SI Financial Group, Inc.
Form 10-Q
November 09, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended September 30, 2016
OR

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

For the Transition Period from _______ to ______

Commission File Number: 0-54241

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

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

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

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

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large Accelerated Filer o	Accelerated Filer x
Non-Accelerated Filer o	Smaller Reporting Company o

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

Yes o No x

As of November 4, 2016, there were 12,210,104 shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.
SI FINANCIAL GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Amounts / Unaudited)

	September 30, 2016	December 31, 2015
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$ 14,924	$ 14,373
Interest-bearing	48,433	26,405
Total cash and cash equivalents	63,357	40,778
Available for sale securities, at fair value	170,691	175,132
Loans held for sale	698	1,804
Loans receivable (net of allowance for loan losses of $11,471 at September 30, 2016 and $9,863 at December 31, 2015)	1,206,532	1,165,372
Federal Home Loan Bank stock, at cost	12,370	12,874
Federal Reserve Bank stock, at cost	3,624	3,621
Bank-owned life insurance	21,136	21,924
Premises and equipment, net	20,409	21,188
Goodwill and other intangibles	17,644	18,096
Accrued interest receivable	4,109	4,283
Deferred tax asset, net	8,554	8,961
Other real estate owned, net	1,397	1,088
Other assets	7,555	6,713
Total assets	$ 1,538,076	$ 1,481,834
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 178,968	$ 163,893
Interest-bearing	957,976	894,124
Total deposits	1,136,944	1,058,017
Mortgagors' and investors' escrow accounts	2,178	3,508
Federal Home Loan Bank advances	208,588	234,595
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	22,293	23,136
Total liabilities	1,378,251	1,327,504
Shareholders' Equity:		
Preferred stock ($.01 par value; 1,000,000 shares authorized; none issued)	—	—
Common stock ($.01 par value; 35,000,000 shares authorized; 12,216,033 and 12,218,818 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively)	122	122
Additional paid-in-capital	125,433	124,997
Unallocated common shares held by ESOP	(3,288)	(3,648)
Unearned restricted shares	(434)	(815)

Retained earnings	37,233	33,864
Accumulated other comprehensive income (loss)	759	(190)
Total shareholders' equity	159,825	154,330
Total liabilities and shareholders' equity	$ 1,538,076	$ 1,481,834

See accompanying notes to unaudited interim consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest and dividend income:				
Loans, including fees	$11,579	$11,278	$34,656	$32,823
Securities:				
Taxable interest	855	766	2,601	2,253
Tax-exempt interest	14	14	42	63
Dividends	171	140	504	281
Other	84	19	217	57
Total interest and dividend income	12,703	12,217	38,020	35,477
Interest expense:				
Deposits	1,703	1,403	4,907	4,150
Federal Home Loan Bank advances	790	846	2,480	2,124
Subordinated debt and other borrowings	48	84	141	251
Total interest expense	2,541	2,333	7,528	6,525
Net interest income	10,162	9,884	30,492	28,952
Provision for loan losses	880	1,017	1,773	1,712
Net interest income after provision for loan losses	9,282	8,867	28,719	27,240
Noninterest income:				
Service fees	1,585	1,699	4,798	5,039
Wealth management fees	296	303	897	916
Increase in cash surrender value of bank-owned life insurance	136	146	413	449
Net gain on sales of securities	55	14	55	146
Mortgage banking	503	139	1,172	416
Net gain (loss) on fair value of derivatives	33	(7)	48	(22)
Net loss on disposal of equipment	(56)	(17)	(92)	(37)
Other	101	469	650	786
Total noninterest income	2,653	2,746	7,941	7,693
Noninterest expenses:				
Salaries and employee benefits	4,992	4,986	14,813	15,059
Occupancy and equipment	1,670	1,816	5,116	5,660
Computer and electronic banking services	1,367	1,413	4,311	4,168
Outside professional services	403	436	1,417	1,410
Marketing and advertising	92	259	543	779
Supplies	130	149	419	441
FDIC deposit insurance and regulatory assessments	263	255	788	748
Core deposit intangible amortization	151	150	452	451
Other real estate owned operations	54	160	179	444

Other	490	521	1,420	1,452
Total noninterest expenses	9,612	10,145	29,458	30,612
Income before income tax provision	2,323	1,468	7,202	4,321
Income tax provision	767	494	2,377	1,421
Net income	$1,556	$974	$4,825	$2,900
Earnings per share:				
Basic	$0.13	$0.08	$0.41	$0.24
Diluted	$0.13	$0.08	$0.41	$0.24

