

Edgar Filing: Waterstone Financial, Inc. - Form 10-Q

Waterstone Financial, Inc.
Form 10-Q
July 29, 2016
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 June 30, 2016

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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Yes No T

The number of shares outstanding of the issuer's common stock, \$0.01 par value per share, was 29,164,384 at July 28, 2016.

WATERSTONE FINANCIAL, INC.

10-Q INDEX

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PART I — FINANCIAL INFORMATION

Item 1. Financial StatementsWATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	(Unaudited)	
	June 30, 2016	December 31, 2015
	(Dollars In Thousands, except share and per share data)	
Assets		
Cash	\$40,887	\$57,419
Federal funds sold	31,301	20,297
Interest-earning deposits in other financial institutions and other short term investments	10,268	22,755
Cash and cash equivalents	82,456	100,471
Securities available for sale (at fair value)	253,726	269,658
Loans held for sale (at fair value)	208,807	166,516
Loans receivable	1,130,036	1,114,934
Less: Allowance for loan losses	15,705	16,185
Loans receivable, net	1,114,331	1,098,749
Office properties and equipment, net	24,518	25,328
Federal Home Loan Bank stock (at cost)	14,850	19,500
Cash surrender value of life insurance	60,454	49,562
Real estate owned, net	8,637	9,190
Prepaid expenses and other assets	31,487	23,755
Total assets	\$1,799,266	\$1,762,729
Liabilities and Shareholders' Equity		
Liabilities:		
Demand deposits	\$106,059	\$102,673
Money market and savings deposits	154,550	140,631
Time deposits	682,100	650,057
Total deposits	942,709	893,361
Borrowings	414,745	441,203
Advance payments by borrowers for taxes	16,011	3,661
Other liabilities	25,220	32,574
Total liabilities	1,398,685	1,370,799
Shareholders' equity:		
Preferred stock (par value \$.01 per share)		
Authorized - 50,000,000 shares in 2016 and in 2015, no shares issued	-	-
Common stock (par value \$.01 per share)		
Authorized - 100,000,000 shares in 2016 and in 2015		
Issued - 29,163,190 in 2016 and 29,407,455 in 2015		
Outstanding - 29,163,190 in 2016 and 29,407,455 in 2015	292	294
Additional paid-in capital	318,187	317,022

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Retained earnings	176,163	168,089
Unearned ESOP shares	(20,771)	(21,365)
Accumulated other comprehensive income, net of taxes	3,257	582
Cost of shares repurchased (5,908,150 shares at June 30, 2016 and 5,624,415 shares at December 31, 2015)	(76,547)	(72,692)
Total shareholders' equity	400,581	391,930
Total liabilities and shareholders' equity	\$1,799,266	\$1,762,729

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(In Thousands, except per share amounts)			
Interest income:				
Loans	\$14,073	\$14,065	\$27,857	\$27,378
Mortgage-related securities	790	820	1,628	1,659
Debt securities, federal funds sold and short-term investments	885	857	1,859	1,723
Total interest income	15,748	15,742	31,344	30,760
Interest expense:				
Deposits	1,835	1,358	3,554	2,711
Borrowings	3,748	4,324	7,642	8,553
Total interest expense	5,583	5,682	11,196	11,264
Net interest income	10,165	10,060	20,148	19,496
Provision for loan losses	-	805	205	1,140
Net interest income after provision for loan losses	10,165	9,255	19,943	18,356
Noninterest income:				
Service charges on loans and deposits	616	443	953	849
Increase in cash surrender value of life insurance	471	352	712	559
Mortgage banking income	34,980	29,577	55,594	50,616
Gain on sale of available for sale securities	-	-	-	44
Other	284	668	537	1,005
Total noninterest income	36,351	31,040	57,796	53,073
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	25,709	23,272	43,395	41,350
Occupancy, office furniture, and equipment	2,419	2,269	4,755	4,712
Advertising	655	712	1,313	1,365
Data processing	638	630	1,281	1,205
Communications	372	351	714	721
Professional fees	489	632	1,012	1,129
Real estate owned	163	686	307	1,229
FDIC insurance premiums	155	271	360	607
Other	3,631	3,124	6,316	6,057
Total noninterest expenses	34,231	31,947	59,453	58,375
Income before income taxes	12,285	8,348	18,286	13,054
Income tax expense	4,518	3,064	6,658	4,754
Net income	\$7,767	\$5,284	\$11,628	\$8,300
Income per share:				
Basic	\$0.29	\$0.17	\$0.43	\$0.26
Diluted	\$0.29	\$0.17	\$0.43	\$0.26
Weighted average shares outstanding:				
Basic	26,919	29,841	26,942	31,098
Diluted	27,204	30,191	27,243	31,413

