2017. Income tax expense is recognized on the statement of income during the nine months ended September 30, 2017 at an effective rate of 35.2% of pretax income compared to 39.0% during the nine months ended September 30, 2016.

During nine months ended September 30, 2017, the Company recognized a benefit of approximately $827,000 related to stock awards exercised during the year as a result of adopting the new stock compensation accounting standard.

During the quarter ended September 30, 2016, the Company incurred a charge related to stock options awarded in 2007. The deferred tax asset established for the stock options was not fully utilized upon exercise, as the deductible compensation recognized was less than the value of the asset established at the time the award vested. A net expense of $564,000 was charged to income tax for the nine months ended September 30, 2016.

Note 10 – Offsetting of Assets and Liabilities

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. In addition, the Company enters into agreements under which it sells loans held for sale subject to an obligation to repurchase the same loans. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of assets. The obligation to repurchase the assets is reflected as a liability in the Company's consolidated statements of financial condition, while the securities and loans held for sale underlying the repurchase agreements remain in the respective investment securities and loans held for sale asset accounts. In other words, there is no offsetting or netting of the investment securities or loans held for sale assets with the repurchase agreement liabilities. One of the Company's two short-term repurchase agreements and all of the Company's long-term repurchase agreements are subject to master netting agreements, which set forth the rights and obligations for repurchase and offset. Under the master netting agreement, the Company is entitled to set off the collateral placed with a single counterparty against obligations owed to that counterparty.

The following table presents the liabilities subject to an enforceable master netting agreement as of September 30, 2017 and December 31, 2016.

	Gross Recognized Liabilities	Gross Amounts Offset	Net Amounts Presented	Gross Amounts Not Offset	Net Amount
	(In Thousands)				
September 30, 2017					
Repurchase Agreements					
Short-term	$ 10,503	$ -	$ 10,503	$ 10,503	$ -
Long-term	15,000	-	15,000	15,000	-
	$ 25,503	$ -	$ 25,503	$ 25,503	$ -
December 31, 2016					
Repurchase Agreements					
Short-term	$ 8,155	$ -	$ 8,155	$ 8,155	$ -
Long-term	84,000	-	84,000	84,000	-
	$ 92,155	$ -	$ 92,155	$ 92,155	$ -

Note 11– Commitments, Off-Balance Sheet Arrangements, and Contingent Liabilities

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated statements of financial condition. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

	September 30, 2017	December 31, 2016
	(In Thousands)	
Financial instruments whose contract amounts represent potential credit risk:		
Commitments to extend credit under amortizing loans (1)	$52,948	$ 30,903
Commitments to extend credit under home equity lines of credit (2)	14,724	14,367
Unused portion of construction loans (3)	18,306	21,137
Unused portion of business lines of credit	17,204	15,095
Standby letters of credit	259	333

(1) Commitments for loans are extended to customers for up to 90 days after which they expire. Excludes commitments to originate loans held for sale, which are discussed in the following footnote.
(2) Unused portions of home equity loans are available to the borrower for up to 10 years.
(3) Unused portions of construction loans are available to the borrower for up to one year.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements of the Company. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral obtained generally consists of mortgages on the underlying real estate.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds mortgages on the underlying real estate as collateral supporting those commitments for which collateral is deemed necessary.

The Company has determined that there are no probable losses related to commitments to extend credit or the standby letters of credit as of September 30, 2017 and December 31, 2016.

In the normal course of business, the Company, or it's subsidiaries, are involved in various legal proceedings. In the opinion of management, any liability resulting from pending proceedings would not be expected to have a material adverse effect on the Company's consolidated financial statements.

Herrington v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a class action lawsuit filed in the United States District Court for the Western District of Wisconsin and subsequently compelled to arbitration before the American Arbitration Association. The plaintiff class alleged that Waterstone Mortgage Corporation violated certain provisions of the Fair Labor Standards Act (FLSA) and failed to pay loan officers consistent with their various employment agreements. On

July 5, 2017, the arbitrator issued a final award finding Waterstone Mortgage Corporation liable for unpaid minimum wages, overtime, unreimbursed business expenses, and liquidated damages under the FLSA. The arbitrator awarded damages under the FLSA in the amount of $7.3 million, and attorney's fees and costs in the amount of $3.3 million. While a judgment confirming the arbitrator's award with respect to damages and fees has not yet been issued, if plaintiff prevails on her theories, the Company has estimated that the award, which includes attorney's fees and costs, could be as high as $11.0 million. Waterstone Mortgage Corporation will continue to vigorously defend its interests in this matter, including challenging any findings regarding liability and damages through appropriate post-arbitration motions and appeal processes and seeking to vacate in its entirety any award against the Company. Given the pending legal strategies that are available, we do not believe that it is probable that the plaintiff will ultimately prevail in this litigation, and estimate the low end of the possible range of loss is $0. In accordance with the authoritative guidance in evaluating contingencies, the Company has not recorded an accrual related to this matter.

Werner v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a putative collection action lawsuit that was filed on August 4, 2017 in the United States District Court for the Western District of Wisconsin, Werner et al. v. Waterstone Mortgage Corporation. Plaintiffs allege that Waterstone Mortgage Corporation violated the Fair Labor Standards Act (FLSA) by failing to pay loan officers minimum and overtime wages. The case is in the very early stages of litigation and the Court has yet to decide if the case can proceed as collective action. The Company intends to vigorously defend its interests in this matter and pursue all possible defenses against the claims. Given the early stage of the litigation, the Company is not yet able to make a determination as to the likelihood of an unfavorable outcome in this matter, nor is it able to estimate the range of any possible loss.

Note 12 – Derivative Financial Instruments

In connection with its mortgage banking activities, the Company enters into derivative financial instruments as part of its strategy to manage its exposure to changes in interest rates. Mortgage banking derivatives include interest rate lock commitments provided to customers to fund mortgage loans to be sold in the secondary market and forward commitments for the future delivery of such loans to third party investors. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of future changes in interest rates on its commitments to fund the loans as well as on its portfolio of mortgage loans held for sale. The Company's mortgage banking derivatives have not been designated as hedge relationships. These instruments are used to manage the Company's exposure to interest rate movements and other identified risks but do not meet the strict hedge accounting requirements of ASC 815. Changes in the fair value of derivatives not designated in hedging relationships are recorded as a component of mortgage banking income in the Company's consolidated statements of operations. The Company does not use derivatives for speculative purposes.

Forward commitments to sell mortgage loans represent commitments obtained by the Company from a secondary market agency to purchase mortgages from the Company at specified interest rates and within specified periods of time. Commitments to sell loans are made to mitigate interest rate risk on interest rate lock commitments to originate loans and loans held for sale. At September 30, 2017, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of approximately $349.3 million and interest rate lock commitments with an aggregate notional amount of approximately $201.8 million. The fair value of the forward commitments to sell mortgage loans at September 30, 2017 included a gain of $604,000 that is reported as a component of other assets on the Company's consolidated statement of financial condition. The fair value of the interest rate locks at September 30, 2017 included a gain of $2.0 million that is reported as a component of other assets on the Company's consolidated statements of financial condition.

In determining the fair value of its derivative loan commitments, the Company considers the value that would be generated by the loan arising from exercise of the loan commitment when sold in the secondary mortgage market. That value includes the price that the loan is expected to be sold for in the secondary mortgage market. The fair value of these commitments is recorded on the consolidated statements of financial condition with the changes in fair value recorded as a component of mortgage banking income.

Residential mortgage loans sold to others are predominantly conventional residential first lien mortgages. The Company's agreements to sell residential mortgage loans in the normal course of business usually require certain representations and warranties on the underlying loans sold related to credit information, loan documentation and collateral, which if subsequently are untrue or breached, could require the Company to repurchase certain loans affected. The Company has only been required to make insignificant repurchases as a result of breaches of these representations and warranties. The Company's agreements to sell residential mortgage loans also contain limited recourse provisions. The recourse provisions are limited in that the recourse provision ends after certain payment criteria have been met. With respect to these loans, repurchase could be required if defined delinquency issues arose during the limited recourse period. Given that the underlying loans delivered to buyers are predominantly conventional first lien mortgages and that historical experience shows negligible losses and insignificant repurchase activity, management believes that losses and repurchases under the limited recourse provisions will continue to be insignificant.

Note 13 – Earnings Per Share

Earnings per share are computed using the two-class method. Basic earnings per share is computed by dividing net income allocated to common shares by the weighted average number of common shares outstanding during the applicable period. Diluted earnings per share is computed by dividing net income by the weighted average number of

common shares outstanding adjusted for the dilutive effect of all potential common shares.

Presented below are the calculations for basic and diluted earnings per share:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In Thousands, except per share amounts)			
Net income	$7,389	$7,505	$22,849	$19,133
Net income available to unvested restricted shares	-	5	-	12
Net income available to common stockholders	$7,389	$7,500	$22,849	$19,121
Weighted average shares outstanding	27,532	27,043	27,449	26,976
Effect of dilutive potential common shares	421	386	478	307
Diluted weighted average shares outstanding	27,953	27,429	27,927	27,283
Basic earnings per share	$0.27	$0.28	$0.83	$0.71
Diluted earnings per share	$0.26	$0.27	$0.82	$0.70

Note 14 – Fair Value Measurements

ASC Topic 820, "Fair Value Measurements and Disclosures" defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This accounting standard applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements. The standard also emphasizes that fair value (i.e., the price that would be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date), among other things, is based on exit price versus entry price, should include assumptions about risk such as nonperformance risk in liability fair values, and is a market-based measurement, not an entity-specific measurement. When considering the assumptions that market participants would use in pricing the asset or liability, this accounting standard establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

The fair value hierarchy prioritizes inputs used to measure fair value into three broad levels.

Level 1 inputs - In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that we have the ability to access.

Level 2 inputs - Fair values determined by Level 2 inputs use inputs other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets where there are few transactions and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Level 3 inputs are unobservable inputs for the asset or liability and include situations where there is little, if any, market activity for the asset or liability.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The following table presents information about our assets recorded in our consolidated statement of financial condition at their fair value on a recurring basis as of September 30, 2017 and December 31, 2016, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

		Fair Value Measurements Using		
	September 30, 2017	Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$62,218	$-	$62,218	$-
Collateralized mortgage obligations				
Government sponsored enterprise issued	54,660	-	54,660	-
Government sponsored enterprise bonds	2,499	-	2,499	-
Municipal securities	65,662	-	65,662	-

Other debt securities	14,574	-	14,574	-
Certificates of deposit	1,227	-	1,227	-
Loans held for sale	175,137	-	175,137	-
Mortgage banking derivative assets	2,572	-	-	2,572

		Fair Value Measurements Using		
	December 31, 2016	Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$73,413	$-	$73,413	$-
Collateralized mortgage obligations				
Government sponsored enterprise issued	62,002	-	62,002	-
Government sponsored enterprise bonds	2,503	-	2,503	-
Municipal securities	70,696	-	70,696	-
Other debt securities	16,950	2,541	14,409	-
Certificates of deposit	1,231	-	1,231	-
Loans held for sale	225,248	-	225,248	-
Mortgage banking derivative assets	3,403	-	-	3,403
Mortgage banking derivative liabilities	69	-	-	69

The following summarizes the valuation techniques for assets recorded in our consolidated statements of financial condition at their fair value on a recurring basis:

Available for sale securities – The Company's investment securities classified as available for sale include: mortgage-backed securities, collateralized mortgage obligations, government sponsored enterprise bonds, municipal securities and other debt securities. The fair value of mortgage-backed securities, collateralized mortgage obligations and government sponsored enterprise bonds are determined by a third party valuation source using observable market data utilizing a matrix or multi-dimensional relational pricing model. Standard inputs to these models include observable market data such as benchmark yields, reported trades, broker quotes, issuer spreads, benchmark securities, prepayment models and bid/offer market data. For securities with an early redemption feature, an option adjusted spread model is utilized to adjust the issuer spread. These model and matrix measurements are classified as Level 2 in the fair value hierarchy. The fair value of municipal securities is determined by a third party valuation source using observable market data utilizing a multi-dimensional relational pricing model. Standard inputs to this model include observable market data such as benchmark yields, reported trades, broker quotes, rating updates and issuer spreads. These model measurements are classified as Level 2 in the fair value hierarchy. The fair value of other debt securities, which includes a trust preferred security issued by a financial institution, is determined through quoted prices in active markets and is classified as Level 1 in the fair value hierarchy.

