Waterstone Financial, Inc.
Form 10-Q
October 30, 2018
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, 2018

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 every Interactive Data File required to be submitted 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 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

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 28,829,339 at October 29, 2018.

WATERSTONE FINANCIAL, INC.

10-Q INDEX

	Page No.
PART I. FINANCIAL INFORMATION	
Item l. Financial Statements	
Consolidated Statements of Financial Condition as of September 30, 2018 (unaudited) and December 31, 2017	3
Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017 (unaudited)	4
Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017 (unaudited)	5
Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2018 and 2017 (unaudited)	6
Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 (unaudited)	7
Notes to Consolidated Financial Statements (unaudited)	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	34 - 53
Item 3. Quantitative and Qualitative Disclosures about Market Risk	54
Item 4. Controls and Procedures	54
PART II. OTHER INFORMATION	55
Item 1. Legal Proceedings	55
Item 1A. Risk Factors	55
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	55
Item 3. Defaults Upon Senior Securities	56
Item 4. Mine Safety Disclosures	56
Item 5. Other Information	56
Item 6. Exhibits	56
Signatures	56

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

	(Unaudited) September 30, 2018	December 31, 2017
	(Dollars In Thousands, except share and per share data)	
Assets		
Cash	$32,966	$22,306
Federal funds sold	18,352	17,034
Interest-earning deposits in other financial institutions and other short term investments	7,538	9,267
Cash and cash equivalents	58,856	48,607
Securities available for sale (at fair value)	179,076	199,707
Loans held for sale (at fair value)	192,674	149,896
Loans receivable	1,357,656	1,291,814
Less: Allowance for loan losses	13,226	14,077
Loans receivable, net	1,344,430	1,277,737
Office properties and equipment, net	22,417	22,941
Federal Home Loan Bank stock (at cost)	19,575	16,875
Cash surrender value of life insurance	67,198	65,996
Real estate owned, net	2,170	4,558
Prepaid expenses and other assets	33,007	20,084
Total assets	$1,919,403	$1,806,401
Liabilities and Shareholders' Equity		
Liabilities:		
Demand deposits	$130,969	$129,597
Money market and savings deposits	159,742	148,804
Time deposits	713,739	688,979
Total deposits	1,004,450	967,380
Borrowings	451,132	386,285
Advance payments by borrowers for taxes	30,460	4,876
Other liabilities	28,717	35,756
Total liabilities	1,514,759	1,394,297
Shareholders' equity:		
Preferred stock (par value $.01 per share)		
Authorized - 50,000,000 shares in 2018 and in 2017, no shares issued	-	-
Common stock (par value $.01 per share)		
Authorized - 100,000,000 shares in 2018 and in 2017		
Issued - 29,049,939 in 2018 and 29,501,346 in 2017		
Outstanding - 29,049,939 in 2018 and 29,501,346 in 2017	291	295
Additional paid-in capital	329,743	326,655
Retained earnings	184,697	183,358
Unearned ESOP shares	(18,101)	(18,991)
Accumulated other comprehensive loss, net of taxes	(3,808)	(477)
Cost of shares repurchased (6,583,837 shares at September 30, 2018 and 6,030,900 shares at December 31, 2017)	(88,178)	(78,736)

Total shareholders' equity	404,644	412,104
Total liabilities and shareholders' equity	$1,919,403	$1,806,401

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,	
	2018	2017	2018	2017
	(In Thousands, except per share amounts)			
Interest income:				
Loans	$17,340	$15,855	$49,498	$45,078
Mortgage-related securities	643	647	1,925	2,021
Debt securities, federal funds sold and short-term investments	1,063	951	2,949	2,680
Total interest income	19,046	17,453	54,372	49,779
Interest expense:				
Deposits	3,063	1,981	8,087	5,614
Borrowings	2,133	2,439	5,574	6,756
Total interest expense	5,196	4,420	13,661	12,370
Net interest income	13,850	13,033	40,711	37,409
Provision for loan losses	40	20	(1,060)	(1,166)
Net interest income after provision for loan losses	13,810	13,013	41,771	38,575
Noninterest income:				
Service charges on loans and deposits	442	300	1,332	1,148
Increase in cash surrender value of life insurance	695	688	1,496	1,476
Loss on sale of securities	-	-	-	(107)
Mortgage banking income	32,653	31,863	88,930	92,774
Other	272	203	805	941
Total noninterest income	34,062	33,054	92,563	96,232
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	27,453	26,153	74,670	73,732
Occupancy, office furniture, and equipment	2,751	2,533	7,995	7,587
Advertising	1,224	821	3,084	2,414
Data processing	809	623	2,057	1,854
Communications	412	394	1,229	1,170
Professional fees	583	629	1,930	1,953
Real estate owned	(128)	(20)	63	258
FDIC insurance premiums	131	129	361	366
Other	3,191	3,054	9,921	10,227
Total noninterest expenses	36,426	34,316	101,310	99,561
Income before income taxes	11,446	11,751	33,024	35,246
Income tax expense	2,743	4,362	7,948	12,397
Net income	$8,703	$7,389	$25,076	$22,849
Income per share:				
Basic	$0.32	$0.27	$0.91	$0.83
Diluted	$0.31	$0.26	$0.90	$0.82
Weighted average shares outstanding:				
Basic	27,451	27,532	27,488	27,449
Diluted	27,680	27,953	27,765	27,927

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,	
	2018	2017	2018	2017
	(In Thousands)			
Net income	$8,703	$7,389	$25,076	$22,849
Other comprehensive (loss) income, net of tax:				
Net unrealized holding (loss) gain on available for sale securities:				
Net unrealized holding (loss) gain arising during the period, net of tax benefit (expense) of $240, ($59), $1,254, ($416), respectively	(641)	91	(3,336)	641
Reclassification adjustment for net loss included in net income during the period, net of tax benefit of $0, $0, $0, ($42) respectively	-	-	-	65
Reclassification adjustment for net deferred tax liability revaluation	-	-	5	-
Total other comprehensive (loss) income	(641)	91	(3,331)	706
Comprehensive income	$8,062	$7,480	$21,745	$23,555

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, 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 compensation activity, net of tax	176	2	820	-	-	-	-	822
Stock compensation expense	-	-	1,427	-	-	-	-	1,427
Purchase 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
Balances at December 31, 2017	29,501	$ 295	$ 326,655	$ 183,358	$ (18,991)	$ (477)	$ (78,736)	$ 412,104
Comprehensive income:								
Net income	-	-	-	25,076	-	-	-	25,076
Other comprehensive loss	-	-	-	-	-	(3,331)	-	(3,331)
Total comprehensive income								21,745
Reclassification for net deferred tax liability revaluation	-	-	-	(5)	-	-	-	(5)