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(In Thousands)			
Net income	\$7,767	\$5,284	\$11,628	\$8,300
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 (\$528), \$1,557, (\$1,728), \$714, respectively	815	(2,410)	2,675	(1,106)
Reclassification adjustment for net gain included in net income during the period, net of tax expense of \$0, \$0, \$0, \$17, respectively	-	-	-	(27)
Total other comprehensive income (loss)	815	(2,410)	2,675	(1,133)
Comprehensive income	\$8,582	\$2,874	\$14,303	\$7,167

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Common Shares	Stock Amount	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Cost of Shares Repurchased	Total Shareholders' Equity
Balances at December 31, 2014	34,420	\$ \$344	\$ 313,894	\$ 157,304	\$ (22,552)	\$ 1,247	\$ -	\$ 450,237
Comprehensive income:								
Net income	-	-	-	8,300	-	-	-	8,300
Other comprehensive loss	-	-	-	-	-	(1,133)	-	(1,133)
Total comprehensive income								7,167
ESOP shares committed to be released to Plan participants	-	-	88	-	594	-	-	682
Cash dividend, \$0.10 per share	-	-	-	(3,029)	-	-	-	(3,029)
Stock compensation activity, net of tax	594	6	89	-	-	-	-	95
Stock compensation expense	-	-	1,851	-	-	-	-	1,851
Purchase of common stock returned to authorized but unissued	(4,307)	(43)	-	-	-	-	(55,522)	(55,565)
Balances at June 30, 2015	30,707	\$ \$307	\$ 315,922	\$ 162,575	\$ (21,958)	\$ 114	\$ (55,522)	\$ 401,438
Balances at December 31, 2015	29,407	\$ \$294	\$ 317,022	\$ 168,089	\$ (21,365)	\$ 582	\$ (72,692)	\$ 391,930
Comprehensive income:								
Net income	-	-	-	11,628	-	-	-	11,628
Other comprehensive income	-	-	-	-	-	2,675	-	2,675
Total comprehensive income								14,303
ESOP shares committed to be	-	-	145	-	594	-	-	739

released to Plan participants								
Cash dividend, \$0.13 per share	-	-	-	(3,554)	-	-	-	(3,554)
Stock based compensation activity	40	-	78	-	-	-	-	78
Stock compensation expense	-	-	942	-	-	-	-	942
Purchase of common stock returned to authorized but unissued	(284)	(2)	-	-	-	-	(3,855)	(3,857)
Balances at June 30, 2016	29,163	\$292	\$318,187	\$176,163	\$(20,771)	\$3,257	\$(76,547)	\$400,581

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Six months ended June 30,	
	2016	2015
	(In Thousands)	
Operating activities:		
Net income	\$11,628	\$8,300
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	205	1,140
Provision for depreciation	1,447	1,571
Stock based compensation	942	1,851
Net amortization of premium/discount on debt and mortgage related securities	510	685
Amortization of unearned ESOP shares	739	682
Amortization and impairment of mortgage servicing rights	389	385
Gain on sale of loans held for sale	(54,929)	(48,472)
Loans originated for sale	(1,046,354)	(995,131)
Proceeds on sales of loans originated for sale	1,058,992	960,756
(Increase) decrease in accrued interest receivable	(21)	39
Increase in cash surrender value of life insurance	(712)	(559)
Decrease in accrued interest on deposits and borrowings	(211)	(41)
Increase in other liabilities	4,149	4,490
(Increase) decrease in accrued tax receivable	(367)	2,402
Gain on sale of available for sale securities	-	(44)
Net loss related to real estate owned	3	379
Gain on sale of mortgage servicing rights	-	(262)
Other	(9,447)	(4,225)
Net cash used in operating activities	(33,037)	(66,054)
Investing activities:		
Net increase in loans receivable	(18,910)	(10,151)
Purchases of:		
Debt securities	-	(10,000)
Mortgage related securities	(5,236)	(15,933)
Premises and equipment, net	(689)	(931)
Bank owned life insurance	(10,180)	(180)
FHLB stock	(2,250)	(2,000)
Proceeds from:		
Principal repayments on mortgage-related securities	19,115	20,652
Maturities of debt securities	5,945	5,690
Sales of debt securities	-	1,034
Sales of FHLB stock	6,900	-
Sales of real estate owned	3,712	13,475
Net cash (used in) provided by investing activities	(1,593)	1,656
Financing activities:		
Net increase (decrease) in deposits	49,348	(13,646)
Net change in short term borrowings	(6,458)	10,000

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Repayment of long term debt	(70,000)	-
Proceeds from long term debt	50,000	-
Net change in advance payments by borrowers for taxes	175	1,924
Cash dividends on common stock	(2,671)	(3,113)
Purchase of common stock returned to authorized but unissued	(3,857)	(55,565)
Proceeds from stock option exercises	78	89
Net cash provided by (used in) financing activities	16,615	(60,311)
Decrease in cash and cash equivalents	(18,015)	(124,709)
Cash and cash equivalents at beginning of period	100,471	172,820
Cash and cash equivalents at end of period	\$82,456	\$48,111