Loans held for sale – The Company carries loans held for sale at fair value under the fair value option model. Fair value is generally determined by estimating a gross premium or discount, which is derived from pricing currently observable in the secondary market, principally from observable prices for forward sale commitments. Loans held-for-sale are considered to be Level 2 in the fair value hierarchy of valuation techniques.

Mortgage banking derivatives - Mortgage banking derivatives include interest rate lock commitments to originate residential loans held for sale to individual customers and forward commitments to sell residential mortgage loans to various investors. The Company utilizes a valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale, which includes applying a pull through rate based upon historical experience and the current interest rate environment and then multiplying by quoted investor prices. The Company also utilizes a valuation model to estimate the fair value of its forward commitments to sell residential loans, which includes matching specific terms and maturities of the forward commitments against applicable investor pricing available. While there are Level 2 and 3 inputs used in the valuation models, the Company has determined that one or more of the inputs significant in the valuation of both of the mortgage banking derivatives fall within Level 3 of the fair value hierarchy.

The table below presents reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2017 and 2016.

	Mortgage banking derivatives, net (In Thousands)
Balance at December 31, 2015	$ 2,188
Mortgage derivative gain, net	1,146
Balance at December 31, 2016	$ 3,334
Mortgage derivative loss, net	(762)
Balance at September 30, 2017	$ 2,572

There were no transfers in or out of Level 1, 2 or 3 measurements during the periods.

Assets Recorded at Fair Value on a Non-recurring Basis

The following tables present information about our assets recorded in our consolidated statement of financial condition at their fair value on a non-recurring basis as of September 30, 2017 and December 31, 2016, and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value.

		Fair Value Measurements Using		
	September 30, 2017	Level 1	Level 2	Level 3
	(In Thousands)			
Impaired loans, net (1)	$1,452	$-	$ -	$1,452
Real estate owned	4,568	-	-	4,568

		Fair Value Measurements Using		
	December 31, 2016	Level 1	Level 2	Level 3
	(In Thousands)			
Impaired loans, net (1)	$2,814	$-	$ -	$2,814
Real estate owned	6,118	-	-	6,118

(1) Represents collateral-dependent impaired loans, net, which are included in loans.

Loans – We do not record loans at fair value on a recurring basis. On a non-recurring basis, loans determined to be impaired are analyzed to determine whether a collateral shortfall exists, and if such a shortfall exists, are recorded on our consolidated statements of financial condition at net realizable value of the underlying collateral. Fair value is determined based on third party appraisals. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of impaired loans, loans that have been deemed to be impaired are considered to be Level 3 in the fair value hierarchy of valuation techniques. At September 30, 2017, loans determined to be impaired with an outstanding balance of $1.8 million were carried net of specific reserves of $313,000 for a fair value of $1.5 million. At December 31, 2016, loans determined to be impaired with an outstanding balance of $3.5 million were carried net of specific reserves of $662,000 for a fair value of $2.8 million. Impaired loans collateralized by assets which are valued in excess of the net investment in the loan do not require any specific reserves.

Real estate owned – On a non-recurring basis, real estate owned, is recorded in our consolidated statements of financial condition at the lower of cost or fair value. Fair value is determined based on third party appraisals and, if less than the carrying value of the foreclosed loan, the carrying value of the real estate owned is adjusted to the fair value. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of the properties, real estate owned is considered to be Level 3 in the fair value hierarchy of valuation techniques. Changes in the value of real estate owned totaled $504,000 and $416,000 during the nine months ended September 30, 2017 and 2016, respectively and are recorded in real estate owned expense. At September 30, 2017 and December 31, 2016, real estate owned totaled $4.6 million and $6.1 million, respectively.

Mortgage servicing rights – The Company utilizes an independent valuation from a third party which uses a discounted cash flow model to estimate the fair value of mortgage servicing rights. The model utilizes prepayment assumptions to project cash flows related to the mortgage servicing rights based upon the current interest rate environment, which is then discounted to estimate an expected fair value of the mortgage servicing rights. The model considers characteristics specific to the underlying mortgage portfolio, such as: contractually specified servicing fees, prepayment assumptions, delinquency rates, late charges and costs to service. Given the significance of the unobservable inputs utilized in the estimation process, mortgage servicing rights are classified as Level 3 within the fair value hierarchy. The Company records the mortgage servicing rights at the lower of amortized cost or fair value. At September 30, 2017 and December 31, 2016, there were no impairment identified for mortgage servicing rights.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of September 30, 2017, the significant unobservable inputs used in the fair value measurements were as follows:

				Significant Unobservable Input Value	
	Fair Value at September 30, 2017	Valuation Technique	Significant Unobservable Inputs	Minimum Value	Maximum Value
Mortgage banking derivatives	$ 2,572	Pricing models	Pull through rate	65.3 %	99.8 %
Impaired loans	1,452	Market approach	Discount rates applied to appraisals	15.0 %	35.0 %
Real estate owned	4,568	Market approach	Discount rates applied to appraisals	15.0 %	85.7 %

The significant unobservable input used in the fair value measurement of the Company's mortgage banking derivatives, including interest rate lock commitments, is the loan pull through rate. This represents the percentage of loans currently in a lock position which the Company estimates will ultimately close. Generally, the fair value of an interest rate lock commitment will be positively (negatively) impacted when the prevailing interest rate is lower

(higher) than the interest rate lock commitment. Generally, an increase in the pull through rate will result in the fair value of the interest rate lock increasing when in a gain position, or decreasing when in a loss position. The pull through rate is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. The pull through rate is computed using historical data and the ratio is periodically reviewed by the Company.

The significant unobservable inputs used in the fair value measurement of collateral for collateral-dependent impaired loans and real estate owned included in the above table primarily relate to discounting criteria applied to independent appraisals received with respect to the collateral. Discounts applied to the appraisals are dependent on the vintage of the appraisal as well as the marketability of the property. The discount factor is computed using actual realization rates on properties that have been foreclosed upon and liquidated in the open market.

The significant unobservable inputs used in the fair value measurement of mortgage servicing rights include the prepayment rate, discount rate and cost to service. The prepayment rate represents the assumed rate of prepayment of the outstanding principal balance of the underlying mortgage notes. Significant increases (decreases) in any of those inputs in isolation could result in a significantly lower (higher) fair value measurement. Although the prepayment rate and discount rate are not directly interrelated, they will generally move in opposite directions.

Fair value information about financial instruments follows, whether or not recognized in the consolidated statements of financial condition, for which it is practicable to estimate that value. 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. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The carrying amounts and fair values of the Company's financial instruments consist of the following:

	September 30, 2017					December 31, 2016				
	Carrying amount	Fair Value Total	Level 1	Level 2	Level 3	Carrying amount	Fair Value Total	Level 1	Level 2	Level 3
	(In Thousands)									
ncial Assets										
. and cash valents	$92,591	$92,591	$74,491	$18,100	$-	$47,217	$47,217	$34,967	$12,250	$-
rities able-for-sale	200,840	200,840	-	200,840	-	226,795	226,795	2,541	224,254	-
ns held for	175,137	175,137	-	175,137	-	225,248	225,248	-	225,248	-
ns receivable	1,261,160	1,284,340	-	-	1,284,340	1,177,884	1,212,967	-	-	1,212,
B stock	18,450	18,450	-	18,450	-	13,275	13,275	-	13,275	-
ued interest vable	4,575	4,575	4,575	-	-	4,281	4,281	4,281	-	-
gage cing rights	718	867	-	-	867	2,260	3,232	-	-	3,232
gage ing vative assets	2,572	2,572	-	-	2,572	3,403	3,403	-	-	3,403
ncial ilities										
osits	956,773	956,710	271,740	684,970	-	949,411	949,825	282,827	666,998	-
ance nents by owers for s	25,107	25,107	25,107	-	-	4,716	4,716	4,716	-	-
owings	435,503	435,398	-	435,398	-	387,155	390,932	-	390,932	-
ued interest ble	918	918	918	-	-	916	916	916	-	-
gage ing vative lities	-	-	-	-	-	69	69	-	-	69

The following methods and assumptions were used by the Company in determining its fair value disclosures for financial instruments.

Cash and Cash Equivalents

The carrying amount reported in the consolidated statements of financial condition for cash and cash equivalents is a reasonable estimate of fair value.

Securities

The fair value of securities is generally determined by a third party valuation source using observable market data utilizing a matrix or multi-dimensional relational pricing model. Standard inputs to these models include observable market data such as benchmark yields, reported trades, broker quotes, issuer spreads, benchmark securities and bid/offer market data. For securities with an early redemption feature, an option adjusted spread model is utilized to adjust the issuer spread. Prepayment models are used for mortgage related securities with prepayment features.

Loans Held for Sale

Fair value is estimated using the prices of the Company's existing commitments to sell such loans and/or the quoted market price for commitments to sell similar loans.

Loans Receivable

Loans determined to be impaired are analyzed to determine whether a collateral shortfall exists, and if such a shortfall exists, are recorded on our consolidated statements of financial condition at fair value. Fair value is determined based on third party appraisals. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. With respect to loans that are not considered to be impaired, fair value is estimated by discounting the future contractual cash flows using discount rates that reflect a current rate offered to borrowers of similar credit standing for the remaining term to maturity. This method of estimating fair value does not incorporate the exit-price concept of fair value prescribed by ASC 820-10 and generally produces a higher fair value.

FHLB Stock

For FHLB stock, the carrying amount is the amount at which shares can be redeemed with the FHLB and is a reasonable estimate of fair value.

Deposits and Advance Payments by Borrowers for Taxes

The fair values for interest-bearing and noninterest-bearing negotiable order of withdrawal accounts, savings accounts, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates of similar remaining maturities to a schedule of aggregated expected monthly maturities of the outstanding certificates of deposit. The advance payments by borrowers for taxes are equal to their carrying amounts at the reporting date.

Borrowings

Fair values for borrowings are estimated using a discounted cash flow calculation that applies current interest rates to estimated future cash flows of the borrowings.

Accrued Interest Payable and Accrued Interest Receivable

For accrued interest payable and accrued interest receivable, the carrying amount is a reasonable estimate of fair value.

Commitments to Extend Credit and Standby Letters of Credit

Commitments to extend credit and standby letters of credit are generally not marketable. Furthermore, interest rates on any amounts drawn under such commitments would be generally established at market rates at the time of the draw. Fair values for the Company's commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the counterparty's credit standing, and discounted cash flow analyses. The fair value of the Company's commitments to extend credit was not material at September 30, 2017 and December 31, 2016.

Mortgage Banking Derivative Assets and Liabilities

Mortgage banking derivatives include interest rate lock commitments to originate residential loans held for sale to individual customers and forward commitments to sell residential mortgage loans to various investors. The Company relies on a valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale, which includes applying a pull through rate based upon historical experience and the current interest rate environment, and then multiplying by quoted investor prices. The Company also relies on a

valuation model to estimate the fair value of its forward commitments to sell residential loans, which includes matching specific terms and maturities of the forward commitments against applicable investor pricing available. On the Company's Consolidated Statements of Condition, instruments that have a positive fair value are included in prepaid expenses and other assets, and those instruments that have a negative fair value are included in other liabilities.

Note 15 – Segment Reporting

Selected financial and descriptive information is required to be provided about reportable operating segments, considering a "management approach" concept as the basis for identifying reportable segments. The management approach is based on the way that management organizes the segments within the enterprise for making operating decisions, allocating resources, and assessing performance. Consequently, the segments are evident from the structure of the enterprise's internal organization, focusing on financial information that an enterprise's chief operating decision-makers use to make decisions about the enterprise's operating matters.

The Company has determined that it has two reportable segments: community banking and mortgage banking. The Company's operating segments are presented based on its management structure and management accounting practices. The structure and practices are specific to the Company and therefore, the financial results of the Company's business segments are not necessarily comparable with similar information for other financial institutions.

Community Banking

The community banking segment provides consumer and business banking products and services to customers primarily within Southeastern Wisconsin along with a loan production office in Minneapolis, Minnesota. Within this segment, the following products and services are provided: (1) lending solutions such as residential mortgages, home equity loans and lines of credit, personal and installment loans, real estate financing, business loans, and business lines of credit; (2) deposit and transactional solutions such as checking, credit, debit and pre-paid cards, online banking and bill pay, and money transfer services; (3) investable funds solutions such as savings, money market deposit accounts, IRA accounts, certificates of deposit, and (4) fixed and variable annuities, insurance as well as trust and investment management accounts.