ESOP shares committed to be released to Plan participants	-	-	472	-	890	-	-	1,362
Cash dividend, $0.86 per share	-	-	-	(23,732)	-	-	-	(23,732)
Stock based compensation activity	102	1	1,289	-	-	-	-	1,290
Stock compensation expense	-	-	1,327	-	-	-	-	1,327
Purchase of common stock returned to authorized but unissued	(553)	(5)	-	-	-	-	(9,442)	(9,447)
Balances at September 30, 2018	29,050	$ 291	$ 329,743	$ 184,697	$ (18,101)	$ (3,808)	$ (88,178)	$ 404,644

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2018	2017
	(In Thousands)	
Operating activities:		
Net income	$25,076	$22,849
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Provision for loan losses	(1,060)	(1,166)
Provision for depreciation	1,704	1,549
Stock based compensation	1,327	1,427
Net amortization of premium/discount on debt and mortgage related securities	373	524
Amortization of unearned ESOP shares	1,362	1,462
Amortization and impairment of mortgage servicing rights	146	71
Gain on sale of loans held for sale	(85,366)	(94,219)
Loans originated for sale	(1,927,627)	(1,881,351)
Proceeds on sales of loans originated for sale	1,970,215	2,025,682
Increase in accrued interest receivable	(457)	(294)
Increase in cash surrender value of life insurance	(1,496)	(1,476)
Increase in accrued interest on deposits and borrowings	268	2
Increase in other liabilities	3,108	336
Increase in prepaid tax expense	(266)	(2,088)
Loss on sale of securities	-	107
Net gain related to real estate owned	(211)	(11)
Gain on sale of mortgage servicing rights	-	(308)
Other	(10,840)	440
Net cash (used in) provided by operating activities	(23,744)	73,536
Investing activities:		
Net increase in loans receivable	(66,178)	(85,685)
Net change in FHLB stock	(2,700)	(5,175)
Purchases of:		
Debt securities	-	(6,140)
Mortgage related securities	(13,179)	(6,940)
Premises and equipment, net	(1,257)	(939)
Bank owned life insurance	(180)	(2,680)
Mortgage banking branch	(163)	-
Proceeds from:		
Principal repayments on mortgage-related securities	22,216	25,177
Maturities of debt securities	8,590	13,941
Sales of debt securities	-	448
Sales of real estate owned	3,128	3,104
Bank owned life insurance	474	-
Net cash used in investing activities	(49,249)	(64,889)
Financing activities:		
Net increase in deposits	37,070	7,362

Net change in short term borrowings	(25,153)	(7,652)
Repayment of long term debt	(165,000)	(69,000)
Proceeds from long term debt	255,000	125,000
Net change in advance payments by borrowers for taxes	13,268	6,021
Cash dividends on common stock	(23,786)	(23,636)
Purchase of common stock returned to authorized but unissued	(9,447)	(2,190)
Proceeds from stock option exercises	1,290	822
Net cash provided by financing activities	83,242	36,727
Increase in cash and cash equivalents	10,249	45,374
Cash and cash equivalents at beginning of period	48,607	47,217
Cash and cash equivalents at end of period	$58,856	$92,591
Supplemental information:		
Cash paid or credited during the period for:		
Income tax payments	$7,763	$14,141
Interest payments	13,393	12,368
Noncash activities:		
Loans receivable transferred to real estate owned	545	1,609
Dividends declared but not paid in other liabilities	3,458	3,877

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, 2017 Annual Report on Form 10-K. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 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." 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 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 completed its overall assessment of revenue streams and related contracts affected by the guidance, including asset management fees, deposit related fees, and other non-interest related fees. The Company adopted ASC 606 as of January 1, 2018 with no impact on total shareholders' equity or net income.

Revenue Recognition

The Company recognizes revenue as it is earned and noted no impact to its revenue recognition policies as a result of the adoption of ASC 606. The following is a discussion of revenues within the scope of the new revenue guidance:

Debit and credit card interchange fee income - Card processing fees consist of interchange fees from consumer debit and credit card networks and other card related services. Interchange fees are based on purchase volumes and other factors and are recognized as transactions occur.
Service charges on deposit accounts - Revenue from service charges on deposit accounts is earned through deposit-related services; as well as overdraft, non-sufficient funds, account management and other deposit-related fees. Revenue is recognized for these services either over time, corresponding with deposit accounts' monthly cycle, or at a point in time for transactional related services and fees.
Service charges on loan accounts - Revenue from loan accounts consists primarily of fees earned on prepayment penalties. Revenue is recognized for these services at a point in time for transactional related services and fees.

ASC Topic 825 "Financial Instruments." 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 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 Company adopted ASC 825 as of January 1, 2018 with no material impact on the Company's statements of operations or financial condition.

ASC Topic 842 "Leases." 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 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 authoritative guidance will be effective for reporting periods after January 1, 2019. The Company is evaluating the guidance and its impact on the Company's statements of operations and financial condition.

ASC Topic 326 "Financial Instruments - Credit Losses." 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 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 authoritative guidance will be effective for reporting periods after January 1, 2020. The Company is evaluating the guidance and its impact on the Company's statements of operations and financial condition.

ASC Topic 310 "Receivables - Nonrefundable Fees and Other Costs." 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 guidance and its impact on the Company's statements of operations and financial condition.

ASC Topic 220 "Income Statement - Reporting Comprehensive Income." Authoritative accounting guidance under ASC Topic 220, "Income Statement - Reporting Comprehensive Income" allows Companies to make a one-time reclassification from accumulated other comprehensive income (loss) to retained earnings for the effects of remeasuring deferred income taxes originally recorded in other comprehensive income as a result of the change in the federal income tax rate by the Tax Cuts and Jobs Act. The Company adopted this guidance as of January 1, 2018 with no impact on total shareholders' equity or net income.