Supplemental information:

Cash paid or credited during the period for:

Income tax payments	\$6,545	\$2,303
Interest payments	11,407	11,305
Noncash activities:		
Loans receivable transferred to real estate owned	3,123	9,066
Dividends declared but not paid in other liabilities	2,304	1,536

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 (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 and multi-family residential real estate loans for retention in its portfolio. WaterStone Bank also offers home equity loans and lines of credit, construction and land loans, commercial real estate 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, 2015 Annual Report on Form 10-K. Operating results for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 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

ASU 2016-13 "Financial Instruments - Credit Losses (Topic 326)" ("ASU 2016-13") requires an entity to utilize a new impairment model known as the current expected credit loss ("CECL") model to estimate its lifetime "expected credit loss" and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net

amount expected to be collected on the financial asset. The CECL model is expected to result in more timely recognition of credit losses. ASU 2016-13 also requires new disclosures for financial assets measured at amortized cost, loans and available-for-sale debt securities. ASU 2016-13 is effective for public companies for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We are in the process of evaluating the impact adoption of ASU 2016-13 will have on our consolidated financial statements and disclosures.

ASU 2016-02 "Lease (Topic 842)" ("ASU 2016-02") requires that lessees and lessors recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. ASU 2016-02 is effective for public companies for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. We are in the process of evaluating the impact adoption of ASU 2016-13 will have on our consolidated financial statements and disclosures.

Note 2— Securities Available for Sale

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

	June 30, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	\$84,445	\$ 2,388	\$ (3)	) \$86,830
Collateralized mortgage obligations:				
Government sponsored enterprise issued	67,855	1,112	-	68,967
Mortgage-related securities	152,300	3,500	(3)	) 155,797
Government sponsored enterprise bonds	3,750	28	-	3,778
Municipal securities	72,371	3,155	(6)	) 75,520
Other debt securities	17,400	128	(628)	) 16,900
Debt securities	93,521	3,311	(634)	) 96,198
Certificates of deposit	1,715	16	-	1,731
	\$247,536	\$ 6,827	\$ (637)	) \$253,726
	December 31, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	\$95,911	\$ 1,004	\$ (248)	) \$96,667
Collateralized mortgage obligations:				
Government sponsored enterprise issued	70,605	123	(300)	) 70,428
Mortgage-related securities	166,516	1,127	(548)	) 167,095
Government sponsored enterprise bonds	3,750	-	(4)	) 3,746
Municipal securities	77,509	1,730	(80)	) 79,159
Other debt securities	17,401	209	(647)	) 16,963
Debt securities	98,660	1,939	(731)	) 99,868
Certificates of deposit	2,695	4	(4)	) 2,695
	\$267,871	\$ 3,070	\$ (1,283)	) \$269,658

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 June 30, 2016, \$93.0 million of the Company's mortgage related securities were pledged as collateral to secure repurchase agreement obligations of the Company. As of June 30, 2016, \$2.2 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities. At December 31, 2015, \$94.1 million of the Company's government sponsored enterprise bonds and \$2.5 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities, respectively.

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The amortized cost and fair values of investment securities by contractual maturity at June 30, 2016 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 Fair	
	Cost	Value
	(In Thousands)	
Debt and other securities		
Due within one year	\$ 10,945	\$ 11,026
Due after one year through five years	19,526	19,799
Due after five years through ten years	42,011	44,103
Due after ten years	22,754	23,001
Mortgage-related securities	152,300	155,797
	\$ 247,536	\$ 253,726

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:

	June 30, 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	\$-	\$ -	\$ 2,177	\$ (3)	\$ 2,177	\$ (3)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	-	-	-	-	-	-
Municipal securities	6,603	(6)	-	-	6,603	(6)
Other debt securities	-	-	9,372	(628)	9,372	(628)
Certificates of deposit	-	-	-	-	-	-
	\$ 6,603	\$ (6)	\$ 11,549	\$ (631)	\$ 18,152	\$ (637)

	December 31, 2015					
	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	\$ 18,488	\$ (163)	\$ 5,577	\$ (85)	\$ 24,065	\$ (248)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	48,281	(300)	-	-	48,281	(300)
Government sponsored enterprise bonds	3,246	(4)	-	-	3,246	(4)
Municipal securities	9,409	(18)	5,555	(62)	14,964	(80)
Other debt securities	14,363	(647)	-	-	14,363	(647)
Certificates of deposit	976	(4)	-	-	976	(4)
	\$ 94,763	\$ (1,136)	\$ 11,132	\$ (147)	\$ 105,895	\$ (1,283)

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.

As of June 30, 2016, the Company held two municipal securities that had previously been deemed to be other-than-temporarily impaired. Both securities were 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 securities to operate as a going concern. During the year ended December 31, 2012, the Company's analysis of these securities resulted in \$100,000 in credit losses charged to earnings with respect to these two municipal securities. During the year ended December 31, 2014, there were sales in the market of municipal issuer bonds at a discounted price that resulted in the Company recording additional credit losses. An additional \$17,000 credit loss was charged to earnings during the year ended December 31, 2014 for these municipal bonds. As of June 30, 2016, these securities had a combined amortized cost of \$198,000 and total life-to-date impairment of \$117,000.