See accompanying notes to unaudited interim consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$1,556	$974	$4,825	$2,900
Other comprehensive income, net of tax:				
Available for sale securities:				
Net unrealized holding gains (losses)	(371)	411	985	633
Reclassification adjustment for gains recognized in net income (1)	(36)	(9)	(36)	(96)
Net unrealized holding gains (losses) on available for sale securities	(407)	402	949	537
Net unrealized gain on interest-rate	—	29	—	81

swap derivative				
Other comprehensive income (loss)	(407)	431	949	618
Comprehensive income	$1,149	$1,405	$5,774	$3,518

(1) Amounts are included in net gain on sales of securities in noninterest income on the consolidated statements of income. Income tax provision associated with the reclassification adjustment for both the three and nine months ended September 30, 2016 was $19,000 and for the three and nine months ended September 30, 2015 was $5,000 and $50,000, respectively.

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016
(In Thousands, Except Share Data / Unaudited)

	Common Stock			Unallocated			Accumulated	
	Shares	Dollars	Additional Paid-in Capital	Common Shares Held by ESOP	Unearned Restricted Shares	Retained Earnings	Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2015	12,218,818	$ 122	$ 124,997	$ (3,648)	$ (815)	$ 33,864	$ (190)	$ 154,330
Comprehensive income	—	—	—	—	—	4,825	949	5,774
Cash dividends declared ($0.12 per share)	—	—	—	—	—	(1,417)	—	(1,417)
Equity incentive plans compensation	—	—	307	—	381	—	—	688
Allocation of 36,477 ESOP shares	—	—	138	360	—	—	—	498
Tax benefit from share-based compensation	—	—	14	—	—	—	—	14
Stock options exercised	5,092	—	37	—	—	—	—	37
Common shares repurchased	(7,877)	—	(60)	—	—	(39)	—	(99)
Balance at September 30, 2016	12,216,033	$ 122	$ 125,433	$ (3,288)	$ (434)	$ 37,233	$ 759	$ 159,825

See accompanying notes to unaudited interim consolidated financial statements.

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

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	$4,825	$2,900
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,773	1,712
Employee stock ownership plan expense	498	425
Equity incentive plan expense	688	683
Excess tax benefit from share-based compensation	(14)	(5)
Amortization of investment premiums and discounts, net	614	851
Amortization of loan premiums and discounts, net	1,041	1,457
Depreciation and amortization of premises and equipment	1,814	2,036
Amortization of core deposit intangible	452	451
Amortization of deferred debt issue costs	—	16
Net gain on sales of securities	(55)	(146)
Net (gain) loss on fair value of derivatives	(48)	22
Deferred income tax (benefit) provision	(82)	53
Loans originated for sale	(33,512)	(18,807)
Proceeds from sale of loans held for sale	35,144	19,524
Net gain on sales of loans held for sale	(958)	(234)
Net loss on disposal of equipment	92	37
Net (gain) loss on sales or write-downs of other real estate owned	(1)	201
Increase in cash surrender value of bank-owned life insurance	(413)	(449)
Change in operating assets and liabilities:		
Accrued interest receivable	174	(377)
Other assets	(410)	727
Accrued expenses and other liabilities	(781)	33
Net cash provided by operating activities	10,841	11,110
Cash flows from investing activities:		
Purchases of available for sale securities	(29,493)	(35,450)
Proceeds from sales of available for sale securities	8,014	9,703
Proceeds from maturities of and principal repayments on available for sale securities	26,799	22,719
Purchases of Federal Home Loan Bank stock	—	(2,088)
Purchases of Federal Reserve Bank stock	(3)	(3,621)
Redemption of Federal Home Loan Bank stock	504	—
Loan principal originations, net	(11,155)	(4,996)
Purchases of loans	(33,660)	(96,640)
Proceeds from sales of other real estate owned	533	62
Purchases of premises and equipment	(1,127)	(2,031)
Proceeds from bank-owned life insurance	1,201	—
Net cash used in investing activities	(38,387)	(112,342)