- 9 -

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, 2018			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$45,384	$ 94	$ (1,112)	$44,366
Collateralized mortgage obligations:				
Government sponsored enterprise issued	66,072	-	(2,248)	63,824
Mortgage-related securities	111,456	94	(3,360)	108,190
Government sponsored enterprise bonds	500	-	(1)	499
Municipal securities	56,415	526	(291)	56,650
Other debt securities	15,003	-	(1,511)	13,492
Debt securities	71,918	526	(1,803)	70,641
Certificates of deposit	245	-	-	245
	$183,619	$ 620	$ (5,163)	$179,076

	December 31, 2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$57,351	$ 324	$ (240)	$57,435
Collateralized mortgage obligations:				
Government sponsored enterprise issued	61,313	3	(816)	60,500
Mortgage-related securities	118,664	327	(1,056)	117,935
Government sponsored enterprise bonds	2,500	-	(3)	2,497
Municipal securities	62,516	1,334	(81)	63,769
Other debt securities	15,005	12	(492)	14,525
Debt securities	80,021	1,346	(576)	80,791
Certificates of deposit	980	1	-	981
	$199,665	$ 1,674	$ (1,632)	$199,707

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, 2018, $1.9 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities. At December 31, 2017, $2.5 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities.

The amortized cost and fair values of investment securities by contractual maturity at September 30, 2018 are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized	Fair

	Cost	Value
	(In Thousands)	
Debt and other securities		
Due within one year	$2,750	$2,746
Due after one year through five years	26,710	26,503
Due after five years through ten years	31,038	31,405
Due after ten years	11,665	10,232
Mortgage-related securities	111,456	108,190
	$183,619	$179,076

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, 2018					
	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	$24,121	$ (530)	$17,479	$ (582)	$41,600	$ (1,112)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	30,376	(779)	31,427	(1,469)	61,803	(2,248)
Government sponsored enterprise bonds	-	-	499	(1)	499	(1)
Municipal securities	27,459	(253)	2,117	(38)	29,576	(291)
Other debt securities	4,980	(23)	8,512	(1,488)	13,492	(1,511)
	$86,936	$ (1,585)	$60,034	$ (3,578)	$146,970	$ (5,163)

	December 31, 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	$35,136	$ (143)	$4,464	$ (97)	$39,600	$ (240)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	37,949	(348)	21,651	(468)	59,600	(816)
Government sponsored enterprise bonds	2,497	(3)	-	-	2,497	(3)
Municipal securities	17,096	(80)	100	(1)	17,196	(81)
Other debt securities	-	-	9,508	(492)	9,508	(492)
	$92,678	$ (574)	$35,723	$ (1,058)	$128,401	$ (1,632)

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, 2016	$ 94
Credit-related impairments related to securities for which an other- than-temporary impairment was not previously recognized	-
Credit-related impairments on securities as of December 31, 2017	94
Credit-related impairments related to securities for which an other- than-temporary impairment was not previously recognized	-

Credit-related impairments on securities as of September 30, 2018	$	94

As of September 30, 2018, 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, 2018, this security had an amortized cost of $116,000 and total life-to-date impairment of $94,000.

As of September 30, 2018, the Company had 22 mortgage-backed securities, 26 government sponsored enterprise issued securities, six municipal bond securities, and one corporate debt security which had been in an unrealized loss position for twelve months or longer and represents a loss of 5.6% of the aggregate amortized cost. These securities were determined not to be other-than-temporarily impaired as of September 30, 2018. 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.

The unrealized losses for the other debt security with an unrealized loss greater than 12 months is due to the current slope of the yield curve. The security currently earns a fixed interest rate but transitions in the future to a floating rate that is indexed to the 10 year Treasury interest rate. The Company does not intend to sell nor does it believe that it will be required to sell the security before recovery of their amortized cost basis.

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, 2018, there were no sales of securities. 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, net of tax, from accumulated other comprehensive income.

Note 3 - Loans Receivable

Loans receivable at September 30, 2018 and December 31, 2017 are summarized as follows:

	September 30, 2018	December 31, 2017
	(In Thousands)	
Mortgage loans:		
Residential real estate:		
One- to four-family	$485,449	$439,597
Multi-family	586,563	578,440
Home equity	20,417	21,124
Construction and land	8,947	19,859
Commercial real estate	222,742	195,842
Consumer	400	255
Commercial loans	33,138	36,697
	$1,357,656	$1,291,814

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 $1.01 billion and $971.3 million at September 30, 2018 and December 31, 2017, respectively, are pledged as collateral against $435.0 million and $375.0 million in outstanding Federal Home Loan Bank of Chicago ("FHLBC") advances under a blanket security agreement at September 30, 2018 and December 31, 2017.

Certain of the Company's executive officers, directors, employees, and their related interests have loans with the Bank. As of September 30, 2018 and December 31, 2017, loans aggregating approximately $3.2 million and $4.5 million, respectively, were outstanding to such parties. None of these loans were considered impaired as of September 30, 2018 or December 31, 2017.

As of September 30, 2018 and December 31, 2017, 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, 2018 and December 31, 2017 follows:

	As of September 30, 2018					
	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	$3,792	$ 27	$3,720	$7,539	$477,910	$485,449
Multi-family	355	-	593	948	585,615	586,563
Home equity	263	-	111	374	20,043	20,417
Construction and land	-	-	-	-	8,947	8,947

Commercial real estate	-	-	172	172	222,570	222,742
Consumer	34	-	-	34	366	400
Commercial loans	-	-	26	26	33,112	33,138
Total	$4,444	$ 27	$4,622	$9,093	$1,348,563	$1,357,656

	As of December 31, 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	$1,494	$146	$3,516	$5,156	$434,441	$439,597
Multi-family	-	128	192	320	578,120	578,440
Home equity	68	-	56	124	21,000	21,124
Construction and land	-	-	-	-	19,859	19,859
Commercial real estate	-	-	184	184	195,658	195,842
Consumer	-	-	-	-	255	255
Commercial loans	-	42	26	68	36,629	36,697
Total	$1,562	$316	$3,974	$5,852	$1,285,962	$1,291,814

(1) Includes $442,000 and $241,000 at September 30, 2018 and December 31, 2017, respectively, which are on non-accrual status.

(2) Includes $- and $15,000 at September 30, 2018 and December 31, 2017, respectively, which are on non-accrual status.

(3) Includes $1.5 million and $1.8 million at September 30, 2018 and December 31, 2017, respectively, which are on non-accrual status.