Consumer products include loan and deposit products: mortgage, home equity loans and lines, personal term loans, demand deposit accounts, interest bearing transaction accounts and time deposits. Consumer products also include personal investment services. Business banking products include secured and unsecured lines and term loans for working capital, inventory and general corporate use, commercial real estate construction loans, demand deposit accounts, interest bearing transaction accounts and time deposits.

Mortgage Banking

The mortgage banking segment provides residential mortgage loans for the primary purpose of sale on the secondary market. Mortgage banking products and services are provided by offices in 24 states.

	As of or for the three months ended September 30, 2017			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income (loss)	$13,120	$(102)	$15	$13,033
Provision for loan losses	-	20	-	20
Net interest income (loss) after provision for loan losses	13,120	(122)	15	13,013
Noninterest income	1,161	32,318	(425)	33,054

Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	4,483	21,792	(122)	26,153
Occupancy, office furniture and equipment	733	1,800	-	2,533
FDIC insurance premiums	129	-	-	129
Real estate owned	(20)	-	-	(20)
Other	1,499	4,290	(268)	5,521
Total noninterest expenses	6,824	27,882	(390)	34,316
Income (loss) before income taxes	7,457	4,314	(20)	11,751
Income tax expense (benefit)	2,597	1,767	(2)	4,362
Net income (loss)	$4,860	$2,547	$(18)	$7,389
Total assets	$1,859,494	$203,826	$(209,192)	$1,854,128

	As of or for the three months ended September 30, 2016			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$11,244	$10	$71	$11,325
Provision for loan losses	100	35	-	135
Net interest income (loss) after provision for loan losses	11,144	(25)	71	11,190
Noninterest income	1,658	36,124	(370)	37,412
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	4,392	23,295	(114)	27,573
Occupancy, office furniture and equipment	740	1,579	-	2,319
FDIC insurance premiums	140	-	-	140
Real estate owned	37	-	-	37
Other	1,252	4,453	(233)	5,472
Total noninterest expenses	6,561	29,327	(347)	35,541
Income before income taxes	6,241	6,772	48	13,061
Income tax expense	2,107	2,767	682	5,556
Net income (loss)	$4,134	$4,005	$(634)	$7,505
Total assets	$1,777,014	$259,636	$(241,615)	$1,795,035

	As of or for the nine months ended September 30, 2017			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$37,233	$23	$153	$37,409
Provision for loan losses	(1,300)	134	-	(1,166)
Net interest income (loss) after provision for loan losses	38,533	(111)	153	38,575
Noninterest income	2,968	94,446	(1,182)	96,232
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	12,964	61,134	(366)	73,732
Occupancy, office furniture and equipment	2,356	5,231	-	7,587
FDIC insurance premiums	366	-	-	366
Real estate owned	258	-	-	258
Other	4,382	13,934	(698)	17,618

Total noninterest expenses	20,326	80,299	(1,064)	99,561
Income before income taxes	21,175	14,036	35	35,246
Income tax expense	6,658	5,716	23	12,397
Net income	$ 14,517	$ 8,320	$ 12	$ 22,849

	As of or for the nine months ended September 30, 2016			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$30,977	$287	$ 209	$ 31,473
Provision for loan losses	200	140	-	340
Net interest income after provision for loan losses	30,777	147	209	31,133
Noninterest income	3,583	92,457	(832)	95,208
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	12,784	58,526	(342)	70,968
Occupancy, office furniture and equipment	2,388	4,686	-	7,074
FDIC insurance premiums	500	-	-	500
Real estate owned	344	-	-	344
Other	3,705	12,790	(387)	16,108
Total noninterest expenses	19,721	76,002	(729)	94,994
Income before income taxes	14,639	16,602	106	31,347
Income tax expense	4,711	6,797	706	12,214
Net income (loss)	$9,928	$9,805	$ (600)	$ 19,133

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

Forward-Looking Information

This Quarterly Report on Form 10-Q may contain various forward-looking statements, which can be identified by the use of words such as "estimate," "project," "believe," "intend," "anticipate," "plan," "seek," "expect" and similar expressions and verbs in the future tense. These forward-looking statements include, but are not limited to:

- Statements of our goals, intentions and expectations;
- Statements regarding our business plans, prospects, growth and operating strategies;
- Statements regarding the quality of our loan and investment portfolio; and
- Estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- general economic conditions, either nationally or in our market area, that are worse than expected;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins and yields, our mortgage banking revenues, the fair value of financial instruments or the origination levels in our lending business, or increase the level of defaults, losses or prepayments on loans we have made and make whether held in portfolio or sold in the secondary markets;
- adverse changes in the securities or secondary mortgage markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- our ability to manage market risk, credit risk and operational risk in the current economic conditions;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities;
- decreased demand for our products and services;
- changes in tax policies or assessment policies;
- the inability of third-party providers to perform their obligations to us;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;
- our ability to retain key employees;
- significant increases in our loan losses; and
- changes in the financial condition, results of operations or future prospects of issuers of securities that we own.

See also the factors referred to in reports filed by the Company with the Securities and Exchange Commission (particularly those under the caption "Risk Factors" in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2016).

Overview

The following discussion and analysis is presented to assist the reader in understanding and evaluating of the Company's financial condition and results of operations. It is intended to complement the unaudited consolidated financial statements, footnotes, and supplemental financial data appearing elsewhere in this Quarterly Report on Form 10-Q and should be read in conjunction therewith. The detailed discussion in the sections below focuses on the results of operations for the three and nine months ended September 30, 2017 and 2016 and the financial condition as of September 30, 2017 compared to the financial condition as of December 31, 2016.

As described in the notes to the unaudited consolidated financial statements, we have two reportable segments: community banking and mortgage banking. The community banking segment provides consumer and business banking products and services to customers primarily within Southeastern Wisconsin along with a loan production office in Minneapolis, Minnesota. Consumer products include loan products, deposit products, and personal investment services. Business banking products include loans for working capital, inventory and general corporate use, commercial real estate construction loans, and deposit accounts. The mortgage banking segment, which is conducted by offices in 24 states through Waterstone Mortgage Corporation, consists of originating residential mortgage loans primarily for sale in the secondary market.

Our community banking segment generates the significant majority of our consolidated net interest income and requires the significant majority of our provision for loan losses. Our mortgage banking segment generates the significant majority of our noninterest income and a majority of our noninterest expenses. We have provided below a discussion of the material results of operations for each segment on a separate basis for the three and nine months ended September 30, 2017 and 2016, which focuses on noninterest income and noninterest expenses. We have also provided a discussion of the consolidated operations of the Company, which includes the consolidated operations of the Bank and Waterstone Mortgage Corporation, for the same periods.

Comparison of Community Banking Segment Results of Operations for the Three Months Ended September 30, 2017 and 2016

Net income for the three months ended September 30, 2017 totaled $4.9 million compared to net income of $4.1 million for the three months ended September 30, 2016. Net interest income increased $1.9 million to $13.1 million for the three months ended September 30, 2017 compared to $11.2 million for the three months ended September 30, 2016. Net interest income increased due primarily to an increase of $1.2 million in interest income as the average loan balance increased along with a decrease of $712,000 in interest expense on borrowings as higher rate FHLB borrowings matured in 2016 and 2017 were replaced with lower rate FHLB borrowings.

Total noninterest income decreased $497,000 due primarily to a decrease in loan fees. The loans fees for the three months ended September 30, 2016 included a significant loan prepayment penalty. The increase in cash surrender value of life insurance decreased as the dividend rate on one of the policies decreased in 2017 compared to 2016.

Compensation, payroll taxes, and other employee benefits expense increased $91,000 due primarily to an increase in ESOP expense partially offset by health insurance expense. The Bank also reported an increase in other noninterest expense for the three months ended September 30, 2017 compared to the three months ended September 30, 2016 due to purchasing loans from the mortgage banking segment. Occupancy, office furniture, and equipment expense, FDIC premiums, and real estate owned expense decreased for the three months ended September 30, 2017 compared to the three months ended September 30, 2016.

Comparison of Mortgage Banking Segment Results of Operations for the Three Months Ended September 30, 2017 and 2016

Net income totaled $2.5 million for the three months ended September 30, 2017 compared to $4.0 million for the three months ended September 30, 2016. Mortgage banking segment revenue decreased $3.8 million, or 10.5%, to $32.3 million for the three months ended September 30, 2017 compared to $36.1 million for the three months ended September 30, 2016. The decrease in revenue was attributable to a $48.0 million, or 6.8%, decrease in origination volume as well as a decrease in margin of approximately 1.5%. The decrease in originations was driven by a 46.5% decrease in the origination of loans made for the purpose of mortgage refinance. Driven by an expansion of our branch network, origination volumes of loans made for the purpose of residential purchases increased 3.1% compared to the comparative quarter in the prior year. In addition to the decrease in margin, the value of the interest rate lock pipeline decreased $643,000 compared to the prior year period.

Our overall margin can be affected by the mix of both loan type (conventional loans versus governmental) and loan purpose (purchase versus refinance). Conventional loans include loans that conform to Fannie Mae and Freddie Mac standards, whereas governmental loans are those loans guaranteed by the federal government, such as a Federal Housing Authority or U.S. Department of Agriculture loan. Loans originated for the purchase of a residential property, which generally yield a higher margin than loans originated for refinancing existing loans, comprised 89.6% of total originations during the three months ended September 30, 2017, compared to 81.7% of total originations during the three months ended September 30, 2016. The mix of loan type trended towards less conventional loans and more governmental loans; with conventional loans and governmental loans comprising 64.5% and 35.5% of all loan originations, respectively, during the three months ended September 30, 2017, compared 67.0% and 33.0% of all loan originations, respectively, during the three months ended September 30, 2016.

Total compensation, payroll taxes and other employee benefits decreased $1.5 million, or 6.5%, to $21.8 million for the three months ended September 30, 2017 compared to $23.3 million for the three months ended September 30, 2016. The decrease in compensation expense was primarily a result of the decrease in mortgage banking income, given our commission-based loan officer compensation model. Occupancy, office furniture, and equipment expense increased $221,000 to $1.8 million as the number of branches increased. Other noninterest expense decreased $163,000, or 3.7%, to $4.3 million as fundings decreased, resulting in less volume-based expenses offset by increased branch loss reserves, higher advertising expenses, and higher legal expenses.

Consolidated Waterstone Financial, Inc. Results of Operations

	Three months ended September 30,	
	2017	2016
	(Dollars in Thousands, except per share amounts)	
Net income	$7,389	7,505
Earnings per share - basic	0.27	0.28
Earnings per share - diluted	0.26	0.27
Annualized return on average assets	1.56 %	1.66 %
Annualized return on average equity	7.12 %	7.36 %

Net Interest Income

Average Balance Sheets, Interest and Yields/Costs
The following tables set forth average balance sheets, annualized average yields and costs, and certain other information for the periods indicated. Non-accrual loans are included in the computation of the average balances of loans receivable and held for sale. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense. Yields on interest-earning assets are computed on a fully tax-equivalent yield, where applicable.