As of June 30, 2016, the Company had two mortgage-backed securities 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 June 30, 2016. 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.

There were no sales of securities during the six months ended June 30, 2016. During the six months ended June 30, 2015, proceeds from the sale of securities totaled \$1.0 million and resulted in gains totaling \$44,000. The \$44,000 included in gain on sale of available for sale securities in the consolidated statements of income during the six months ended June 30, 2015 was reclassified from accumulated other comprehensive income.

Note 3 - Loans Receivable

Loans receivable at June 30, 2016 and December 31, 2015 are summarized as follows:

	June 30, 2016	December 31, 2015
	(In Thousands)	
Mortgage loans:		
Residential real estate:		
One- to four-family	\$383,029	\$381,992
Multi-family	544,753	547,250
Home equity	23,173	24,326
Construction and land	16,842	19,148
Commercial real estate	134,537	118,820
Consumer	342	361
Commercial loans	27,360	23,037
	\$1,130,036	\$1,114,934

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 \$885.2 million and \$872.8 million at June 30, 2016 and December 31, 2015, respectively, are pledged as collateral against \$330.0 million in outstanding Federal Home Loan Bank of Chicago (FHLBC) advances under a blanket security agreement.

As of June 30, 2016 and December 31, 2015, there were no loans 90 or more days past due and still accruing interest.

An analysis of past due loans receivable as of June 30, 2016 and December 31, 2015 follows:

	As of June 30, 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	\$1,064	\$99	\$5,441	\$6,604	\$376,425	\$383,029
Multi-family	379	-	700	1,079	543,674	544,753
Home equity	30	-	58	88	23,085	23,173
Construction and land	-	-	66	66	16,776	16,842
Commercial real estate	-	-	209	209	134,328	134,537
Consumer	-	-	-	-	342	342
Commercial loans	-	2	26	28	27,332	27,360
Total	\$1,473	\$101	\$6,500	\$8,074	\$1,121,962	\$1,130,036

As of December 31, 2015

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	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	\$851	\$1,133	\$6,503	\$8,487	\$373,505	\$381,992
Multi-family	—	207	1,858	2,065	545,185	547,250
Home equity	255	96	110	461	23,865	24,326
Construction and land	-	-	238	238	18,910	19,148
Commercial real estate	57	-	223	280	118,540	118,820
Consumer	-	-	-	-	361	361
Commercial loans	-	-	-	-	23,037	23,037
Total	\$1,163	\$1,436	\$8,932	\$11,531	\$1,103,403	\$1,114,934

⁽¹⁾ Includes \$447,000 and \$315,000 at June 30, 2016 and December 31, 2015, respectively, which are on non-accrual status.

⁽²⁾ Includes \$32,000 and \$467,000 at June 30, 2016 and December 31, 2015, respectively, which are on non-accrual status.

⁽³⁾ Includes \$4.4 million and \$7.9 million at June 30, 2016 and December 31, 2015, respectively, which are on non-accrual status.

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A summary of the activity for the six months ended June 30, 2016 and 2015 in the allowance for loan losses follows:

	One- to Four- Family (In Thousands)	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total	
Six months ended June 30, 2016									
Balance at beginning of period	\$7,763	\$ 5,000	\$ 433	\$ 904	\$ 1,680	\$ 9	\$ 396	\$16,185	
Provision (credit) for loan losses	(103)	(5)	(2)	(13)	52	1	275	205	
Charge-offs	(464)	(445)	(62)	(3)	-	-	-	(974)	
Recoveries	178	59	19	33	-	-	-	289	
Balance at end of period	\$7,374	\$ 4,609	\$ 388	\$ 921	\$ 1,732	\$ 10	\$ 671	\$15,705	
Six months ended June 30, 2015									
Balance at beginning of period		\$9,877	\$5,358	\$422	\$687	\$1,951	\$8	\$403	\$18,706
Provision (credit) for loan losses		1,402	(147)	(54)	47	(115)	(2)	9	1,140
Charge-offs		(1,220)	(1,304)	(48)	(47)	(45)	-	-	(2,664)
Recoveries		289	753	95	33	5	3	-	1,178
Balance at end of period		\$10,348	\$4,660	\$415	\$720	\$1,796	\$9	\$412	\$18,360

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of June 30, 2016 follows:

	One- to Four- Family (In Thousands)	Multi- Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
Allowance related to loans individually evaluated for impairment	\$605	\$-	\$75	\$-	\$88	\$-	\$2	\$770
Allowance related to loans collectively evaluated for impairment	6,769	4,609	313	921	1,644	10	669	14,935
Balance at end of period	\$7,374	\$4,609	\$388	\$921	\$1,732	\$10	\$671	\$15,705
Loans individually evaluated for impairment	\$12,124	\$4,287	\$319	\$504	\$1,631	\$-	\$48	\$18,913
Loans collectively evaluated for impairment	370,905	540,466	22,854	16,338	132,906	342	27,312	1,111,123
Total gross loans	\$383,029	\$544,753	\$23,173	\$16,842	\$134,537	\$342	\$27,360	\$1,130,036

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A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of December 31, 2015 follows:

	One- to Four-Family (In Thousands)	Multi- Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
Allowance related to loans individually evaluated for impairment	\$1,114	\$242	\$108	\$3	\$106	\$-	\$3	\$1,576
Allowance related to loans collectively evaluated for impairment	6,649	4,758	325	901	1,574	9	393	14,609
Balance at end of period	\$7,763	\$5,000	\$433	\$904	\$1,680	\$9	\$396	\$16,185
Loans individually evaluated for impairment	\$18,385	\$5,100	\$472	\$1,795	\$1,766	\$-	\$27	\$27,545
Loans collectively evaluated for impairment	363,607	542,150	23,854	17,353	117,054	361	23,010	1,087,389
Total gross loans	\$381,992	\$547,250	\$24,326	\$19,148	\$118,820	\$361	\$23,037	\$1,114,934

The following table presents information relating to the Company's internal risk ratings of its loans receivable as of June 30, 2016 and December 31, 2015:

	One to Four- Family (In Thousands)	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
At June 30, 2016								
Substandard	\$14,271	\$1,757	\$406	\$66	\$1,631	\$-	\$47	\$18,178
Watch	9,800	2,931	113	874	1,465	-	3,070	18,253
Pass	358,958	540,065	22,654	15,902	131,441	342	24,243	1,093,605
	\$383,029	\$544,753	\$23,173	\$16,842	\$134,537	\$342	\$27,360	\$1,130,036
At December 31, 2015								
Substandard	\$19,148	\$2,553	\$684	\$1,794	\$1,766	\$-	\$55	\$26,000
Watch	11,352	3,634	128	-	1,161	-	402	16,677
Pass	351,492	541,063	23,514	17,354	115,893	361	22,580	1,072,257
	\$381,992	\$547,250	\$24,326	\$19,148	\$118,820	\$361	\$23,037	\$1,114,934

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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 June 30, 2016 and December 31, 2015.

	As of or for the Six Months Ended June 30, 2016					
	Recorded Investment (In Thousands)	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
Total Impaired with Reserve						
One- to four-family	\$3,040	\$3,080	\$ 605	\$ 40	\$ 3,066	\$ 69
Multi-family	-	-	-	-	-	-
Home equity	163	163	75	-	167	7
Construction and land	-	-	-	-	-	-

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Commercial real estate	296	705	88	409	303	6
Consumer	-	-	-	-	-	-
Commercial	2	2	2	-	3	-
	3,501	3,950	770	449	3,539	82
Total Impaired with no Reserve						
One- to four-family	9,084	10,509	-	1,425	9,340	179
Multi-family	4,287	5,315	-	1,028	4,313	118
Home equity	156	156	-	-	156	2
Construction and land	504	504	-	-	780	12
Commercial real estate	1,335	1,335	-	-	1,397	31
Consumer	-	-	-	-	-	-
Commercial	46	46	-	-	48	1
	15,412	17,865	-	2,453	16,034	343
Total Impaired						
One- to four-family	12,124	13,589	605	1,465	12,406	248
Multi-family	4,287	5,315	-	1,028	4,313	118
Home equity	319	319	75	-	323	9
Construction and land	504	504	-	-	780	12
Commercial real estate	1,631	2,040	88	409	1,700	37
Consumer	-	-	-	-	-	-
Commercial	48	48	2	-	51	1
	\$18,913	\$21,815	\$ 770	\$ 2,902	\$ 19,573	\$ 425

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As of or for the Year Ended December 31, 2015

	Recorded Unpaid Investment (In Thousands)	Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
Total Impaired with Reserve						
One- to four-family	\$7,903	\$8,923	\$1,114	\$1,020	\$8,113	\$393
Multi-family	1,055	1,055	242	-	1,044	42
Home equity	169	169	108	-	174	10
Construction and land	156	269	3	113	155	-
Commercial real estate	314	723	106	409	367	23
Consumer	-	-	-	-	-	-
Commercial	3	3	3	-	5	1
	9,600	11,142	1,576	1,542	9,858	469
Total Impaired with no Reserve						
One- to four-family	10,482	11,991	-	1,509	10,676	500
Multi-family	4,045	5,090	-	1,045	4,106	245
Home equity	303	303	-	-	307	13
Construction and land	1,639	1,639	-	-	1,827	62
Commercial real estate	1,452	1,452	-	-	1,458	72
Consumer	-	-	-	-	-	-
Commercial	24	24	-	-	29	2
	17,945	20,499	-	2,554	18,403	894
Total Impaired						
One- to four-family	18,385	20,914	1,114	2,529	18,789	893
Multi-family	5,100	6,145	242	1,045	5,150	287
Home equity	472	472	108	-	481	23
Construction and land	1,795	1,908	3	113	1,982	62
Commercial real estate	1,766	2,175	106	409	1,825	95
Consumer	-	-	-	-	-	-
Commercial	27	27	3	-	34	3
	\$27,545	\$31,641	\$1,576	\$4,096	\$28,261	\$1,363

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 \$15.4 million of impaired loans as of June 30, 2016 for which no allowance has been

provided, \$2.5 million in 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.