A summary of the activity for the nine months ended September 30, 2018 and 2017 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, 2018								
Balance at beginning of period	$5,794	$ 4,431	$ 356	$ 949	$ 1,881	$ 10	$ 656	$14,077
Provision (credit) for loan losses	205	(491)	(57)	(702)	133	4	(152)	(1,060)
Charge-offs	(68)	(13)	(1)	-	-	-	-	(82)
Recoveries	150	82	18	40	1	-	-	291
Balance at end of period	$6,081	$ 4,009	$ 316	$ 287	$ 2,015	$ 14	$ 504	$13,226
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

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of September 30, 2018 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	$51	$-	$32	$ -	$ 21	$ -	$ -	$104
Allowance related to loans collectively evaluated for impairment	6,030	4,009	284	287	1,994	14	504	13,122
Balance at end of period	$6,081	$4,009	$316	$ 287	$ 2,015	$ 14	$ 504	$13,226
Loans individually evaluated for impairment	$7,903	$981	$217	$ -	$ 457	$ -	$ 26	$9,584
Loans collectively evaluated for impairment	477,546	585,582	20,200	8,947	222,285	400	33,112	1,348,072
Total gross loans	$485,449	$586,563	$20,417	$ 8,947	$ 222,742	$ 400	$ 33,138	$1,357,656

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of December 31, 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	$77	$-	$44	$ -	$ 34	$ -	$ -	$155
Allowance related to loans collectively evaluated for impairment	5,717	4,431	312	949	1,847	10	656	13,922
Balance at end of period	$5,794	$4,431	$356	$ 949	$ 1,881	$ 10	$ 656	$14,077
Loans individually evaluated for impairment	$7,418	$1,007	$185	$ -	$ 540	$ -	$ 26	$9,176
Loans collectively evaluated for impairment	432,179	577,433	20,939	19,859	195,302	255	36,671	1,282,638
Total gross loans	$439,597	$578,440	$21,124	$ 19,859	$ 195,842	$ 255	$ 36,697	$1,291,814

The following table presents information relating to the Company's internal risk ratings of its loans receivable as of September 30, 2018 and December 31, 2017:

	One to Four-Family	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
At September 30, 2018								
Substandard	$8,061	$ 981	$249	$ -	$ 732	$ -	$ 936	$10,959
Watch	6,053	326	421	-	109	-	923	7,832
Pass	471,335	585,256	19,747	8,947	221,901	400	31,279	1,338,865
	$485,449	$ 586,563	$20,417	$ 8,947	$ 222,742	$ 400	$ 33,138	$1,357,656
At December 31, 2017								
Substandard	$7,581	$ 1,135	$138	$ -	$ 1,124	$ -	$ 1,585	$11,563
Watch	4,939	330	401	-	295	-	741	6,706
Pass	427,077	576,975	20,585	19,859	194,423	255	34,371	1,273,545
	$439,597	$ 578,440	$21,124	$ 19,859	$ 195,842	$ 255	$ 36,697	$1,291,814

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. A member of the credit department, independent of the loan originator, performs a loan review 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, 2018 and December 31, 2017.

	As of or for the Nine Months Ended September 30, 2018					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
	(In Thousands)					
Total Impaired with Reserve						
One- to four-family	$467	$467	$ 51	$ -	$ 468	$ 24
Multi-family	-	-	-	-	-	-
Home equity	76	76	32	-	79	4
Construction and land	-	-	-	-	-	-
Commercial real estate	21	430	21	409	28	-
Consumer	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
	564	973	104	409	575	28
Total Impaired with no Reserve						
One- to four-family	7,436	8,386	-	950	7,577	311
Multi-family	981	1,817	-	836	874	51
Home equity	141	141	-	-	145	4
Construction and land	-	-	-	-	-	-
Commercial real estate	436	436	-	-	438	11
Consumer	-	-	-	-	-	-
Commercial	26	26	-	-	26	-
	9,020	10,806	-	1,786	9,060	377
Total Impaired						
One- to four-family	7,903	8,853	51	950	8,045	335
Multi-family	981	1,817	-	836	874	51
Home equity	217	217	32	-	224	8
Construction and land	-	-	-	-	-	-
Commercial real estate	457	866	21	409	466	11
Consumer	-	-	-	-	-	-
Commercial	26	26	-	-	26	-
	$9,584	$11,779	$ 104	$ 2,195	$ 9,635	$ 405

	As of or for the Year Ended December 31, 2017					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
	(In Thousands)					
Total Impaired with Reserve						
One- to four-family	$ 903	$ 903	$ 77	$ -	$ 913	$ 52
Multi-family	-	-	-	-	-	-
Home equity	79	79	44	-	83	6
Construction and land	-	-	-	-	-	-
Commercial real estate	34	443	34	409	43	-
Consumer	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
	1,016	1,425	155	409	1,039	58
Total Impaired with no Reserve						
One- to four-family	6,515	7,604	-	1,089	6,796	359
Multi-family	1,007	1,864	-	857	1,005	94
Home equity	106	106	-	-	111	5
Construction and land	-	-	-	-	-	-
Commercial real estate	506	506	-	-	513	19
Consumer	-	-	-	-	-	-
Commercial	26	26	-	-	26	-
	8,160	10,106	-	1,946	8,451	477
Total Impaired						
One- to four-family	7,418	8,507	77	1,089	7,709	411
Multi-family	1,007	1,864	-	857	1,005	94
Home equity	185	185	44	-	194	11
Construction and land	-	-	-	-	-	-
Commercial real estate	540	949	34	409	556	19
Consumer	-	-	-	-	-	-
Commercial	26	26	-	-	26	-
	$ 9,176	$ 11,531	$ 155	$ 2,355	$ 9,490	$ 535

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 $9.0 million of impaired loans as of September 30, 2018 for which no allowance has

been provided, $1.8 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, 2018, total impaired loans included $4.3 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, 2017, total impaired loans included $5.1 million of troubled debt restructurings.