	Three months ended September 30,							
	2017				2016			
	Average Balance	Interest	Yield/Cost		Average Balance	Interest	Yield/Cost	
	(Dollars in Thousands)							
Assets								
Interest-earning assets:								
Loans receivable and held for sale (1)	$1,419,477	$15,855	4.43	%	$1,333,666	$14,754	4.40	%
Mortgage related securities (2)	119,902	647	2.14	%	150,790	743	1.96	%
Debt securities, federal funds sold and short-term investments (2)(3)	215,597	1,118	2.06	%	186,201	1,034	2.21	%
Total interest-earning assets	1,754,976	17,620	3.98	%	1,670,657	16,531	3.94	%
Noninterest-earning assets	121,982				123,318			
Total assets	$1,876,958				$1,793,975			
Liabilities and equity								
Interest-bearing liabilities:								
Demand accounts	$35,211	7	0.08	%	$35,066	5	0.06	%
Money market and savings accounts	175,666	104	0.23	%	176,582	97	0.22	%
Time deposits	676,881	1,870	1.10	%	685,969	1,821	1.06	%
Total interest-bearing deposits	887,758	1,981	0.89	%	897,617	1,923	0.85	%
Borrowings	461,549	2,439	2.10	%	374,730	3,082	3.27	%
Total interest-bearing liabilities	1,349,307	4,420	1.30	%	1,272,347	5,005	1.56	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	91,710				80,407			
Other noninterest-bearing liabilities	24,265				35,331			
Total noninterest-bearing liabilities	115,975				115,738			
Total liabilities	1,465,282				1,388,085			
Equity	411,676				405,890			
Total liabilities and equity	$1,876,958				$1,793,975			
Net interest income / Net interest rate spread (4)		13,200	2.68	%		11,526	2.38	%
Less: taxable equivalent adjustment		167	0.03	%		201	0.05	%
Net interest income / Net interest rate spread, as reported		$13,033	2.65	%		$11,325	2.33	%
Net interest-earning assets (5)	$405,669				$398,310			
Net interest margin (6)			2.95	%			2.70	%
Tax equivalent effect			0.03	%			0.04	%
			2.98	%			2.74	%

Net interest margin on a fully tax equivalent basis (6)		
Average interest-earning assets to average interest-bearing liabilities	130.06 %	131.31 %

(1) Interest income includes net deferred loan fee amortization income of $178,000 and $229,000 for the three months ended September 30, 2017 and 2016, respectively.
(2) Average balance of mortgage related and debt securities are based on amortized historical cost.
(3) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented. The yields on debt securities, federal funds sold and short-term investments before tax-equivalent adjustments were 1.75% and 1.78% for the three months ended September 30, 2017 and 2016, respectively.
(4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities and is presented on a fully tax equivalent basis.
(5) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
(6) Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income for the periods indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Three months ended September 30, 2017 versus 2016 Increase (Decrease) due to		
	Volume	Rate	Net
	(In Thousands)		
Interest income:			
Loans receivable and held for sale (1)(2)	$1,011	$90	$1,101
Mortgage related securities (3)	(160)	64	(96)
Other earning assets (3)(4)	156	(72)	84
Total interest-earning assets	1,007	82	1,089
Interest expense:			
Demand accounts	-	2	2
Money market and savings accounts	(2)	9	7
Time deposits	(26)	75	49
Total interest-earning deposits	(28)	86	58
Borrowings	1,183	(1,826)	(643)
Total interest-bearing liabilities	1,155	(1,740)	(585)
Net change in net interest income	$(148)	$1,822	$1,674

(1) Interest income includes net deferred loan fee amortization income of $178,000 and $229,000 for the three months ended September 30, 2017 and 2016, respectively.
(2) Non-accrual loans have been included in average loans receivable balance.
(3) Includes available for sale securities. Average balance of available for sale securities is based on amortized historical cost.
(4) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented.

Net interest income increased $1.7 million, or 15.1%, to $13.0 million during the three months ended September 30, 2017 compared to $11.3 million during the three months ended September 30, 2016.

Interest income on loans increased $1.1 million due primarily to an increase of $85.8 million in average loans along with a three basis point increase in average yield on loans. The increase in average loan balance was driven by a $118.8 million, or 10.5%, increase in the average balance of loans held in portfolio partially offset by a decrease of $32.9 million, or 16.4%, in the average balance of loans held for sale.
Interest income from mortgage-related securities decreased $96,000 year over year as the average balance decreased $30.9 million due to securities paying down in 2016 and into 2017 and fewer purchases occurring to replace those securities due to current market conditions. This was partially offset by an increase in rate.
Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) increased $118,000 due to an increase of $29.4 million in average balance, which was due primarily to

higher average cash held on hand and commercial paper. This increase in average balance was partially offset by a three basis point decrease in the average yield. The decrease in average yield was driven by higher rate municipal bond securities maturing and being replaced at a slower pace and at a lower rate. Offsetting the decrease from the municipal bonds maturing, the yield on cash increased with a 25 basis point increase in the Federal Funds rate in each of December 2016, March 2017, and June 2017, as well as an increase in the cash dividend paid by the FHLB on its stock.

Interest expense on time deposits increased $49,000 primarily due to a four basis point increase of average cost of time deposits, as maturing time deposits have repriced or have been replaced at a slightly higher rate in the current competitive market. Partially offsetting the increase in cost of time deposits, the average balance of time deposit decreased $9.1 million compared to the prior year period.

Interest expense on money market and savings accounts increased $7,000 due primarily to an increase of one basis point in rate partially offset by a decrease in average balance of $916,000. The increase in rate reflects the Company's strategy to remain aggressive with competitors in this segment of retail funds for more aggressive growth.

Interest expense on borrowings decreased $643,000 due to a decrease in the average cost of borrowings that resulted from the maturity and replacement of fixed rate borrowings since the beginning of the prior year. The average cost of borrowings totaled 2.10% during the quarter ended September 30, 2017, compared to 3.27% during the quarter ended September 30, 2016.

Provision for Loan Losses

Our provision for loan losses decreased $115,000 as the mortgage banking segment had to reserve $20,000 for additional loans during the three months ended September 30, 2017, compared to $135,000 of provision for loan losses for the three months ended September 30, 2016. The community banking segment recorded no provision during the current quarter due to the continued improvement in loan quality metrics including: non-accrual loans, loans rated substandard or watch, and loans past due.

The provision is primarily a function of the Company's reserving methodology and assessments of certain quantitative and qualitative factors which are used to determine an appropriate allowance for loan losses for the period. See further discussion regarding the allowance for loan losses in the "Asset Quality" section for an analysis of charge-offs, nonperforming assets, specific reserves and additional provisions and the "Allowance for Loan Losses" section.

Noninterest Income

	Three months ended September 30,			
	2017	2016	$ Change	% Change
	(Dollars in Thousands)			
Service charges on loans and deposits	$300	$789	$(489)	(62.0)%
Increase in cash surrender value of life insurance	688	734	(46)	(6.3)%
Loss on sale of securities	-	-	-	N/M
Mortgage banking income	31,863	35,552	(3,689)	(10.4)%
Other	203	337	(134)	(39.8)%
Total noninterest income	$33,054	$37,412	$(4,358)	(11.6)%

N/M - Not meaningful

Total noninterest income decreased $4.4 million, or 11.6%, to $33.1 million during the three months ended September 30, 2017 compared to $37.4 million during the three months ended September 30, 2016. The decrease resulted primarily from a decrease in mortgage banking income along with decreases in all other categories.

The decrease in mortgage banking income was the result of a decrease in origination volumes. The volume decreased $48.0 million, or 6.8%, to $662.1 million during the three months ended September 30, 2017 compared to a $710.1 million during the three months ended September 30, 2016. See "Comparison of Mortgage Banking Segment Operations for the Three Months Ended September 30, 2017 and 2016" above for additional discussion of the decrease in mortgage banking income.

Service charges on loans and deposits decreased primarily due to a decrease in loan prepayment fees as one significant loan relationship paid off during the three months ended September 30, 2016.

The decrease in cash surrender value of life insurance was due to a decrease on one policy's annual dividend rate partially offset by an increase in earnings due to a purchase of a $2.5 million policy in June 2017.

The $134,000 decrease in other noninterest income was due primarily to a decrease in servicing fee revenue on loans sold at the mortgage banking segment, which resulted from a bulk sale of mortgage servicing rights in the first quarter of 2017.

Noninterest Expenses

	Three months ended September 30,			
	2017	2016	$ Change	% Change
	(Dollars in Thousands)			
Compensation, payroll taxes, and other employee benefits	$26,153	$27,573	$(1,420)	(5.1)%
Occupancy, office furniture and equipment	2,533	2,319	214	9.2%
Advertising	821	661	160	24.2%
Data processing	623	616	7	1.1%
Communications	394	374	20	5.3%
Professional fees	629	474	155	32.7%
Real estate owned	(20)	37	(57)	(154.1)%
FDIC insurance premiums	129	140	(11)	(7.9)%
Other	3,054	3,347	(293)	(8.8)%
Total noninterest expenses	$34,316	$35,541	$(1,225)	(3.4)%

Total noninterest expenses decreased $1.2 million, or 3.4%, to $34.3 million during the three months ended September 30, 2017 compared to $35.5 million during the three months ended September 30, 2016.

Compensation, payroll taxes and other employee benefit expense at our mortgage banking segment decreased $1.5 million, or 6.5%, to $21.8 million during the three months ended September 30, 2017. The decrease in compensation within our mortgage banking segment correlates to the decrease in mortgage banking income due to the commission-based compensation structure in place for our mortgage banking loan officers.

Compensation, payroll taxes and other employee benefit expense at the community banking segment increased $91,000, or 2.1%, to $4.4 million during the three months ended September 30, 2017. This was primarily due to an increase in ESOP expense, which increased due to the increased average stock price of the shares in the second quarter of 2017.

Advertising expense increased $160,000, or 24.2%, to $821,000 during the three months ended September 30, 2017. This was primarily due to marketing increases at the mortgage banking segment in an effort to increase volumes.

Professional fees increased $155,000, or 32.7%, to $629,000 during the three months ended September 30, 2017. This was primarily due to an increase in legal fees at the mortgage banking segment related to ongoing litigation and an increase in audit and tax expenses at the community banking segment.

Occupancy, office furniture and equipment expense increased $214,000 to $2.5 million during the three months ended September 30, 2017, resulting from additional rent expense in the current year period compared to prior year period due to the addition of mortgage banking segment branches. Offsetting the rent increase, there was less depreciation expense at the mortgage banking segment in the quarter ended September 30, 2017 compared to the prior year period. The community banking segment had a slight decrease in expense year over year due to less depreciation and utilities expenses.

Net real estate owned expense decreased $57,000, resulting in $20,000 of income during the three months ended September 30, 2017, compared to $37,000 of expense during the three months ended September 30, 2016. Property management expense (other than gains/losses) decreased $71,000 during the three months ended September 30, 2017 compared to the three months ended September 30, 2016 due to a reduction in the number of properties under management. Net gains on sales of REO decreased $38,000 to $153,000 for the three months ended September 30, 2017 compared to $191,000 for the three months ended September 30, 2016. Real estate owned writedowns decreased $25,000 to $40,000 for the three months ended September 30, 2017 compared to $65,000 for the three months ended September 30, 2016.

FDIC insurance expense decreased during the three months ended September 30, 2017 due to improved asset quality metrics.

Other noninterest expense decreased $293,000 to $3.1 million during the three months ended September 30, 2017. This decrease was primarily at the mortgage banking segment and resulted from lower volume-based fees as fundings decreased.

Income Taxes

Driven by an decrease in pre-tax income, income tax expense decreased $1.2 million, or 21.5%, to $4.4 million during the three months ended September 30, 2017, compared to $5.6 million during the three months ended September 30, 2016. Income tax expense was recognized during the three months ended September 30, 2017 at an effective rate of 37.1% compared to an effective rate of 42.5% during the three months ended September 30, 2016. During the quarter ended September 30, 2017, the Company recognized a benefit of approximately $21,000 related to stock awards exercised within the current period as a result of adopting the new stock compensation accounting standard. During the quarter ended September 30, 2016, the Company incurred a charge related to the write-off of a deferred tax asset established with respect to stock options awarded in 2007. The deferred tax asset established for the stock options was not fully utilized upon exercise, as the deductible compensation recognized was less than the value of the asset established at the time the award vested. A net expense of $564,000 was charged to income tax for the quarter ended September 30, 2016.

Comparison of Community Banking Segment for the Nine Months Ended September 30, 2017 and 2016

Net income for the nine months ended September 30, 2017 totaled $14.5 million compared to net income of $9.9 million for the nine months ended September 30, 2016. Net interest income increased $6.3 million to $37.2 million for the nine months ended September 30, 2017 compared to $31.0 million for the nine months ended September 30, 2016. Provision for loan losses decreased $1.5 million as asset quality metrics continued to improve. Noninterest income decreased $615,000 as loan prepayment fees decreased and a $107,000 loss on sale of securities occurred in 2017 partially offset by an increase in the cash surrender value of life insurance. Compensation, payroll taxes, and other employee benefits expense increased $180,000 primarily due to increases in salary expense along with an increase in ESOP expense, offset by a decrease in health insurance cost. FDIC premiums and real estate owned expense decreased as asset quality improved and we experienced a reduction of foreclosed properties. Those decreases were partially offset by an increase in other noninterest expense for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016.