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

	Nine Months Ended September 30,	
	2016	2015
Cash flows from financing activities:		
Net increase in deposits	78,927	32,417
Net decrease in mortgagors' and investors' escrow accounts	(1,330)	(1,654)
Proceeds from Federal Home Loan Bank advances	24,000	120,478
Repayments of Federal Home Loan Bank advances	(50,007)	(44,312)
Excess tax benefit from share-based compensation	14	5
Cash dividends on common stock	(1,417)	(1,444)
Stock options exercised	37	708
Common shares repurchased	(99)	(7,655)
Net cash provided by financing activities	50,125	98,543
Net change in cash and cash equivalents	22,579	(2,689)
Cash and cash equivalents at beginning of period	40,778	39,251
Cash and cash equivalents at end of period	$63,357	$36,562
Supplemental cash flow information:		
Interest paid	$7,559	$6,490
Income taxes paid, net	2,284	989
Transfer of loans to other real estate owned	841	333
Stock options exercised by net-share settlement	—	2,563

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016 AND 2015 AND DECEMBER 31, 2015

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

Nature of Business

SI Financial Group, Inc. (the “Company”) is the holding company for Savings Institute Bank and Trust Company (the “Bank”). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its 25 offices in eastern Connecticut and Rhode Island. Its primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans and consumer loans. In addition, wealth management services, which include trust, financial planning, life insurance and investment services, are offered to individuals and businesses through the Bank’s offices. The Company does not conduct any material business other than owning all of the stock of the Bank and making payments on the subordinated debentures held by the Company.

Principles of Consolidation

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

Basis of Financial Statement Presentation

The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, the instructions to Form 10-Q and Rule 10.01 of Regulation S-X of the Securities and Exchange Commission ("SEC") and general practices within the banking industry. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited financial statements of the Company and the accompanying notes for the year ended December 31, 2015 contained in the Company’s Form 10-K.

In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the periods covered herein. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the operating results for the year ending December 31, 2016 or for any other period.

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

Reclassifications

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

Loans Receivable

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

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

Troubled Debt Restructurings

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

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

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

Allowance for Loan Losses

The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loan losses are charged against the allowance for loan losses when management believes the uncollectibility of the principal loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received. In the determination of the allowance for loan losses, management may obtain independent appraisals for significant properties, when necessary.

Management's judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic and real estate market conditions, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, historical loan loss experience, the amount and trends of nonperforming loans, delinquencies, classified assets and loan charge-offs and evaluations of loans and other relevant factors.

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

- Specific allowance for identified impaired loans. For loans identified as impaired, an allowance is established when the present value of expected cash flows (or observable market price of the loan or fair value of the collateral if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan.

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

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

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

- Multi-family and Commercial – Loans in this segment are originated to acquire, develop, improve or refinance multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The underlying cash flows generated by the properties can be impacted by the economy as evidenced by increased vacancy rates. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. Management continually monitors the cash flows of these loans.

- Construction – This segment includes loans to individuals and, to a lesser extent, builders to finance the construction of residential dwellings. The Bank also originates construction loans for commercial development projects. Upon the completion of construction, the loan generally converts to a permanent mortgage loan. Credit risk is affected by cost overruns, correct estimates of the sale price of the property, time to sell at an adequate price and market conditions.

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

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

In computing the allowance for loan losses, we do not assign a general valuation allowance to the Small Business Administration (“SBA”) and United States Department of Agriculture (“USDA”) loans that we purchase as such loans are fully guaranteed. These loans are included in commercial business loans. See Note 4 for details.

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

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

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

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

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

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

Recent Accounting Pronouncements
Revenue from Contracts with Customers (Topic 606) - In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance that improves the revenue recognition requirements for contracts with customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve the core principle, a company should apply a five step approach to revenue recognition. In August 2015, the FASB delayed the effective date for this guidance for one year to fiscal years beginning after December 15, 2017, and we do not expect this to have a material impact on our financial statements.

Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs - In April 2015, FASB issued guidance simplifying the presentation of debt issuance costs. The amended guidance requires debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amended guidance was applied on a retrospective basis and effective for fiscal years, and interim periods within those years, that began after December 15, 2015. The adoption of the amended guidance on January 1, 2016 did not have a material impact on the Company’s consolidated financial statements.

Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements - In August 2015, the FASB issued amended guidance pursuant to the SEC Staff Announcement at the June 18, 2015 Emerging Issues Task Force meeting that the update issued in April 2015 does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance within the previous update for debt issuance costs related to line-of-credit-arrangements, the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there were any outstanding borrowings on the line-of-credit arrangement. The adoption of the amended guidance on January 1, 2016 did not have a material impact on the Company’s consolidated financial statements.