The following presents data on troubled debt restructurings:

	As of September 30, 2018					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
One- to four-family	$2,740	2	$ 890	5	$3,630	7
Multi-family	-	-	388	2	388	2
Commercial real estate	285	1	21	1	306	2
	$3,025	3	$ 1,299	8	$4,324	11

	As of December 31, 2017					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
One- to four-family	$2,740	2	$1,156	7	$3,896	9
Multi-family	-	-	815	3	815	3
Home equity	47	1	-	-	47	1
Commercial real estate	290	1	34	1	324	2
	$3,077	4	$2,005	11	$5,082	15

At September 30, 2018, $4.3 million in loans had been modified in troubled debt restructurings and $1.3 million of these loans were included in the non-accrual loan total. The remaining $3.0 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 $21,000 valuation allowance has been established as of September 30, 2018 with respect to the $4.3 million in troubled debt restructurings. As of December 31, 2017, a $34,000 valuation allowance had been established with respect to the $5.1 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, 2018		
	Performing in accordance with	In Default	Total

	modified terms					
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
Interest reduction and principal forbearance	$3,404	6	$579	2	$3,983	8
Interest reduction	341	3	-	-	341	3
	$3,745	9	$579	2	$4,324	11

	As of December 31, 2017					
	Performing in accordance with modified terms		In Default		Total	
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
Interest reduction and principal forbearance	$4,022	9	$660	2	$4,682	11
Principal forbearance	47	1	-	-	47	1
Interest reduction	353	3	-	-	353	3
	$4,422	13	$660	2	$5,082	15

There were no loans modified as troubled debt restructurings during the three or nine months ended September 30, 2018 and September 30, 2017.

There were no troubled debt restructurings within the past twelve months for which there was a default during the three months or nine ended September 30, 2018 and September 30, 2017.

The following table presents data on non-accrual loans as of September 30, 2018 and December 31, 2017:

	September 30, 2018	December 31, 2017
	(Dollars in Thousands)	
Non-accrual loans:		
Residential		
One- to four-family	$5,162	$ 4,677
Multi-family	981	1,007
Home equity	203	107
Construction and land	-	-
Commercial real estate	172	251
Commercial	26	26
Consumer	-	-
Total non-accrual loans	$6,544	$ 6,068
Total non-accrual loans to total loans receivable	0.48 %	0.47 %
Total non-accrual loans to total assets	0.34 %	0.34 %

Note 4— Real Estate Owned

Real estate owned is summarized as follows:

	September 30, 2018	December 31, 2017
	(In Thousands)	
One- to four-family	$181	$ 1,330
Multi-family	-	-
Construction and land	3,327	4,582
Commercial real estate	300	300
Total real estate owned	3,808	6,212
Valuation allowance at end of period	(1,638)	(1,654)
Total real estate owned, net	$2,170	$ 4,558

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

	Nine months ended September 30,	
	2018	2017
	(In Thousands)	
Real estate owned at beginning of the period	$4,558	6,118
Transferred from loans receivable	545	1,609
Sales (net of gains / losses)	(2,632)	(2,654)
Write downs	(301)	(504)
Other	-	(1)
Real estate owned at the end of the period	$2,170	4,568

Residential one- to four-family mortgage loans that were in the process of foreclosure were $2.5 million and $2.3 million at September 30, 2018 and December 31, 2017, respectively.

Note 5— Mortgage Servicing Rights

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

	Nine months ended September 30,	
	2018	2017
	(In Thousands)	
Mortgage servicing rights at beginning of the period	$888	$2,260
Additions	357	793
Amortization	(146)	(71)
Sales	-	(2,264)
Mortgage servicing rights at end of the period	1,099	718
Valuation allowance at end of period	-	-
Mortgage servicing rights at end of the period, net	$1,099	$718

During the nine months ended September 30, 2018, $1.93 billion in residential loans were originated for sale on a consolidated basis. During the same period, sales of loans held for sale totaled $1.97 billion, generating mortgage banking income of $88.9 million. The unpaid principal balance of loans serviced for others was $158.3 million and $126.3 million at September 30, 2018 and December 31, 2017, respectively. These loans are not reflected in the consolidated statements of financial condition.

During the nine months ended September 30, 2018, the Company did not sell any mortgage servicing rights. 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.

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)
2018	$ 49
2019	138
2020	128
2021	119
2022	109
Thereafter	556
Total	$ 1,099

Note 6— Deposits

At September 30, 2018 and December 31, 2017, time deposits with balances greater than $250,000 amounted to $58.0 million and $45.9 million, respectively.

A summary of the contractual maturities of time deposits at September 30, 2018 is as follows:

	(In Thousands)
Within one year	$ 509,294
More than one to two years	193,084
More than two to three years	7,794
More than three to four years	1,992
More than four through five years	1,575
	$ 713,739

Note 7— Borrowings

Borrowings consist of the following:

	September 30, 2018			December 31, 2017		
	Balance	Weighted Average Rate		Balance	Weighted Average Rate	
	(Dollars in Thousands)					
Short term:						
Repurchase agreement	$16,132	5.51	%	$11,285	4.32	%
Federal Home Loan Bank, Chicago advances	5,000	2.24	%	35,000	1.28	%
Long term:						
Federal Home Loan Bank, Chicago advances maturing:						
2018	-	-		65,000	2.97	%
2021	-	-		100,000	0.78	%
2027	175,000	1.38	%	175,000	1.38	%
2028	255,000	2.37	%	-	-	
	$$ 451,132	2.10	%	$$ 386,285	1.57	%

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 $16.1 million balance at September 30, 2018 and an $11.3 million balance at December 31, 2017.

The $5.0 million short-term advance has a fixed rate of 2.24% and a maturity date of October 1, 2018.

The $175.0 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, one $25.0 million advance with a fixed rate of 1.23% with a FHLB single call option in August 2019, and one $50.0 million advance with a fixed rate of 1.73% with a FHLB single call option in December 2019.

The $255.0 million in advances due in 2028 consists of one $25.0 million advance with a fixed rate of 2.16% with a FHLB single call option in March 2020, two advances totaling $55.0 million with a fixed rate of 2.27% and with a FHLB single call option in March 2021, one advance of $25.0 million with a fixed rate of 2.40% and with a FHLB single call option in May 2020, two advances totaling $50.0 million with fixed rates of 2.34% and 2.48% and with a FHLB single call option in May 2021, one advance of $50.0 million with a fixed rate of 2.34% and with a FHLB quarterly call option beginning in June 2020, and one advance of $50.0 million with a fixed rate of 2.57% and with a FHLB quarterly call option beginning in September 2020.

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 77% of the carrying value of unencumbered one- to four-family mortgage loans, 75% of the carrying value of multi-family loans and 64% of the carrying value of home equity loans. In addition, these advances were collateralized by FHLBC stock of $19.6 million at September 30, 2018 and $16.9 million at December 31, 2017. 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.

As a result of the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act, the Federal Reserve Board is required to amend its small bank holding company and savings and loan holding company policy statement to provide that holding companies with consolidated assets of less than $3 billion that are (i) not engaged in significant nonbanking activities, (ii) do not conduct significant off-balance sheet activities, and (3) do not have a material amount of SEC-registered debt or equity securities, other than trust preferred securities, that contribute to an organization's complexity, will no longer be subject to regulatory capital requirements, effective no later than November 2018.