Comparison of Mortgage Banking Segment Operations for the Nine Months Ended September 30, 2017 and 2016

Net income decreased $1.5 million to $8.3 million for the nine months ended September 30, 2017, compared to net income of $9.8 million for the nine months ended September 30, 2016. Mortgage banking segment revenues increased $2.0 million, or 2.2%, to $94.4 million for the nine months ended September 30, 2017 compared to $92.5 million for the nine months ended September 30, 2016. The increase in revenue was attributable to a 7.1% increase in volume origination to $1.88 billion during the nine months ended September 30, 2017 compared to $1.76 billion during the nine months ended September 30, 2016 offset by a decrease in margin. While revenue increased 2.2%, noninterest expenses increased $4.3 million, or 5.7%, to $80.3 million for the nine months ended September 30, 2017 compared to $76.0 million for the nine months ended September 30, 2016.

Loans originated by the mortgage banking segment for the purpose of sale in the secondary market increased $124.9 million, or 7.1%, to $1.88 billion during the nine months ended September 30, 2017, compared to $1.76 billion for the nine months ended September 30, 2016. The increase in originations was driven by an increase in the origination of loans made for the purpose of residential purchases, which yield a higher margin than refinance loans, partially offset by a decrease in the origination of mortgage refinance products. Our origination efforts continue to be focused on loans made for the purpose of residential purchases, as opposed to mortgage refinance. The percentage of origination volume related to purchase activity increased slightly to 89.5% from 85.1% of total originations for the nine months ended September 30, 2017 and 2016, respectively. The mix of loan type trended towards less conventional loans and more governmental loans; with conventional loans and governmental loans comprising 63.9% and 36.1% of all loan originations, respectively, during the nine months ended September 30, 2017, compared 64.6% and 35.4% of all loan originations, respectively, during the nine months ended September 30, 2016.

Consolidated Waterstone Financial, Inc. Results of Operations

	Nine months ended September 30,	
	2017	2016
	(Dollars in Thousands, except per share amounts)	
Net income	$22,849	$19,133
Earnings per share - basic	0.83	0.71
Earnings per share - diluted	0.82	0.70
Annualized return on average assets	1.70 %	1.45 %
Annualized return on average equity	7.42 %	6.38 %

Average Balance Sheets, Interest and Yields/Costs

The following tables set forth average balance sheets, annualized average yields and costs, and certain other information for the periods indicated. Non-accrual loans are included in the computation of the average balances of loans receivable and held for sale. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense. Yields on interest-earning assets are computed on a fully tax-equivalent yield, where applicable.

	Nine months ended September 30,							
	2017				2016			
	Average Balance	Interest	Yield/Cost		Average Balance	Interest	Yield/Cost	
	(Dollars in Thousands)							
Assets								
Interest-earning assets:								
Loans receivable and held for sale (1)	$1,357,884	$45,078	4.44	%	$1,274,369	$42,611	4.47	%
Mortgage related securities (2)	126,856	2,021	2.13	%	158,854	2,371	1.99	%
Debt securities, federal funds sold and short-term investments (2)(3)	198,947	3,210	2.16	%	208,241	3,309	2.12	%
Total interest-earning assets	1,683,687	50,309	3.99	%	1,641,464	48,291	3.93	%
Noninterest-earning assets	117,316				116,863			
Total assets	$1,801,003				$1,758,327			
Liabilities and equity								
Interest-bearing liabilities:								
Demand accounts	$36,419	20	0.07	%	$33,679	14	0.06	%
Money market and savings accounts	171,659	315	0.25	%	163,550	294	0.24	%
Time deposits	667,168	5,279	1.06	%	673,343	5,169	1.03	%
Total interest-bearing deposits	875,246	5,614	0.86	%	870,572	5,477	0.84	%
Borrowings	401,931	6,756	2.25	%	387,867	10,724	3.69	%
Total interest-bearing liabilities	1,277,177	12,370	1.29	%	1,258,439	16,201	1.72	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	88,454				73,828			
Other noninterest-bearing liabilities	23,408				25,537			
Total noninterest-bearing liabilities	111,862				99,365			
Total liabilities	1,389,039				1,357,804			
Equity	411,964				400,523			
Total liabilities and equity	$1,801,003				$1,758,327			
Net interest income / Net interest rate spread (4)		37,939	2.70	%		32,090	2.21	%
Less: taxable equivalent adjustment		530	0.04	%		617	0.05	%
Net interest income / Net interest rate spread, as reported		$37,409	2.66	%		$31,473	2.16	%
Net interest-earning assets (5)	$406,510				$383,025			
Net interest margin (6)			2.97	%			2.56	%
Tax equivalent effect			0.04	%			0.05	%
Net interest margin on a fully tax equivalent basis (6)			3.01	%			2.61	%
			131.83	%			130.44	%

Average interest-earning assets to average interest-bearing liabilities

---

(1) Interest income includes net deferred loan fee amortization income of $563,000 and $596,000 for the nine months ended September 30, 2017 and 2016, respectively.
(2) Average balance of mortgage related and debt securities are based on amortized historical cost.
(3) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented. The yields on debt securities, federal funds sold and short-term investments before tax-equivalent adjustments were 1.80% and 1.73% for the nine months ended September 30, 2017 and 2016, respectively.
(4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities and is presented on a fully tax equivalent basis.
(5) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
(6) Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income for the periods indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Nine months ended September 30, 2017 versus 2016 Increase (Decrease) due to		
	Volume	Rate	Net
	(In Thousands)		
Interest income:			
Loans receivable and held for sale (1)(2)	$2,758	$(291)	$2,467
Mortgage related securities (3)	(507)	157	(350)
Other earning assets (3) (4)	(157)	58	(99)
Total interest-earning assets	2,094	(76)	2,018
Interest expense:			
Demand accounts	-	6	6
Money market and savings accounts	12	9	21
Time deposits	(51)	161	110
Total interest-earning deposits	(39)	176	137
Borrowings	406	(4,374)	(3,968)
Total interest-bearing liabilities	367	(4,198)	(3,831)
Net change in net interest income	$1,727	$4,122	$5,849

(1) Interest income includes net deferred loan fee amortization income of $563,000 and $596,000 for the nine months ended September 30, 2017 and 2016, respectively.
(2) Non-accrual loans have been included in average loans receivable balance.
(3) Includes available for sale securities. Average balance of available for sale securities is based on amortized historical cost.
(4) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented.

Net interest income increased $5.9 million, or 18.9%, to $37.4 million during the nine months ended September 30, 2017 compared to $31.5 million during the nine months ended September 30, 2016.

Interest income on loans increased $2.5 million due to an increase in average balance of $83.5 million partially offset by a three basis point decrease in average yield on loans. The increase in average loan balance was driven by a $93.9 million increase in the average balance of loans held in portfolio offset by a decrease in the average balance of loans held for sale of $10.4 million.

Interest income from mortgage related securities decreased $350,000 year over year as securities have paid down and less purchases have occurred to replace those securities due to current market conditions.

Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) decreased due to a $9.2 million decrease in average balance, as municipal securities matured and were not replaced due to market conditions. Those funds were primarily held in a cash account. This decrease in average balance was partially offset by a seven basis point increase in the average yield. The increase in average yield was driven by a 25 basis point increase in the Federal Funds rate in December 2016, March 2017, and June 2017.

Interest expense on time deposits increased $110,000 primarily due to a three basis point increase in the average cost of funds, as maturing time deposits have repriced, or have been replaced at a higher rate in the current competitive market. Partially offsetting the increase in rate, the average balance of time deposits decreased $6.2 million compared to the prior year period.

Interest expense on money market and savings accounts increased $21,000 due primarily to an increase in average balance along with a slight increase in rate. The increase in volume and rate reflect the Company's strategy to remain competitive and grow this segment of retail funds.

Interest expense on borrowings decreased $4.0 million due to a decrease in the average cost of borrowings that resulted from the maturity and replacement of fixed rate borrowings. The average cost of borrowings totaled 2.25% during the nine months ended September 30, 2017, compared to 3.69% during the nine months ended September 30, 2016.

Provision for Loan Losses

Our provision for loan losses decreased $1.5 million, to a negative provision of $1.2 million during the nine months ended September 30, 2017, from a provision of $340,000 during the nine months ended September 30, 2016. The negative provision recorded during the current year period reflects the continued improvement in loan quality metrics including: non-accrual loans, loans rated substandard or watch, and loans past due.

The provision is primarily a function of the Company's reserving methodology and assessments of certain quantitative and qualitative factors which are used to determine an appropriate allowance for loan losses for the period. See further discussion regarding the allowance for loan losses in the "Asset Quality" section for an analysis of charge-offs, nonperforming assets, specific reserves and additional provisions and the "Allowance for Loan Losses" section.

Noninterest Income

	Nine months ended September 30,			
	2017	2016	$ Change	% Change
	(Dollars in Thousands)			
Service charges on loans and deposits	$1,148	$1,742	$(594)	(34.1)%
Increase in cash surrender value of life insurance	1,476	1,446	30	2.1%
Loss on sale of securities	(107)	-	(107)	N/M
Mortgage banking income	92,774	91,146	1,628	1.8%
Other	941	874	67	7.7%
Total noninterest income	$96,232	$95,208	$1,024	1.1%

N/M - Not meaningful

Total noninterest income increased $1.0 million, or 1.1%, to $96.2 million during the nine months ended September 30, 2017 compared to $95.2 million during the nine months ended September 30, 2016. The increase resulted primarily from an increase in mortgage banking income.

The $1.6 million increase in mortgage banking income was the result of an increase in origination volumes but partially offset by a decrease in margins. The volume increased $124.9 million, or 7.1%, to $1.88 billion during the nine months ended September 30, 2017 compared to $1.76 billion during the nine months ended September 30, 2016. See "Comparison of Mortgage Banking Segment Operations for the Nine Months Ended September 30, 2017 and 2016" above, for additional discussion of the increase in mortgage banking income.

The decrease in service charges on loans and deposits was related to an decrease in loan prepayment fees.

The increase in cash surrender value of life insurance was primarily due to the purchase of a $10.0 million policy in March 2016 and a $2.5 million policy in June 2017.

The $107,000 loss on sale of securities was due to a sale of a municipal bond in June 2017. There were no sales of securities in 2016.

The $67,000 increase in other noninterest income was primarily due to a gain on mortgage servicing rights as there was a bulk sale of mortgage servicing rights for $308,000 during the nine months ended September 30, 2017. There were no bulk sales of mortgage servicing rights during the nine months ended September 30, 2016. Offsetting the gain on sale of mortgage servicing rights, servicing fee income on loans sold decreased from the bulk sale.

Noninterest Expenses

	Nine months ended September 30,			
	2017	2016	$ Change	% Change
	(Dollars in Thousands)			
Compensation, payroll taxes, and other employee benefits	$73,732	$70,968	$2,764	3.9 %
Occupancy, office furniture and equipment	7,587	7,074	513	7.3 %
Advertising	2,414	1,974	440	22.3 %
Data processing	1,854	1,897	(43)	(2.3)%
Communications	1,170	1,088	82	7.5 %
Professional fees	1,953	1,486	467	31.4 %
Real estate owned	258	344	(86)	(25.0)%
FDIC insurance premiums	366	500	(134)	(26.8)%
Other	10,227	9,663	564	5.8 %
Total noninterest expenses	$99,561	$94,994	$4,567	4.8 %

Total noninterest expenses increased $4.6 million, or 4.8%, to $99.6 million during the nine months ended September 30, 2017 compared to $95.0 million during the nine months ended September 30, 2016.

Compensation, payroll taxes and other employee benefit expense at our mortgage banking segment increased $2.6 million, or 4.5%, to $61.1 million for the nine months ended September 30, 2017. The increase in compensation within our mortgage banking segment correlated to the increase in mortgage banking income due to the commission-based compensation structure in place for our mortgage banking loan officers along with the additional branches brought on during the year.

Compensation, payroll taxes and other employee benefit expense within the community banking segment increased $180,000 primarily due to ESOP expense along with an increase to salaries partially offset by a decrease in health insurance. ESOP expense increased due to the increased average stock price of the shares through the first nine months of 2017. The salaries increase was primarily due to annual wage increases. Health insurance decreased as claims have been lower in 2017 compared to 2016.

Occupancy, office furniture and equipment expense increased, resulting from additional rent expense in the current year compared to prior year due to the addition of mortgage banking segment branches. Partially offsetting the rent increase, there was less depreciation expense at the mortgage banking segment in the nine months ended September 30, 2017 compared to the same period during the prior year. Additionally, the community banking segment had slightly lower expense year over year due to less depreciation expense.