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At June 30, 2016, total impaired loans included \$11.6 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, 2015, total impaired loans included \$17.5 million of troubled debt restructurings.

The following presents data on troubled debt restructurings:

	As of June 30, 2016					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(dollars in thousands)					
One- to four-family	\$3,308	3	\$2,502	34	\$5,810	37
Multi-family	2,530	1	1,464	5	3,994	6
Home equity	-	-	98	1	98	1
Construction and land	437	1	-	-	437	1
Commercial real estate	1,192	2	65	1	1,257	3
	\$7,467	7	\$4,129	41	\$11,596	48

	As of December 31, 2015					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(dollars in thousands)					
One- to four-family	\$3,900	4	\$5,739	45	\$9,639	49
Multi-family	2,546	1	2,317	7	4,863	8
Home equity	-	-	98	1	98	1
Construction and land	1,556	2	-	-	1,556	2
Commercial real estate	1,306	1	77	1	1,383	2
	\$9,308	8	\$8,231	54	\$17,539	62

At June 30, 2016, \$11.6 million in loans had been modified in troubled debt restructurings and \$4.1 million of these loans were included in the non-accrual loan total. The remaining \$7.5 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 \$442,000 valuation allowance has been established as of June 30, 2016 with respect to the \$11.6 million in troubled debt restructurings. As of December 31, 2015, a \$996,000 valuation allowance had been established with respect to the \$17.5 million in troubled debt restructurings.

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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 June 30, 2016					
	Performing in accordance with modified terms		In Default		Total	
	Amount	Number	Amount	Number	Amount	Number
	(dollars in thousands)					
Interest reduction and principal forbearance	\$9,666	24	\$800	2	\$10,466	26
Interest reduction	1,130	22	-	-	1,130	22
	\$10,796	46	\$800	2	\$11,596	48

	As of December 31, 2015					
	Performing in accordance with modified terms		In Default		Total	
	Amount	Number	Amount	Number	Amount	Number
	(dollars in thousands)					
Interest reduction and principal forbearance	\$13,971	30	\$1,012	5	\$14,983	35
Principal forbearance	97	1	-	-	97	1
Interest reduction	2,459	26	-	-	2,459	26
	\$16,527	57	\$1,012	5	\$17,539	62

There were no loans modified as troubled debt restructurings for the three or six months ended June 30, 2016 and June 30, 2015.

There were no troubled debt restructurings within the past twelve months for which there was a default during the three or six months ended June 30, 2016 and June 30, 2015.

The following table presents data on non-accrual loans as of June 30, 2016 and December 31, 2015:

	June 30, 2016	December 31, 2015
	(Dollars in Thousands)	
Non-accrual loans:		
Residential		
One- to four-family	\$8,765	\$13,888
Multi-family	1,757	2,553
Home equity	304	437
Construction and land	66	239
Commercial real estate	439	460
Commercial	48	27
Consumer	-	-
Total non-accrual loans	\$11,379	\$17,604
Total non-accrual loans to total loans receivable	1.01 %	1.58 %
Total non-accrual loans to total assets	0.63 %	1.00 %

Note 4— Real Estate Owned

Real estate owned is summarized as follows:

	June 30, 2016	December 31, 2015
	(In Thousands)	
One- to four-family	\$3,834	\$ 4,610
Multi-family	402	209
Construction and land	5,346	5,262
Commercial real estate	300	300
Total real estate owned	9,882	10,381
Valuation allowance at end of period	(1,245)	(1,191)
Total real estate owned, net	\$8,637	\$ 9,190

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

	Six months ended June 30,	
	2016	2015
	(In Thousands)	
Real estate owned at beginning of the period	\$9,190	\$18,706
Transferred from loans receivable	3,123	9,066
Sales (net of gains / losses)	(3,325)	(12,484)
Write downs	(351)	(1,244)
Other	-	282
Real estate owned at the end of the period	\$8,637	\$14,326

Residential one- to four-family mortgage loans that were in the process of foreclosure were \$3.4 million and \$5.1 million at June 30, 2016 and December 31, 2015, respectively.