In addition, as a result of the legislation, the federal banking agencies are required to develop a "Community Bank Leverage Ratio" (the ratio of a bank's tangible equity capital to average total consolidated assets) for financial institutions with assets of less than $10 billion. A "qualifying community bank" that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered "well capitalized" under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution's risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement. The federal banking agencies must set the minimum capital for the new Community Bank Leverage Ratio at not less than 8% and not more than 10%. A financial institution can elect to be subject to this new definition.

The table below includes the 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, 2018, 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, 2018 and December 31, 2017 are presented in the table below:

	September 30, 2018			
	Actual	For Capital	Minimum Capital	To Be Well

			Adequacy Purposes		Adequacy with Capital Buffer		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.	$421,058	28.82 %	$116,891	8.00 %	$144,287	9.875 %	$N/A	N/A
WaterStone Bank	394,128	27.01 %	116,757	8.00 %	144,949	9.875 %	145,946	10.00 %
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	407,832	27.91 %	87,668	6.00 %	115,064	7.875 %	N/A	N/A
WaterStone Bank	380,902	26.10 %	87,568	6.00 %	116,757	7.875 %	116,757	8.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	407,832	27.91 %	65,751	4.50 %	93,147	6.375 %	N/A	N/A
WaterStone Bank	380,902	26.10 %	65,676	4.50 %	93,041	6.375 %	94,865	6.50 %
Tier 1 Capital (to average assets)								
Consolidated Waterstone Financial, Inc.	407,832	21.33 %	76,495	4.00 %	N/A	N/A	N/A	N/A
WaterStone Bank	380,902	19.92 %	76,495	4.00 %	N/A	N/A	95,618	5.00 %
State of Wisconsin (to total assets)								
WaterStone Bank	380,902	19.89 %	114,919	6.00 %	N/A	N/A	N/A	N/A

	December 31, 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.	$426,057	30.75%	$110,829	8.00%	$128,146	9.25%	$N/A	N/A
WaterStone Bank	400,792	28.93%	110,812	8.00%	128,127	9.25%	138,515	10.00%
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	411,980	29.74%	83,122	6.00%	100,439	7.25%	N/A	N/A
WaterStone Bank	386,715	27.92%	83,109	6.00%	100,424	7.25%	110,812	8.00%
Common Equity Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	411,980	29.74%	62,341	4.50%	79,658	5.75%	N/A	N/A
WaterStone Bank	386,715	27.92%	62,332	4.50%	79,646	5.75%	90,035	6.50%
Tier 1 Capital (to average assets)								
Consolidated Waterstone Financial, Inc.	411,980	22.43%	73,481	4.00%	N/A	N/A	N/A	N/A
WaterStone Bank	386,715	21.10%	73,304	4.00%	N/A	N/A	91,630	5.00%
State of Wisconsin (to total assets)								
WaterStone Bank	386,715	21.44%	108,243	6.00%	N/A	N/A	N/A	N/A

Note 9 – Income Taxes

Income tax expense decreased $4.4 million, or 35.9%, to $7.9 million for the nine months ended September 30, 2018 compared to $12.4 million during the nine months ended September 30, 2017. Income tax expense was recognized on the statement of income during the nine months ended September 30, 2018 at an effective rate of 24.1% of pretax income compared to 35.2% during the nine months ended September 30, 2017. The decrease in the effective rate primarily resulted from the federal tax rate decrease from 35% to 21% as a result of The Tax Cuts and Jobs Act that was enacted into law on December 22, 2017. During the nine months ended September 30, 2018, the Company recognized a benefit of approximately $197,000 related to stock awards exercised compared to a benefit of $827,000 recognized during the nine months ended September 30, 2017.

Note 10 – Offsetting of Assets and Liabilities

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. In addition, the Company enters into agreements under which it sells loans held for sale subject to an obligation to repurchase the same loans. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of assets. The obligation to repurchase the assets is reflected as a liability in the Company's consolidated statements of condition, while the securities and loans held for sale underlying the repurchase agreements remain in the respective investment securities and loans held for sale asset accounts. In other words, there is no offsetting or netting of the investment securities or loans held for sale assets with the repurchase agreement liabilities. The Company's repurchase agreement is subject to master netting agreements, which sets 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, 2018 and December 31, 2017.

	Gross Recognized Liabilities	Gross Amounts Offset	Net Amounts Presented	Gross Amounts Not Offset	Net Amount
	(In Thousands)				
September 30, 2018					
Repurchase Agreements					
Short-term	$16,132	$ -	$ 16,132	$16,132	$ -
	$16,132	$ -	$ 16,132	$16,132	$ -
December 31, 2017					
Repurchase Agreements					
Short-term	$11,285	$ -	$ 11,285	$11,285	$ -
	$11,285	$ -	$ 11,285	$11,285	$ -

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, 2018	December 31, 2017
	(In Thousands)	
Financial instruments whose contract amounts represent potential credit risk:		
Commitments to extend credit under amortizing loans (1)	$29,213	$ 31,543
Commitments to extend credit under home equity lines of credit (2)	14,850	14,972
Unused portion of construction loans (3)	49,850	17,097
Unused portion of business lines of credit	17,740	16,878
Standby letters of credit	839	259

(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, 2018 and December 31, 2017.

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 et al. v. Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is a defendant in a class action lawsuit that was 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 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. On December 8, 2017, the District Court confirmed the award in large part, and entered a judgment against Waterstone in the amount of $7,267,919 in damages to Claimants, $3,298,851 in attorney fees and costs, and a $20,000 incentive fee to Plaintiff Herrington, plus post-judgment interest. On February 12, 2018, the District Court awarded post-arbitration fees and costs of approximately $98,000. The judgment was appealed by Waterstone to the Seventh Circuit Court of Appeals, where oral argument was held on May 29, 2018. On October 22, 2018, the Seventh Circuit issued a ruling vacating the District Court's order enforcing the arbitration award. If the District Court determines the agreement only allows for individual arbitration, the award would be vacated and the case sent to individual arbitration for a new proceeding. If the District Court determines the arbitration agreement nevertheless allows for collective arbitration, the District Court could confirm the prior award.