Advertising expense increased as a result of increased advertising efforts to generate more volume at the mortgage banking segment branches.

Professional fees expense increased as a result of an increase in legal fees at the mortgage banking segment primarily related to ongoing litigation. Audit and tax expense increased at the community banking segment.

Net real estate owned expense decreased $86,000, to $258,000 during the nine months ended September 30, 2017 compared to $344,000 for the nine months ended September 30, 2016. Property management expense (other than gains/losses) decreased $199,000 to $269,000 during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 due to a reduction in the number of properties under management. Net gains on sales of real estate owned decreased $24,000 to $515,000 for the nine months ended September 30, 2017 compared to $539,000 for the nine months ended September 30, 2016. Real estate owned writedowns increased $88,000 to $504,000 for the nine months ended September 30, 2017 compared to $416,000 for the nine months ended September 30, 2016.

FDIC insurance expense decreased during the nine months ended September 30, 2017. This was driven by a decrease in the FDIC assessment rate due to improved asset quality metrics.

Other noninterest expense increased primarily due to increased expense at the mortgage banking segment. The mortgage banking segment increase was associated with volume-based fees due to the increase in loan origination activity.

Income Taxes

Driven by an increase in pre-tax income, income tax expense increased $183,000, or 1.5%, to $12.4 million during the nine months ended September 30, 2017, compared to $12.2 million during the nine months ended September 30, 2016. Income tax expense was recognized during the nine months ended September 30, 2017 at an effective rate of 35.2% compared to 39.0% for the nine months ended September 30, 2016. During the nine months ended September 30, 2017, the Company recognized a benefit of approximately $827,000 related to stock awards exercised within 2017 as a result of adopting the new stock compensation accounting standard. During the nine months ended September 30, 2016, the Company incurred a charge related to the write-off of a deferred tax asset established with respect to stock options awarded in 2007. The deferred tax asset established for the stock options was not fully utilized upon exercise, as the deductible compensation recognized was less than the value of the asset established at the time the award vested. A net expense of $564,000 was charged to income tax in the nine months ended September 30, 2016.

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

Total Assets -Total assets increased by $63.5 million, or 3.5%, to $1.85 billion at September 30, 2017 from $1.79 billion at December 31, 2016. The increase in total assets primarily reflects an increase in cash and cash equivalents and loans receivable, partially offset by a decrease in loans held for sale and securities available for sale. Funding needed for loan origination were provided by deposits and additional long-term FHLB debt in 2017.

Cash and Cash Equivalents – Cash and cash equivalents increased $45.4 million, or 96.1%, to $92.6 million at September 30, 2017, compared to $47.2 million at December 31, 2016. The increase in cash and cash equivalents primarily reflects the increase in deposits and long-term FHLB borrowings to take advantage of the current interest rate environment in advance of wholesale borrowing maturities.

Securities Available for Sale – Securities available for sale decreased $26.0 million at September 30, 2017 compared to December 31, 2016. The decrease was due to paydowns in mortgage related securities and maturities of debt securities exceeding security purchases for the year.

Loans Held for Sale - Loans held for sale decreased at September 30, 2017 due to the slowdown of mortgage originations for the purpose of refinance along with timing of loans sold to investors.

Loans Receivable - Loans receivable held for investment increased $83.3 million to $1.26 billion at September 30, 2017 from $1.18 billion at December 31, 2016. The increase in total loans receivable was primarily attributable to increases in the one- to four-family, multi-family, commercial real estate, and commercial categories. Offsetting those increases, the home equity, land and construction, and consumer loan categories decreased.

The following table shows loan origination, loan purchases, principal repayment activity, transfers to real estate owned, charge-offs and sales during the periods indicated.

	As of or for the Nine months ended September 30,		As of or for the Year Ended December 31, 2016
	2017	2016	
	(In Thousands)		
Total gross loans receivable and held for sale at beginning of period	$1,403,132	$1,281,450	$1,281,450
Real estate loans originated for investment:			
Residential			
One- to four-family	87,473	57,080	78,045
Multi-family	90,422	93,724	118,072
Home equity	655	3,305	5,037
Construction and land	4,539	5,648	5,878
Commercial real estate	38,904	21,822	35,443
Total real estate loans originated for investment	221,993	181,579	242,475
Consumer loans originated for investment	-	-	-
Commercial business loans originated for investment	12,846	6,920	11,692
Total loans originated for investment	234,839	188,499	254,167
Principal repayments	(148,750)	(146,941)	(185,020)
Transfers to real estate owned	(1,609)	(3,442)	(4,590)
Loan principal charged-off	(1,204)	(1,354)	(1,607)
Net activity in loans held for investment	83,276	36,762	62,950

Loans originated for sale	1,881,351	1,756,454	2,378,926
Loans sold	(1,931,462)	(1,695,205)	(2,320,194)
Net activity in loans held for sale	(50,111)	61,249	58,732
Total gross loans receivable and held for sale at end of period	$1,436,297	$1,379,461	$1,403,132

Allowance for Loan Losses - The allowance for loan losses decreased $2.0 million September 30, 2017 from December 31, 2016. The decrease resulted from the negative provision due to improvement of key loan quality metrics decreasing the allowance related to the loans collectively and specifically reviewed. The overall decrease was primarily related to the one- to four-family, multi-family, construction and land, commercial real estate, consumer, and commercial categories. The home equity category increased compared to the balance at December 31, 2016. See Note 3 for further discussion on the Allowance for Loan Losses.

Cash surrender value of life insurance – Total cash surrender value of life insurance increased $4.2 million from December 31, 2016. During the nine months ended September 30, 2017, the policy value increased due to continued earnings and dividends along with the annual premiums paid during the year. In addition, a $2.5 million policy was purchased in June 2017.

Federal Home Loan Bank stock – Total Federal Home Loan Bank stock increased $5.2 million from December 31, 2016. During the nine months ended September 30, 2017, $9.7 million of stock was purchased when entering into new short-term and long-term FHLB borrowings. A total of $4.5 million of stock was sold as short-term FHLB borrowings matured and our ownership requirement decreased accordingly.

Real Estate Owned – Total real estate owned decreased $1.6 million from December 31, 2016. During the nine months ended September 30, 2017, $1.6 million was transferred from loans receivable to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled $2.7 million and writedowns were $504,000 in an effort to sell various aged properties.

Deposits – Total deposits increased $7.4 million to $956.8 million at September 30, 2017 from December 31, 2016. The increase was driven by an increase of $18.4 million in time deposits and $2.8 million in demand deposits offset by a decrease of $13.8 million in money market and savings deposits.

Borrowings – Total borrowings increased $48.3 million to $435.5 million at September 30, 2017 from December 31, 2016. The Company borrowed additional short and long term FHLB advances to replace the FHLB advances and repurchase agreements that matured. External short term borrowings at the mortgage banking segment increased a total of $2.3 million at September 30, 2017 from December 31, 2016 to fund loans held for sale.

Advance Payments by Borrowers for Taxes - Advance payments by borrowers for taxes increased $20.4 million. The increase was the result of payments received from borrowers for their real estate taxes and is seasonally normal, as balances increase during the course of the calendar year until real estate tax obligations are paid in the fourth quarter.

Other Liabilities - Other liabilities decreased $13.8 million at September 30, 2017 compared to December 31, 2016. The decrease was primarily related to a seasonal decrease in outstanding checks related to advance payments by borrowers for taxes. The Company receives payments from borrowers for their real estate taxes during the course of the calendar year until real estate tax obligations are paid in the fourth quarter. At the time at which the disbursements are made, the outstanding checks are classified as other liabilities. These amounts remain classified as other liabilities until settled.

Shareholders' Equity – Shareholders' equity increased by $1.2 million to $411.9 million at September 30, 2017 from December 31, 2016. Shareholders' equity increased primarily due to net income, additional paid in capital as stock options were exercised, accumulated other comprehensive income increasing as the fair value of the security portfolio increased, and unearned ESOP shares as they continue to vest. Partially offsetting these increases was the declaration of regular dividends and a special dividend and the repurchase of stock.

ASSET QUALITY

NONPERFORMING ASSETS

	At September 30, 2017	At December 31, 2016
	(Dollars in Thousands)	
Non-accrual loans:		
Residential		
One- to four-family	$5,709	$ 7,623
Multi-family	833	1,427
Home equity	223	344
Construction and land	37	-
Commercial real estate	181	422
Commercial	26	41
Consumer	-	-
Total non-accrual loans	7,009	9,857
Real estate owned		
One- to four-family	1,021	2,141
Multi-family	169	-
Construction and land	4,822	5,082
Commercial real estate	300	300
Total real estate owned	6,312	7,523
Valuation allowance at end of period	(1,744)	(1,405)
Total real estate owned, net	4,568	6,118
Total nonperforming assets	$11,577	$ 15,975
Total non-accrual loans to total loans, net	0.56 %	0.84 %
Total non-accrual loans to total assets	0.38 %	0.55 %
Total nonperforming assets to total assets	0.62 %	0.89 %

All loans that exceed 90 days past due with respect to principal and interest are recognized as non-accrual. Troubled debt restructurings that are non-accrual either due to being past due greater than 90 days or which have not yet performed under the modified terms for a reasonable period of time, are included in the table above. In addition, loans that are past due less than 90 days are evaluated to determine the likelihood of collectability given other credit risk factors such as early stage delinquency, the nature of the collateral or the results of a borrower review. When the collection of all contractual principal and interest is determined to be unlikely, the loan is moved to non-accrual status and an updated appraisal of the underlying collateral is ordered. This process generally takes place when a loan is contractually past due between 60 and 90 days. Upon determining the updated estimated value of the collateral, a loan loss provision is recorded to establish a specific reserve to the extent that the outstanding principal balance exceeds the updated estimated net realizable value of the collateral. When a loan is determined to be uncollectible, typically coinciding with the initiation of foreclosure action, the specific reserve is reviewed for adequacy, adjusted if necessary, and charged-off.

The following table sets forth activity in our non-accrual loans for the periods indicated.

	As of or for the Nine Months Ended September 30,	
	2017	2016
	(In Thousands)	
Balance at beginning of period	$9,857	17,604
Additions	2,553	1,990
Transfers to real estate owned	(1,609)	(3,442)
Charge-offs	(649)	(662)
Returned to accrual status	(2,168)	(3,661)
Principal paydowns and other	(975)	(1,162)
Balance at end of period	$7,009	10,667

Total non-accrual loans decreased by $2.8 million, or 28.9%, to $7.0 million as of September 30, 2017 compared to $9.9 million as of December 31, 2016. The ratio of non-accrual loans to total loans receivable was 0.56% at September 30, 2017 compared to 0.84% at December 31, 2016. During the nine months ended September 30, 2017, $1.6 million in non-accrual loans were transferred to real estate owned, $649,000 in loan principal was charged off, $2.2 million in loans were returned to accrual status and approximately $975,000 in principal payments were received. Offsetting this activity, $2.6 million in loans were placed on non-accrual status during the nine months ended September 30, 2017.

Of the $7.0 million in total non-accrual loans as of September 30, 2017, $6.6 million in loans have been specifically reviewed to assess whether a specific valuation allowance is necessary. A specific valuation allowance is established for an amount equal to the impairment when the carrying value of the loan exceeds the present value of expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral with an adjustment made for costs to dispose of the asset. Based upon these specific reviews, a total of $2.1 million in cumulative partial net charge-offs have been recorded over the life of these loans as of September 30, 2017. Partially charged-off loans measured for impairment based upon net realizable collateral value are maintained in a "non-performing" status and are disclosed as impaired loans. In addition, specific reserves totaling $284,000 have been recorded as of September 30, 2017. The remaining $403,000 of non-accrual loans were reviewed on an aggregate basis and $81,000 in general valuation allowance was deemed necessary related to those loans as of September 30, 2017. The $81,000 in valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

The outstanding principal balance of our five largest non-accrual loans as of September 30, 2017 totaled $2.2 million, which represents 31.8% of total non-accrual loans as of that date. These five loans are carried net of cumulative life-to-date net charge-offs of $540,000. Aggregate specific valuation allowances with respect to these five loans total $64,000 as of September 30, 2017.

For the nine months ended September 30, 2017, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was $417,000. We received $308,000 of interest payments on such loans during the nine months ended September 30, 2017. Interest payments received are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

There were no accruing loans past due 90 days or more at September 30, 2017 or December 31, 2016.