Note 5— Mortgage Servicing Rights

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

	Six months ended June 30, 2016 2015 (In Thousands)	
Mortgage servicing rights at beginning of the period	\$1,422	\$2,521
Additions	972	1,999
Amortization	(239)	(375)
Sales	-	(614)
Mortgage servicing rights at end of the period	2,155	3,531
Valuation allowance at end of period	(150)	(20)
Mortgage servicing rights at end of the period, net	\$2,005	\$3,511

During the six months ended June 30, 2016, \$1.0 billion in residential loans were originated for sale. During the same period, sales of loans held for sale totaled \$1.1 billion, generating mortgage banking income of \$55.6 million. The unpaid principal balance of loans serviced for others was \$291.6 million and \$176.4 million at June 30, 2016 and December 31, 2015, respectively. These loans are not reflected in the consolidated statements of financial condition.

During the six months ended June 30, 2016, the Company did not sell any mortgage servicing rights. During the six months ended June 30, 2015, the Company sold mortgage servicing rights related to \$87.3 million in loans receivable with a book value of \$614,000 for \$876,000 resulting in a gain on sale of \$262,000.

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

Estimate for the period ended December 31:	(In Thousands)
2016	\$ 204
2017	348
2018	304
2019	260
2020	218
Thereafter	671
Total	\$ 2,005

Note 6— Deposits

At June 30, 2016 and December 31, 2015, time deposits with balances greater than \$250,000 amounted to \$45.4 million and \$37.7 million, respectively.

A summary of the contractual maturities of time deposits at June 30, 2016 is as follows:

	(In Thousands)
Within one year	\$ 479,358
More than one to two years	192,580
More than two to three years	4,311
More than three to four years	3,986
More than four through five years	1,865
	\$ 682,100

Note 7— Borrowings

Borrowings consist of the following:

	June 30, 2016		December 31, 2015		
	Balance	Weighted Average Rate	Balance	Weighted Average Rate	
	(Dollars in Thousands)				
Short-term repurchase agreement	\$745	3.22 %	\$7,203	3.19 %	
Long term:					
Federal Home Loan Bank, Chicago advances maturing:					
2016	150,000	4.44 %	220,000	4.34 %	
2017	65,000	3.19 %	65,000	3.19 %	
2018	65,000	2.97 %	65,000	2.97 %	
2021	50,000	0.70 %	-	0.00 %	
Repurchase agreements maturing	2017 84,000	3.96 %	84,000	3.96 %	
	\$414,745	3.46 %	\$441,203	3.88 %	

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 \$745,000 balance at June 30, 2016 and a \$7.2 million balance at December 31, 2015.

The \$150.0 million in advances due in 2016 consists of five advances with fixed rates ranging from 4.25% to 4.82% callable quarterly until maturity.

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 \$50.0 million in advances due in 2021 consists of two advances with fixed rates ranging from 0.67% to 0.73% with a FHLB call option in June 2018.

The \$84.0 million in repurchase agreements have fixed rates ranging from 2.89% to 4.31% callable quarterly until their maturity in 2017. The repurchase agreements are collateralized by securities available for sale with an estimated fair value of \$93.0 million at June 30, 2016 and \$94.1 million at December 31, 2015.

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 80% of the carrying value of unencumbered one- to four-family mortgage loans, 51% of the carrying value of home equity loans and 75% of the carrying value of multi-family loans. In addition, these advances are collateralized by FHLBC stock of \$14.9 million at June 30, 2016 and \$19.5 million at December 31, 2015. 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 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 percent. A banking organization with a conservation buffer of less than 2.5 percent (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 the present time, 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 June 30, 2016 and December 31, 2015 are presented in the table below:

	June 30, 2016						To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Actual		For Capital Adequacy Purposes		Minimum Capital Adequacy with Capital Buffer		Amount	Ratio
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
(Dollars In Thousands)								
Total Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	\$412,262	33.17%	\$99,442	8.00%	\$107,211	8.625%	\$N/A	N/A
WaterStone Bank	383,720	30.91%	99,307	8.00%	107,065	8.625%	124,133	10.00%
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	396,723	31.92%	74,581	6.00%	82,350	6.625%	N/A	N/A
WaterStone Bank	368,202	29.66%	74,480	6.00%	82,238	6.625%	99,307	8.00%

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Common Equity Tier 1 Capital
(to risk-weighted assets)

Consolidated Waterstone

Financial, Inc.	396,723	31.92 %	55,936	4.50 %	63,705	5.125 %	N/A	N/A
WaterStone Bank	368,202	29.66 %	55,860	4.50 %	63,618	5.125 %	80,687	6.50 %

Tier 1 Capital (to average assets)

Consolidated Waterstone

Financial, Inc.	396,723	22.63 %	70,112	4.00 %	N/A	N/A	N/A	N/A
WaterStone Bank	368,202	21.06 %	69,919	4.00 %	N/A	N/A	87,399	5.00 %

State of Wisconsin (to total
assets)