If the judgment is upheld in full, the Company has estimated that the award, which includes attorney's fees, costs, and interest, could be as high as $11 million. However, Waterstone has meaningful appellate rights and intends to vigorously defend its interests in this matter, including arguing for complete reversal on appeal. Although the Company believes there is a strong basis to vacate the award, there remains a reasonable possibility that the Court's judgment will be affirmed in whole or in part, with the possible range of loss from $0 to $11 million. We do not believe that the loss is probable at this time, as that term is used in assessing loss contingencies. Accordingly, in accordance with the authoritative guidance in the evaluation of 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. On October 26, 2017, Plaintiffs moved for conditional certification and to provide notice to the putative class. On February 9, 2018, the Court denied Plaintiffs' motion for conditional certification and notice. The Company intends to continue 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, or 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, 2018, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of approximately $399.2 million and interest rate lock commitments with an aggregate notional amount of approximately $252.7 million. The fair value of the forward commitments to sell mortgage loans at September 30, 2018 included a gain of $1.6 million 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, 2018 included a gain of $1.8 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.

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.

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,	
	2018	2017	2018	2017
	(In Thousands, except per share amounts)			
Net income	$8,703	$7,389	$25,076	$22,849
Weighted average shares outstanding	27,451	27,532	27,488	27,449
Effect of dilutive potential common shares	229	421	277	478
Diluted weighted average shares outstanding	27,680	27,953	27,765	27,927
Basic earnings per share	$0.32	$0.27	$0.91	$0.83
Diluted earnings per share	0.31	0.26	0.90	0.82

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, 2018 and December 31, 2017, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

		Fair Value Measurements Using		
	September 30, 2018	Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$44,366	$-	$44,366	$-
Collateralized mortgage obligations				
Government sponsored enterprise issued	63,824	-	63,824	-
Government sponsored enterprise bonds	499	-	499	-
Municipal securities	56,650	-	56,650	-

Other debt securities	13,492	-	13,492	-
Certificates of deposit	245	-	245	-
Loans held for sale	192,674	-	192,674	-
Mortgage banking derivative assets	3,466	-	-	3,466
Mortgage banking derivative liabilities	-	-	-	-

		Fair Value Measurements Using		
	December 31, 2017	Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$57,435	$-	$57,435	$-
Collateralized mortgage obligations				
Government sponsored enterprise issued	60,500	-	60,500	-
Government sponsored enterprise bonds	2,497	-	2,497	-
Municipal securities	63,769	-	63,769	-
Other debt securities	14,525	-	14,525	-
Certificates of deposit	981	-	981	-
Loans held for sale	149,896	-	149,896	-
Mortgage banking derivative assets	2,004	-	-	2,004
Mortgage banking derivative liabilities	-	-	-	-

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 and other debt 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 change in fair value is recorded through an adjustment to the statement of comprehensive income.

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. The change in fair value is recorded through an adjustment to the statement of income.

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 change in fair value is recorded through an adjustment to the statement of income.

The table below presents reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2018 and 2017.

	Mortgage banking derivatives, net (In Thousands)
Balance at December 31, 2016	$ 3,334
Mortgage derivative loss, net	(1,330)
Balance at December 31, 2017	$ 2,004
Mortgage derivative gain, net	1,462
Balance at September 30, 2018	$ 3,466

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, 2018 and December 31, 2017, and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value.

		Fair Value Measurements Using		
	September 30, 2018	Level 1	Level 2	Level 3
	(In Thousands)			
Impaired loans, net (1)	$460	$-	$ -	$460
Real estate owned	2,170	-	-	2,170

		Fair Value Measurements Using		
	December 31, 2017	Level 1	Level 2	Level 3
	(In Thousands)			
Impaired loans, net (1)	$861	$-	$ -	$861
Real estate owned	4,558	-	-	4,558

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

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

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, 2018					December 31, 2017				
	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	$58,856	$58,856	$51,581	$7,275	$-	$48,607	$48,607	$39,607	$9,000	$-
rities able-for-sale	179,076	179,076	-	179,076	-	199,707	199,707	-	199,707	-
s held for	192,674	192,674	-	192,674	-	149,896	149,896	-	149,896	-
s receivable	1,357,656	1,278,679	-	-	1,278,679	1,291,814	1,291,142	-	-	1,291,
B stock	19,575	19,575	-	19,575	-	16,875	16,875	-	16,875	-
ued interest vable	5,381	5,381	5,381	-	-	4,924	4,924	4,924	-	-
gage cing rights	1,099	1,575	-	-	1,575	888	1,125	-	-	1,125
gage ing vative assets	3,466	3,466	-	-	3,466	2,004	2,004	-	-	2,004
ncial ilities										
osits	1,004,450	1,003,886	290,711	713,175	-	967,380	967,558	278,401	689,157	-
ance nents by owers for s	30,460	30,460	30,460	-	-	4,876	4,876	4,876	-	-
owings	451,132	445,500	-	445,500	-	386,285	384,348	-	384,348	-
ued interest ble	1,154	1,154	1,154	-	-	886	886	886	-	-
gage ing vative lities	-	-	-	-	-	-	-	-	-	-

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

The fair value estimation process for the loan portfolio uses an exit price concept and reflects discounts the Company believes are consistent with discounts in the market place. Fair values are estimated for portfolios of loans with similar characteristics. Loans are segregated by type such as one- to four-family, multi-family, home equity, construction and land, commercial real estate, commercial, and other consumer. The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for similar maturities. The fair value analysis also includes other assumptions to estimate fair value, intended to approximate those a market participant would use in an orderly transaction, with adjustments for discount rates, interest rates, liquidity, and credit spreads, as appropriate.

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, 2018 and December 31, 2017.

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 with the ability to lend in 47 states.

