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

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.

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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.

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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 (In Thousands)	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
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 (In Thousands)	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
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 %

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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							