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

Leases (Topic 842): In February 2016, the FASB issued amended guidance to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is still reviewing the impact the adoption of this guidance will have on its consolidated financial statements.

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

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

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requires a modified retrospective transition under which a cumulative effect to equity will be recognized in the period of adoption. The Company is currently evaluating the impact the adoption of this guidance will have on its consolidated financial statements.

Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230): In August 2016, the FASB issued guidance to reduce the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This update provides guidance on eight specific cash flow issues. The update is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The amendments in this update should be applied using a retrospective transition method to each period presented. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

NOTE 2. EARNINGS PER SHARE

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

Anti-dilutive shares are common stock equivalents with weighted average exercise prices in excess of the weighted average market value for the periods presented, and are not considered in diluted earnings per share calculations. The Company had anti-dilutive common shares outstanding of 157,391 and 153,391 for the three and nine months ended September 30, 2016, respectively, and 321,793 and 342,819 for the three and nine months ended September 30, 2015, respectively.

The computation of earnings per share is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(Dollars in Thousands, Except Per Share Amounts)			
Net income	$1,556	$ 974	$4,825	$ 2,900
Weighted average common shares outstanding:				
Basic	11,815,313	11,793,218	11,802,574	12,036,573
Effect of dilutive stock options	53,334	21,713	57,369	28,485
Diluted	11,868,647	11,814,931	11,859,943	12,065,058

Earnings per share:				
Basic	$0.13	$ 0.08	$0.41	$ 0.24
Diluted	$0.13	$ 0.08	$0.41	$ 0.24

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NOTE 3. SECURITIES

Available for Sale Securities
The amortized cost, gross unrealized gains and losses and fair values of available for sale securities at September 30, 2016 and December 31, 2015 are as follows:

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	$ 66,367	$ 531	$ (582)	$ 66,316
Government-sponsored enterprises	11,282	296	—	11,578
Mortgage-backed securities:(1)				
Agency - residential	85,482	1,044	(221)	86,305
Non-agency - residential	100	—	(5)	95
Corporate debt securities	1,000	—	—	1,000
Collateralized debt obligation	1,158	—	(8)	1,150
Obligations of state and political subdivisions	1,000	—	—	1,000
Tax-exempt securities	3,152	95	—	3,247
Total available	$ 169,541	$ 1,966	$ (816)	$ 170,691

for sale securities

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

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	$ 71,142	$ 242	$ (388)	$ 70,996
Government-sponsored enterprises	25,313	95	(5)	25,403
Mortgage-backed securities:[1]				
Agency - residential	72,248	680	(962)	71,966
Non-agency - residential	116	—	(4)	112
Corporate debt securities	1,000	—	—	1,000
Collateralized debt obligation	1,156	—	(10)	1,146
Obligations of state and political subdivisions	1,270	1	—	1,271
Tax-exempt securities	3,175	64	(1)	3,238
Total available for sale securities	$ 175,420	$ 1,082	$ (1,370)	$ 175,132

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

or the U.S. Government.

The amortized cost and fair value of debt securities by contractual maturities at September 30, 2016 are presented below. Maturities are based on the final contractual payment dates and do not reflect the impact of potential prepayments or early redemptions. Because mortgage-backed securities ("MBS") are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	Amortized Cost	Fair Value
	(In Thousands)	
Within 1 year	$2,497	$2,507
After 1 but within 5 years	31,319	31,667
After 5 but within 10 years	8,563	8,618
After 10 years	41,580	41,499
	83,959	84,291
Mortgage-backed securities	85,582	86,400
Total debt securities	$169,541	$170,691

The following is a summary of realized gains and losses on the sales of securities for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In Thousands)			
Gross gains on sales	$55	$ 14	$55	$169
Gross losses on sales	—	—	—	(23)
Net gain on sales of securities	$55	$ 14	$55	$146

Proceeds from the sale of available for sale securities were $8.0 million for both the three and nine months ended September 30, 2016, respectively, and $0 and $9.7 million for the three and nine months ended September 30, 2015, respectively.

The following tables present information pertaining to securities with gross unrealized losses at September 30, 2016 and December 31, 2015, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position.