WaterStone Bank	368,202	20.52 %	107,654	6.00 %	N/A	N/A	N/A	N/A
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December 31, 2015
(Dollars In Thousands)

Total Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	\$405,947	33.41 %	\$97,207	8.00 %	\$N/A	N/A	\$N/A	N/A
WaterStone Bank	374,435	30.92 %	96,885	8.00 %	N/A	N/A	121,106	10.00 %
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	390,747	32.16 %	72,905	6.00 %	N/A	N/A	N/A	N/A
WaterStone Bank	359,284	29.67 %	72,664	6.00 %	N/A	N/A	96,885	8.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	390,747	32.16 %	54,679	4.50 %	N/A	N/A	N/A	N/A
WaterStone Bank	359,284	29.67 %	54,498	4.50 %	N/A	N/A	78,719	6.50 %
Tier 1 Capital (to average assets)								
Consolidated Waterstone Financial, Inc.	390,747	22.20 %	70,417	4.00 %	N/A	N/A	N/A	N/A
WaterStone Bank	359,284	20.45 %	70,286	4.00 %	N/A	N/A	87,857	5.00 %
State of Wisconsin (to total assets)								
WaterStone Bank	359,284	20.43 %	105,493	6.00 %	N/A	N/A	N/A	N/A

Note 9 – Income Taxes

Income tax expense increased from \$4.8 million during the six months ended June 30, 2015 to \$6.7 million for the six months ended June 30, 2016. This increase was due to the increase in our income before income taxes, which increased from \$13.1 million during the six months ended June 30, 2015 to \$18.3 million during the six months ended June 30, 2016. Income tax expense is recognized on the statement of income during the six months ended June 30, 2016 at an effective rate of 36.4% of pretax income consistent with 36.4% during the six months ended June 30, 2015.

The Company has a deferred tax asset of \$857,000 related to stock options awarded in 2007. The stock options awarded in 2007 expire in January 2017. If these awards are not exercised, the Company will have to recognize additional tax expense equal to the amount of the deferred tax asset upon expiration. In the event that these options are exercised, the Company's tax deduction would be limited to the amount by which the fair market value of the stock, on the exercise date, exceeds the options strike price. Per ASC 718, the determination of a need for a valuation allowance against stock-based compensation awards by a company should not consider the current fair market value of its stock. Therefore, no valuation allowance has been recorded against these awards, even though these awards are currently out-of-the-money and may not be exercised.

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 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 June 30, 2016 and December 31, 2015.

	Gross Recognized Liabilities (In Thousands)	Gross Amounts Offset	Net Amounts Presented	Gross Amounts Not Offset	Net Amount
June 30, 2016					
Repurchase Agreements					
Short-term	\$745	\$ -	\$ 745	\$ 745	\$ -
Long-term	84,000	-	84,000	84,000	-
	\$84,745	\$ -	\$ 84,745	\$ 84,745	\$ -
December 31, 2015					
Repurchase Agreements					
Short-term	\$7,203	\$ -	\$ 7,203	\$ 7,203	\$ -
Long-term	84,000	-	84,000	84,000	-
	\$91,203	\$ -	\$ 91,203	\$ 91,203	\$ -

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 balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

	June 30, 2016	December 31, 2015
	(In Thousands)	
Financial instruments whose contract amounts represent potential credit risk:		
Commitments to extend credit under amortizing loans (1)	\$27,130	\$ 10,307
Commitments to extend credit under home equity lines of credit (2)	13,736	14,173
Unused portion of construction loans (3)	32,725	25,545
Unused portion of business lines of credit	15,134	16,392
Standby letters of credit	392	566

(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 ten 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 June 30, 2016 and December 31, 2015.

In the normal course of business, the Company, or its 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, et al. v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a lawsuit that was filed in the Federal District Court for the Western District of Wisconsin and has been transferred to arbitration, alleging that Waterstone Mortgage Corporation violated the Fair Labor Standards Act and failed to pay loan officers consistent with their various contracts. Waterstone Mortgage Corporation is and will continue to vigorously defend its interests in this matter.

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 June 30, 2016, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of approximately \$476.0 million and interest rate lock commitments with an aggregate notional amount of approximately \$273.8 million. The fair value of the forward commitments to sell mortgage loans at June 30, 2016 included a loss of \$2.9 million that is reported as a component of other liabilities on the Company's consolidated statement of financial condition. The fair value of the interest rate locks at June 30, 2016 included a gain of \$5.5 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, excluding outstanding participating securities. Participating securities include unvested restricted stock awards. Unvested restricted stock awards issued in 2012 are considered participating securities because holders of these securities have the right to receive dividends at the same rate as holders of the Company's common stock. 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 June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(In Thousands, except per share amounts)			
Net income	\$7,767	\$5,284	\$11,628	\$8,300
Net income available to unvested restricted shares	5	83	7	126
Net income available to common stockholders	\$7,762	\$5,201	\$11,621	\$8,174
Weighted average shares outstanding	26,919	29,841		