	As of or for the three months ended September 30, 2018			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income (loss)	$14,121	$(286)	$15	$13,850
Provision for loan losses	-	40	-	40
Net interest income (loss) after provision for loan losses	14,121	(326)	15	13,810
Noninterest income	1,312	33,165	(415)	34,062

Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	4,435	23,164	(146)	27,453
Occupancy, office furniture and equipment	826	1,925	-	2,751
FDIC insurance premiums	131	-	-	131
Real estate owned	(128)	-	-	(128)
Other	1,536	4,947	(264)	6,219
Total noninterest expenses	6,800	30,036	(410)	36,426
Income before income taxes	8,633	2,803	10	11,446
Income tax expense	2,003	737	3	2,743
Net income	$6,630	$2,066	$7	$8,703
Total assets	$1,901,441	$230,769	$(212,807)	$1,919,403

	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 nine months ended September 30, 2018			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$41,172	$(518)	$57	$40,711
Provision for loan losses	(1,150)	90	-	(1,060)
Net interest income (loss) after provision for loan losses	42,322	(608)	57	41,771
Noninterest income	3,388	90,443	(1,268)	92,563
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	13,624	61,483	(437)	74,670
Occupancy, office furniture and equipment	2,465	5,530	-	7,995
FDIC insurance premiums	361	-	-	361
Real estate owned	63	-	-	63
Other	4,557	14,457	(793)	18,221
Total noninterest expenses	21,070	81,470	(1,230)	101,310
Income before income taxes	24,640	8,365	19	33,024
Income tax expense	5,641	2,305	2	7,948

Net income	$18,999	$6,060	$17	$25,076

	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 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 (loss)	$14,517	$8,320	$ 12	$ 22,849

Note 16. - Business Combination

Academy Mortgage Corporation Branch

On June 29, 2018, Waterstone Mortgage Corporation, a subsidiary of WaterStone Bank SSB, completed an acquisition of a branch of Academy Mortgage Corporation, a mortgage banking company. Waterstone Mortgage Corporation paid Academy approximately $600,000 in cash for the transaction.

Waterstone Mortgage Corporation's acquisition of the branch was accounted for as a business combination. Under the transaction, fixed assets and a customer list were acquired and the branch leases were assumed. Under this method of accounting, assets acquired are recorded at their estimated fair values. Total consideration paid less the fair value of assets acquired was recorded as goodwill. The Company recorded an insignificant amount of goodwill as a result of this acquisition. The determination of estimated fair values required management to make certain estimates that are subjective in nature and may require adjustments upon the availability of new information regarding facts and circumstances which existed at the date of acquisition (i.e., appraisals) for up to a year following the acquisition. The Company continues to review information relating to events or circumstances existing at the acquisition date. Management's continuing review could result in adjustments to the acquisition date valuation amounts presented herein but does not anticipate that these adjustments will be material.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

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;
changes in monetary or fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board;
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 demand, 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;

- cyber attacks, computer viruses and other technological risks that may breach the security of our websites or other systems to obtain unauthorized access to confidential information and destroy data or disable our systems;
- technological changes that may be more difficult or expensive than expected;
- the ability of third-party providers to perform their obligations to us;
- the ability of the U.S. Government to manage federal debt limits;
- 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, 2017).

Overview

The following discussion and analysis is presented to assist the reader in understanding and evaluating 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, 2018 and 2017 and the financial condition as of September 30, 2018 compared to the financial condition as of December 31, 2017.
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, 2018 and 2017, 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, 2018 and 2017

Net income for the three months ended September 30, 2018 totaled $6.6 million compared to net income of $4.9 million for the three months ended September 30, 2017. Net interest income increased $1.0 million to $14.1 million for the three months ended September 30, 2018 compared to $13.1 million for the three months ended September 30, 2017. Net interest income increased due to an increase in average loan balances, an increase in loan rates, and a reduction in our overall cost of borrowings. The long-term borrowings that matured during 2017 and the first nine months ended September 30, 2018 were replaced with a lower cost mix of funding, including long and short-term borrowings and deposits raised through our retail network. There was no provision for loan losses for either the three months ended September 30, 2018 or the three months ended September 30, 2017.

Total noninterest income increased $151,000 due primarily to increases in loan fees, cash surrender value of life insurance, and other income. The loan fees increased primary due to increased loan prepayments. Cash surrender value of life insurance increased as the earnings rate improved slightly year over year. Other income increased primarily due to an increase in rental and wealth management income.

Compensation, payroll taxes, and other employee benefits expense decreased $48,000 to $4.4 million due primarily to a decrease in stock based compensation expenses partially offset by increases in salaries expense. Occupancy, office furniture, and equipment increased $93,000 due primarily to increased computer and maintenance expense. Real estate owned expense decreased as there was an increase in gain on sale of real estate owned and a decrease in writedowns. Other noninterest expense increased resulting from an increase in professional fees and advertising costs.

Comparison of Mortgage Banking Segment Results of Operations for the Three Months Ended September 30, 2018 and 2017

Net income totaled $2.1 million for the three months ended September 30, 2018 compared to $2.5 million for the three months ended September 30, 2017. We originated $761.2 million in mortgage loans held for sale during the three months ended September 30, 2018, which was an increase of $76.7 million, or 11.2%, from the $684.5 million originated during the three months ended September 30, 2017. The increase in loan production volume was driven by a 14.3% increase in mortgage purchase products offset by a 15.5% decrease in refinance products. Total mortgage banking noninterest income increased $847,000, or 2.6%, to $33.2 million during the three months ended September 30, 2018 compared to $32.3 million during the three months ended September 30, 2017. The increase in mortgage banking noninterest income related to an increase in volume. Offsetting the increase in volume, margins decreased approximately 10% for the three months ended September 30, 2018 compared to September 30, 2017. The margin compression reflects industry dynamics, as price-based competition has escalated to maintain market share in the face of lower demand.

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 92.1% of total originations during the three months ended September 30, 2018, compared to 89.6% of total originations during the three months ended September 30, 2017. The mix of loan type trended towards more conventional loans and less governmental loans; with conventional loans and governmental loans comprising 70.4% and 29.6% of all loan originations, respectively, during the three months ended September 30, 2018, compared 64.5% and 35.5% of all loan originations, respectively, during the three months ended September 30, 2017.

Total compensation, payroll taxes and other employee benefits increased $1.4 million, or 6.3%, to $23.2 million for the three months ended September 30, 2018 compared to $21.8 million for the three months ended September 30, 2017. The increase in compensation expense was primarily a result of the increase in salaries as the New Mexico branches were added at the end of the second quarter. In addition to the salaries increased, commission expense increased as volumes grew with the New Mexico expansion. Occupancy, office furniture, and equipment expense increased as the New Mexico branches were added. Other noninterest expense increased primarily due to increased origination expenses, advertising expenses, data processing expenses, and communication expenses offset by slightly lower legal fees.

Consolidated Waterstone Financial, Inc. Results of Operations

	Three months ended September 30,	
	2018	2017
	(Dollars in Thousands, except per share amounts)	
Net income	$8,703	7,389
Earnings per share - basic	0.32	0.27
Earnings per share - diluted	0.31	0.26
Annualized return on average assets	1.80 %	1.56 %