TROUBLED DEBT RESTRUCTURINGS

The following table summarizes information with respect to the accrual status of our troubled debt restructurings:

	As of September 30, 2017		
	Accruing	Non-accruing	Total
	(In Thousands)		
One- to four-family	$2,747	$ 1,204	3,951
Multi-family	-	833	833
Home equity	48	-	48

Commercial real estate	291	37	328
	$3,086	$ 2,074	5,160

	As of December 31, 2016		
	Accruing	Non-accruing	Total
One- to four-family	$3,296	$ 2,399	5,695
Multi-family	2,514	1,427	3,941
Home equity	49	97	146
Commercial real estate	295	60	355
	$6,154	$ 3,983	10,137

All troubled debt restructurings are considered to be impaired, are risk rated as either substandard or watch and are included in the internal risk rating tables disclosed in the notes to the financial statements. Specific reserves have been established to the extent that collateral-based impairment analyses indicate that a collateral shortfall exists.

We do not participate in government-sponsored troubled debt restructuring programs. Our troubled debt restructurings are short-term modifications. Typical initial restructured terms include six to twelve months of principal forbearance, a reduction in interest rate or both. Restructured terms do not include a reduction of the outstanding principal balance unless mandated by a bankruptcy court. Troubled debt restructuring terms may be renewed or further modified at the end of the initial term for an additional period if performance has been acceptable and the short-term borrower difficulty persists.

If a restructured loan is current in all respects and a minimum of six consecutive restructured payments have been received, it can be considered for return to accrual status. After a restructured loan that is current in all respects reverts to contractual/market terms, if a credit department review indicates no evidence of elevated market risk, the loan is removed from the troubled debt restructuring classification.

LOAN DELINQUENCY

The following table summarizes loan delinquency in total dollars and as a percentage of the total loan portfolio:

	At September 30, 2017	At December 31, 2016
	(Dollars in Thousands)	
Loans past due less than 90 days	$4,052	$ 2,910
Loans past due 90 days or more	4,903	5,289
Total loans past due	$8,955	$ 8,199
Total loans past due to total loans receivable	0.71 %	0.70 %

Past due loans increased by $756,000, or 9.2%, to $9.0 million at September 30, 2017 from $8.2 million at December 31, 2016. Loans past due less than 90 days increased by $1.1 million, or 39.2%. Loans past due 90 days or more decreased by $386,000, or 7.3%, during the nine months ended September 30, 2017. The $1.1 million increase in loans past due less than 90 days or more was primarily due to one relationship in the one-to four-family loan category.

REAL ESTATE OWNED

Total real estate owned decreased by $1.6 million, or 25.3%, to $4.6 million at September 30, 2017, compared to $6.1 million at December 31, 2016. During the nine months ended September 30, 2017, $1.6 million was transferred from loans to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled $2.7 million. A total of $504,000 in write downs occurred during the nine months ended September 30, 2017. New appraisals received on real estate owned and collateral dependent impaired loans are based upon an "as is value" assumption. During the period of time in which we are awaiting receipt of an updated appraisal, loans evaluated for impairment based upon collateral value are measured by the following:

- Applying an updated adjustment factor (as described previously) to an existing appraisal;
- Confirming that the physical condition of the real estate has not significantly changed since the last valuation date;
- Comparing the estimated current value of the collateral to that of updated sales values experienced on similar collateral;
- Comparing the estimated current value of the collateral to that of updated values seen on current appraisals of similar collateral; and
- Comparing the estimated current value to that of updated listed sales prices on our real estate owned and that of similar properties (not owned by the Company).

Virtually all habitable real estate owned (both residential and commercial properties) is managed with the intent of attracting a lessee to generate revenue. Foreclosed properties are recorded at the lower of carrying value or fair value, less costs to sell, with charge-offs, if any, charged to the allowance for loan losses upon transfer to real estate owned. The fair value is primarily based upon updated appraisals in addition to an analysis of current real estate market conditions.

ALLOWANCE FOR LOAN LOSSES

	As of or for the Nine Months Ended September 30,	
	2017	2016
	(Dollars in Thousands)	
Balance at beginning of period	$16,029	$16,185
Provision for loan losses	(1,166)	340
Charge-offs:		
Mortgage		
One- to four-family	1,092	801
Multi-family	92	488
Home equity	-	62
Commercial real estate	6	-
Construction and land	14	3
Consumer	-	-
Commercial	-	-
Total charge-offs	1,204	1,354
Recoveries:		
Mortgage		

One- to four-family	200	246
Multi-family	102	134
Home equity	21	24
Commercial real estate	1	-
Construction and land	80	58
Consumer	-	-
Commercial	-	-
Total recoveries	404	462
Net charge-offs	800	892
Allowance at end of period	$14,063	$15,633
Ratios:		
Allowance for loan losses to non-accrual loans at end of period	200.64 %	146.55 %
Allowance for loan losses to loans receivable at end of period	1.12 %	1.36 %
Net charge-offs to average loans outstanding (annualized)	0.09 %	0.11 %
Current period provision for loan losses to net charge-offs	(145.75)%	38.12 %
Net charge-offs (annualized) to beginning of the period allowance	6.67 %	7.36 %

At September 30, 2017, the allowance for loan losses decreased $2.0 million to $14.1 million compared to $16.0 million at December 31, 2016. The decrease in allowance for loan losses reflects the negative provision. The negative provision recorded during the current quarter reflects the continued improvement in loan quality metrics including: non-accrual loans, loans rated substandard or watch, and loans past due.

Net charge-offs totaled $800,000, or an annualized 0.09% of average loans for the nine months ended September 30, 2017, compared to $892,000, or an annualized 0.11% of average loans for the nine months ended September 30, 2016. Of the $800,000 in charge-offs during the nine months ended September 30, 2017, a majority of the activity related to loans secured by one- to four-family residential loans.

Our underwriting policies and procedures emphasize that credit decisions must rely on both the credit quality of the borrower and the estimated value of the underlying collateral. Credit quality is assured only when the estimated value of the collateral is objectively determined and is not subject to significant fluctuation.

The allowance for loan losses has been determined in accordance with GAAP. We are responsible for the timely and periodic determination of the amount of the allowance required. Any future provisions for loan losses will continue to be based upon our assessment of the overall loan portfolio and the underlying collateral, trends in non-performing loans, current economic conditions and other relevant factors. To the best of management's knowledge, all probable losses have been provided for in the allowance for loan losses.

The establishment of the amount of the loan loss allowance inherently involves judgments by management as to the appropriateness of the allowance, which ultimately may or may not be correct. Higher than anticipated rates of loan default would likely result in a need to increase provisions in future years.

Liquidity and Capital Resources

We maintain liquid assets at levels we consider adequate to meet our liquidity needs. We adjust our liquidity levels to fund loan commitments, repay our borrowings, fund deposit outflows and pay real estate taxes on mortgage loans. We also adjust liquidity as appropriate to meet asset and liability management objectives. The level of our liquidity position at any point in time is dependent upon the judgment of the senior management as supported by the Asset/Liability Committee. Liquidity is monitored on a daily, weekly and monthly basis using a variety of measurement tools and indicators.

Our primary sources of liquidity are deposits, amortization and repayment of loans, sales of loans held for sale, maturities of investment securities and other short-term investments, and earnings and funds provided from operations. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows and loan repayments are greatly influenced by market interest rates, economic conditions, and rates offered by our competitors. We set the interest rates on our deposits to maintain a desired level of total deposits. In addition, we invest excess funds in short-term, interest-earning assets, which provide liquidity to meet lending requirements. Additional sources of liquidity used for the purpose of managing long- and short-term cash flows include advances from the FHLB.

During the nine months ended September 30, 2017 primary uses of cash and cash equivalents included: $1.88 billion funding loans held for sale, $85.7 million increase in loans receivable, $69.0 decrease in repurchase agreements, $23.6 million for cash dividends paid, $7.7 million decrease from fewer short-term borrowings, $6.9 million in purchases of mortgage related securities, $6.1 million in purchases of debt securities, and $5.2 million in purchases of FHLB stock.

During the nine months ended September 30, 2017, primary sources of cash and cash equivalents included: $2.03 billion in proceeds from the sale of loans held for sale, $125.0 million in proceeds from long-term FHLB debt, $25.2 million in principal repayments on mortgage related securities, $22.8 million in net income, $13.9 million from maturities of debt securities, $7.4 million increase in deposits, $6.0 million increase in advance payments by borrowers for taxes, and $3.1 million from real estate owned sales.

During the nine months ended September 30, 2016 primary uses of cash and cash equivalents included: $1.76 billion funding loans held for sale, $220.0 million in the payment of long term debt, $41.1 million increase in loans receivable, purchase of $10.0 million in bank owned life insurance, $3.9 million for the repurchase of common stock, $5.2 million in purchases of mortgage related securities, $4.5 million in purchases of FHLB stock, $4.1 million in purchases of debt securities, and $4.8 million in dividends paid.

During the nine months ended September 30, 2016, primary sources of cash and cash equivalents included: $1.79 billion in proceeds from the sale of loans held for sale, $62.3 million increase in deposits, $100.0 million from long term borrowings, $56.8 million from short term borrowings, $29.7 million in principal repayments on mortgage related securities, $6.6 from maturities of debt securities, $19.1 million in net income, $11.4 from sales of FHLB stock, and $5.3 million from real estate owned sales.

A portion of our liquidity consists of cash and cash equivalents, which are a product of our operating, investing and financing activities. At September 30, 2017 and 2016, respectively, $92.6 million and $54.3 million of our assets were invested in cash and cash equivalents. At September 30, 2017, cash and cash equivalents are comprised of the following: $39.3 million in cash held at the Federal Reserve Bank and other depository institutions and $53.3 million in federal funds sold and short-term investments. Our primary sources of cash are principal repayments on loans, proceeds from the calls and maturities of debt and mortgage-related securities, increases in deposit accounts and advances from the FHLBC.

Liquidity management is both a daily and longer-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLBC which provide an additional source of funds. At September 30, 2017, we had $55.0 million in short-term advances from the FHLBC. Of the $55.0 million, a total of $35.0 million has a contractual maturity date of March 15, 2018 and a total of $20.0 million has a contractual maturity date of October 4, 2017. At September 30, 2017, we had $410.0 million in long term advances from the FHLBC with contractual maturity dates in 2017, 2018, 2021, and 2027. The advances with maturity dates in 2017 and 2018 are callable quarterly until maturity. The 2021 advance maturities have quarterly call options beginning in June 2018 and September 2018. The 2027 advance maturities have single call options in May 2019, June 2019, and August 2019. As an additional source of funds, we also have a repurchase agreement. At September 30, 2017, we had $15.0 million outstanding under the repurchase agreement. The repurchase agreement matures in November 2017.

At September 30, 2017, we had outstanding commitments to originate loans receivable of $52.9 million. In addition, at September 30, 2017, we had unfunded commitments under construction loans of $18.3 million, unfunded commitments under business lines of credit of $17.2 million and unfunded commitments under home equity lines of credit and standby letters of credit of $14.7 million. At September 30, 2017, certificates of deposit scheduled to mature in one year or less totaled $514.3 million. Based on prior experience, management believes that, subject to the Bank's funding needs, a significant portion of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits is not retained by us, we will have to utilize other funding sources, such as FHLBC advances, in order to maintain our level of assets. However, we cannot assure that such borrowings would be available on attractive terms, or at all, if and when needed. Alternatively, we could reduce our level of liquid assets, such as our cash and cash equivalents and securities available-for-sale in order to meet funding needs. In addition, the cost of such deposits may be significantly higher if market interest rates are higher or there is an increased amount of competition for deposits in our market area at the time of renewal.

Waterstone Financial, Inc. is a separate legal entity from WaterStone Bank and must provide for its own liquidity to pay dividends to its shareholders, repurchase shares of its common stock, and for other corporate purposes. The primary source of liquidity for Waterstone Financial, Inc. is dividend payments from WaterStone Bank. The ability of WaterStone Bank to pay dividends is subject to regulatory restrictions. At September 30, 2017, Waterstone Financial, Inc. (on an unconsolidated basis) had liquid assets totaling $24.5 million.

Capital

Shareholders' equity increased by $1.2 million to $411.9 million at September 30, 2017 from December 31, 2016. Shareholders' equity increased primarily due to net income, additional paid in capital as stock options were exercised, accumulated other comprehensive income increasing as the fair value of the security portfolio increased, and unearned ESOP shares as they continue to vest. Partially offsetting these increases was the declaration of regular dividends and a special dividend and the repurchase of stock.