September 30, 2016	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
U.S. Government and agency obligations	$10,731	$ 96	$20,476	$ 486	$31,207	$ 582
Mortgage-backed securities:						
Agency - residential	29,660	77	10,511	144	40,171	221
Non-agency - residential	—	—	95	5	95	5
Collateralized debt obligation	—	—	1,150	8	1,150	8

Total	$40,391	$ 173	$32,232	$ 643	$72,623	$ 816

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December 31, 2015	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
U.S. Government and agency obligations	$9,374	$ 36	$18,715	$ 352	$28,089	$ 388
Government-sponsored enterprises	8,454	5	—	—	8,454	5
Mortgage-backed securities:						
Agency - residential	21,956	129	27,210	833	49,166	962
Non-agency - residential	—	—	112	4	112	4
Collateralized debt obligation	—	—	1,146	10	1,146	10
Tax-exempt securities	582	1	—	—	582	1
Total	$40,366	$ 171	$47,183	$ 1,199	$87,549	$ 1,370

At September 30, 2016, 36 debt securities with gross unrealized losses had aggregate depreciation of 1.10% of the Company's amortized cost basis. The unrealized losses are primarily related to the Company's U.S. Government and agency obligations and agency mortgage-backed securities. There were no investments deemed other-than-temporarily impaired for the three and nine months ended September 30, 2016 and 2015. The following summarizes, by security type, the basis for management's determination during the preparation of the financial statements of whether the applicable investments within the Company's securities portfolio were not other-than-temporarily impaired at September 30, 2016.

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

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

Collateralized Debt Obligation. The unrealized loss on the Company's collateralized debt obligation relates to one investment in a pooled trust preferred security ("PTPS") which management does not believe will suffer from any credit-related losses, based on its senior credit profile. The unrealized loss on this security is caused by the low interest rate environment as this security reprices quarterly to the three-month LIBOR and market spreads on similar newly issued securities have increased.

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NOTE 4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loan Portfolio
The composition of the Company's loan portfolio at September 30, 2016 and December 31, 2015 is as follows:

	September 30, 2016	December 31, 2015
	(In Thousands)	
Real estate loans:		
Residential - 1 to 4 family	$408,271	$417,458
Multi-family and commercial	414,516	385,341
Construction	36,276	21,786
Total real estate loans	859,063	824,585
Commercial business loans:		
SBA and USDA guaranteed	124,857	145,238
Time share	45,465	55,192
Condominium association	22,556	21,986
Medical loans	24,918	23,445
Other	82,851	45,588
Total commercial business	300,647	291,449

loans		
Consumer loans:		
Home equity	53,852	53,779
Indirect automobile	714	1,741
Other	1,716	1,946
Total consumer loans	56,282	57,466
Total loans	1,215,992	1,173,500
Deferred loan origination costs, net of fees	2,011	1,735
Allowance for loan losses	(11,471)	(9,863)
Loans receivable, net	$ 1,206,532	$ 1,165,372

The Company purchased commercial business loans totaling $33.7 million during the nine months ended September 30, 2016. For the twelve months ended December 31, 2015, the Company purchased commercial business loans totaling $113.2 million.

Allowance for Loan Losses

Changes in the allowance for loan losses for the three and nine months ended September 30, 2016 and 2015 are as follows:

Three Months Ended September 30, 2016	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	$1,026	$ 5,420	$ 798	$ 2,693	$ 706	$10,643
Provision for loan losses	106	183	141	442	8	880
Loans charged-off	(38)	(22)	—	—	(4)	(64)
Recoveries of loans previously charged-off	—	1	—	10	1	12
Balance at end of period	$1,094	$ 5,582	$ 939	$ 3,145	$ 711	$11,471

Nine Months Ended September 30, 2016	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	$1,036	$ 5,033	$ 516	$ 2,625	$ 653	$9,863
Provision for loan losses	150	485	423	534	181	1,773
Loans charged-off	(120)	(46)	—	(68)	(124)	(358)
Recoveries of loans previously charged-off	28	110	—	54	1	193
Balance at end of period	$1,094	$ 5,582	$ 939	$ 3,145	$ 711	$11,471

Three Months Ended September 30, 2015	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	$986	$ 3,766	$ 434	$ 2,618	$ 633	$8,437
Provision (credit) for loan losses	30	666	(7)	322	6	1,017
Loans charged-off	—	(136)	—	(140)	—	(276)
Recoveries of loans previously charged-off	41	22	—	5	—	68
Balance at end of period	$1,057	$ 4,318	$ 427	$ 2,805	$ 639	$9,246