The Company's Board of Directors authorized a stock repurchase program in the first quarter of 2015. The Company authorized two stock repurchase programs in the second quarter of 2015. These first three programs have been either fulfilled or cancelled and replaced. The Company's Board of Directors authorized a fourth stock repurchase program in the third quarter of 2015. The timing of the repurchases will depend on certain factors, including but not limited to, market conditions and prices, available funds and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions and pursuant to a trading plan that will be adopted in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934. Repurchased shares are held by the Company as authorized but unissued shares.

As of September 30, 2017, the Company had repurchased 5,919,853 shares at an average price of $13.02 under previously approved stock repurchase plans. As of September 30, 2017, the Company is authorized to purchase up to 916,800 additional shares under the current approved stock repurchase program.

WaterStone Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning assets and off-balance sheet items to broad risk categories. At September 30, 2017, WaterStone Bank exceeded all regulatory capital requirements and is considered "well capitalized" under regulatory guidelines. See "Notes to Consolidated Financial Statements - Note 8 Regulatory Capital."

Contractual Obligations, Commitments, Contingent Liabilities, and Off-balance Sheet Arrangements

The following tables present information indicating various contractual obligations and commitments of the Company as of September 30, 2017 and the respective maturity dates.

	Total	One Year or Less	More than One Year Through Three Years	More than Three Years Through Five Years	Over Five Years
	(In Thousands)				
Demand deposits (4)	$123,133	$123,133	$-	$-	$-
Money market and savings deposits (4)	148,607	148,607	-	-	-
Time deposit (4)	685,033	514,304	166,831	3,898	-
Bank lines of credit (4)	10,503	10,503	-	-	-
Federal Home Loan Bank advances (1)	410,000	185,000	-	100,000	125,000
Repurchase agreements (2)(4)	15,000	15,000	-	-	-
Operating leases (3)	8,364	2,824	3,061	1,312	1,167
	$1,400,640	$999,371	$169,892	$105,210	$126,167

(1) Secured under a blanket security agreement on qualifying assets, principally, mortgage loans. Excludes interest which will accrue on the advances.
All Federal Home Loan Bank advances with maturities exceeding one year are callable on a quarterly basis.
(2) The repurchase agreements are callable on a quarterly basis until maturity.
(3) Represents non-cancelable operating leases for offices and equipment.
(4) Excludes interest.

Herrington v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a class action lawsuit filed in the United States District Court for the Western District of Wisconsin and subsequently compelled to arbitration before the American Arbitration Association. The plaintiff class alleged that Waterstone Mortgage Corporation violated certain provisions of the Fair Labor Standards Act (FLSA) and failed to pay loan officers consistent with their various employment agreements. On July 5, 2017, the arbitrator issued a final award finding Waterstone Mortgage Corporation liable for unpaid minimum wages, overtime, unreimbursed business expenses, and liquidated damages under the FLSA. The arbitrator awarded damages under the FLSA in the amount of $7.3 million, and attorney's fees and costs in the amount of $3.3 million. While a judgment confirming the arbitrator's award with respect to damages and fees has not yet been issued, if plaintiff prevails on her theories, the Company has estimated that the award, which includes attorney's fees and costs, could be as high as $11.0 million. Waterstone Mortgage Corporation will continue to vigorously defend its interests in this matter, including challenging any findings regarding liability and damages through appropriate post-arbitration motions and appeal processes and seeking to vacate in its entirety any award against the Company. Given the pending legal strategies that are available, we do not believe that it is probable that the plaintiff will ultimately prevail in this litigation, and estimate the low end of the possible range of loss is $0. In accordance with the authoritative guidance in evaluating contingencies, the Company has not recorded an accrual related to this matter.

Werner v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a putative collection action lawsuit that was filed on August 4, 2017 in the United States District Court for the Western District of Wisconsin, Werner et al. v. Waterstone Mortgage Corporation. Plaintiffs allege that Waterstone Mortgage Corporation violated the Fair Labor Standards Act (FLSA) by

failing to pay loan officers minimum and overtime wages. The case is in the very early stages of litigation and the Court has yet to decide if the case can proceed as collective action. The Company intends to vigorously defend its interests in this matter and pursue all possible defenses against the claims. Given the early stage of the litigation, the Company is not yet able to make a determination as to the likelihood of an unfavorable outcome in this matter, nor is it able to estimate the range of any possible loss.

Off-Balance Sheet Commitments

The following table details the amounts and expected maturities of significant off-balance sheet commitments as of September 30, 2017.

	Total	One Year or Less	More than One Year Through Three Years	More than Three Years Through Five Years	Over Five Years
	(In Thousands)				
Real estate loan commitments (1)	$52,948	$52,948	$ -	$ -	$ -
Unused portion of home equity lines of credit (2)	14,724	14,724	-	-	-
Unused portion of construction loans (3)	18,306	18,306	-	-	-
Unused portion of business lines of credit	17,204	17,204	-	-	-
Standby letters of credit	259	259	-	-	-
Total Other Commitments	$103,441	$103,441	$ -	$ -	$ -

General: Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract and generally have fixed expiration dates or other termination clauses.

(1) Commitments for loans are extended to customers for up to 90 days after which they expire.

(2) Unused portions of home equity loans are available to the borrower for up to 10 years.

(3) Unused portions of construction loans are available to the borrower for up to one year.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Management of Market Risk

General. The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, WaterStone Bank's board of directors has established an Asset/Liability Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the board of directors. Management monitors the level of interest rate risk on a regular basis and the Asset/Liability Committee meets at least weekly to review our asset/liability policies and interest rate risk position, which are evaluated quarterly.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. We have implemented the following strategies to manage our interest rate risk: (i) emphasizing variable rate loans including variable rate one- to four-family, and commercial real estate loans as well as three to five year commercial real estate balloon loans; (ii) reducing and shortening the expected average life of the investment portfolio; and (iii) whenever possible, lengthening the term structure of our deposit base and our borrowings from the FHLBC. These measures should reduce the volatility of our net interest income in different interest rate environments.

Income Simulation. Simulation analysis is an estimate of our interest rate risk exposure at a particular point in time. At least quarterly we review the potential effect changes in interest rates may have on the repayment or repricing of rate sensitive assets and funding requirements of rate sensitive liabilities. Our most recent simulation uses projected repricing of assets and liabilities at September 30, 2017 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rate assumptions may have a significant impact on interest income simulation results. Because of the large percentage of loans and mortgage-backed securities we hold, rising or falling interest rates may have a significant impact on the actual prepayment speeds of our mortgage related assets that may in turn affect our interest rate sensitivity position. When interest rates rise, prepayment speeds slow and the average expected lives of our assets would tend to lengthen more than the expected average lives of our liabilities and therefore would most likely have a positive impact on net interest income and earnings.

The following interest rate scenario displays the percentage change in net interest income over a one-year time horizon assuming increases of 100, 200 and 300 basis points and a decreases of 100 basis points. The results incorporate actual cash flows and repricing characteristics for balance sheet accounts following an instantaneous parallel change in market rates based upon a static (no growth balance sheet).

Analysis of Net Interest Income Sensitivity

	Immediate Change in Rates			
	+300	+200	+100	-100
	(Dollar Amounts in Thousands)			
As of March 31, 2017				
Dollar Change	$2,522	1,746	886	(1,283)
Percentage Change	4.73 %	3.28	1.66	(2.41)

At September 30, 2017, a 100 basis point instantaneous increase in interest rates had the effect of increasing forecast net interest income over the next 12 months by 2.51% while a 100 basis point decrease in rates had the effect of decreasing net interest income by 2.89%.

Item 4. Controls and Procedures

Disclosure Controls and Procedures: Company management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.

Internal Control Over Financial Reporting: There have been no material changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Other than as disclosed below, the Company is not involved in any pending legal proceedings as a defendant other than routine legal proceedings occurring in the ordinary course of business. At September 30, 2017, the Company believes that any liability arising from the resolution of any pending legal proceedings will not be material to its financial condition or results of operations.

Herrington v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a class action lawsuit filed in the United States District Court for the Western District of Wisconsin and subsequently compelled to arbitration before the American Arbitration Association. The plaintiff class alleged that Waterstone Mortgage Corporation violated certain provisions of the Fair Labor Standards Act (FLSA) and failed to pay loan officers consistent with their various employment agreements. On July 5, 2017, the arbitrator issued a final award finding Waterstone Mortgage Corporation liable for unpaid minimum wages, overtime, unreimbursed business expenses, and liquidated damages under the FLSA. The arbitrator awarded damages under the FLSA in the amount of $7.3 million, and attorney's fees and costs in the amount of $3.3 million. While a judgment confirming the arbitrator's award with respect to damages and fees has not yet been issued, if plaintiff prevails on her theories, the Company has estimated that the award, which includes attorney's fees and costs, could be as high as $11.0 million. Waterstone Mortgage Corporation will continue to vigorously defend its interests in this matter, including challenging any findings regarding liability and damages through appropriate post-arbitration motions and appeal processes and seeking to vacate in its entirety any award against the Company. Given the pending legal strategies that are available, we do not believe that it is probable that the plaintiff will ultimately prevail in this litigation, and estimate the low end of the possible range of loss is $0. In accordance with the authoritative guidance in evaluating contingencies, the Company has not recorded an accrual related to this matter.

Werner v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a putative collection action lawsuit that was filed on August 4, 2017 in the United States District Court for the Western District of Wisconsin, Werner et al. v. Waterstone Mortgage Corporation. Plaintiffs allege that Waterstone Mortgage Corporation violated the Fair Labor Standards Act (FLSA) by failing to pay loan officers minimum and overtime wages. The case is in the very early stages of litigation and the Court has yet to decide if the case can proceed as collective action. The Company intends to vigorously defend its interests in this matter and pursue all possible defenses against the claims. Given the early stage of the litigation, the Company is not yet able to make a determination as to the likelihood of an unfavorable outcome in this matter, nor is it able to estimate the range of any possible loss.

Item 1A. Risk Factors

There have been no changes in risk factors applicable to the Company from those disclosed in "Risk Factors" in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

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

Following are the Company's monthly common stock repurchases during the third quarter of 2017:

Period	Total Number of Shares Purchased[b]	Average Price Paid per Share	Total Number of Shares Purchased as Part of	Maximum Number of Shares that May Yet Be

			Publicly Announced Plans	Purchased Under the Plan[(a)]
July 1, 2017 - July 31, 2017	-	$ -	-	989,500
August 1, 2017 - August 31, 2017	45,300	17.51	45,300	944,200
September 1, 2017 - September 30, 2017	27,768	17.53	27,400	916,800
Total	73,068	$ 17.52	72,700	916,800

(a) On September 4, 2015, the Board of Directors terminated the then-existing plan and authorized the repurchase of 1,500,000 shares of common stock.

(b) During the third quarter of 2017, the Company repurchased 368 shares for minimum tax withholding settlements on equity compensation. These purchases are included in the monthly common stock purchases table above but do not count against the maximum number of shares that may yet be purchased under the Board of Directors' authorization.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

(a) Exhibits: See Exhibit Index, which follows the signature page hereof.

Signatures

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

	WATERSTONE FINANCIAL, INC. (Registrant)
Date: October 27, 2017	
	/s/ Douglas S. Gordon Douglas S. Gordon Chief Executive Officer Principal Executive Officer
Date: October 27, 2017	
	/s/ Mark R. Gerke Mark R. Gerke Chief Financial Officer Principal Financial Officer

EXHIBIT INDEX

WATERSTONE FINANCIAL, INC.

Form 10-Q for Quarter Ended September 30, 2017

Exhibit No.	Description	Filed Herewith
31.1	Sarbanes-Oxley Act Section 302 Certification signed by the Chief Executive Officer of Waterstone Financial, Inc.	X
31.2	Sarbanes-Oxley Act Section 302 Certification signed by the Chief Financial Officer of Waterstone Financial, Inc.	X
32.1	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Executive Officer of Waterstone Financial, Inc.	X
32.2	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Financial Officer of Waterstone Financial, Inc.	X
101	The following financial statements from Waterstone Financial, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statements of financial condition, (ii) consolidated statements of income, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of changes in shareholders' equity, (v) consolidated statements of cash flows and (vi) the notes to consolidated financial statements.	X