Waterstone Financial, Inc.
Form 10-Q
July 29, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2016

OR

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

Commission File Number 001-36271

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

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

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

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

Yes T No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes T No

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

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

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

Yes No T

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

WATERSTONE FINANCIAL, INC.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

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

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

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

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

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

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

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

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

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

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

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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

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

Repayment of long term debt	(70,000)	-
Proceeds from long term debt	50,000	-
Net change in advance payments by borrowers for taxes	175	1,924
Cash dividends on common stock	(2,671)	(3,113)
Purchase of common stock returned to authorized but unissued	(3,857)	(55,565)
Proceeds from stock option exercises	78	89
Net cash provided by (used in) financing activities	16,615	(60,311)
Decrease in cash and cash equivalents	(18,015)	(124,709)
Cash and cash equivalents at beginning of period	100,471	172,820
Cash and cash equivalents at end of period	$82,456	$48,111
Supplemental information:		
Cash paid or credited during the period for:		
Income tax payments	$6,545	$2,303
Interest payments	11,407	11,305
Noncash activities:		
Loans receivable transferred to real estate owned	3,123	9,066
Dividends declared but not paid in other liabilities	2,304	1,536

See Accompanying Notes to Unaudited Consolidated Financial Statements.

Note 1 — Basis of Presentation

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

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

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

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

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

The accompanying unaudited consolidated financial statements and related notes should be read in conjunction with the Company's December 31, 2015 Annual Report on Form 10-K. Operating results for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 or for any other period.

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

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

Impact of Recent Accounting Pronouncements

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

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

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

Note 2— Securities Available for Sale

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

	June 30, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$84,445	$ 2,388	$ (3)	$86,830
Collateralized mortgage obligations:				
Government sponsored enterprise issued	67,855	1,112	-	68,967
Mortgage-related securities	152,300	3,500	(3)	155,797
Government sponsored enterprise bonds	3,750	28	-	3,778
Municipal securities	72,371	3,155	(6)	75,520
Other debt securities	17,400	128	(628)	16,900
Debt securities	93,521	3,311	(634)	96,198
Certificates of deposit	1,715	16	-	1,731
	$247,536	$ 6,827	$ (637)	$253,726

	December 31, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$95,911	$ 1,004	$ (248)	$96,667
Collateralized mortgage obligations:				
Government sponsored enterprise issued	70,605	123	(300)	70,428
Mortgage-related securities	166,516	1,127	(548)	167,095
Government sponsored enterprise bonds	3,750	-	(4)	3,746
Municipal securities	77,509	1,730	(80)	79,159
Other debt securities	17,401	209	(647)	16,963
Debt securities	98,660	1,939	(731)	99,868
Certificates of deposit	2,695	4	(4)	2,695
	$267,871	$ 3,070	$ (1,283)	$269,658

The Company's mortgage-backed securities and collateralized mortgage obligations issued by government sponsored enterprises are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. At June 30, 2016, $93.0 million of the Company's mortgage related securities were pledged as collateral to secure repurchase agreement obligations of the Company. As of June 30, 2016, $2.2 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities. At December 31, 2015, $94.1 million of the Company's government sponsored enterprise bonds and $2.5 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities, respectively.

The amortized cost and fair values of investment securities by contractual maturity at June 30, 2016 are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Debt and other securities		
Due within one year	$10,945	$11,026
Due after one year through five years	19,526	19,799
Due after five years through ten years	42,011	44,103
Due after ten years	22,754	23,001
Mortgage-related securities	152,300	155,797
	$247,536	$253,726

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

	June 30, 2016					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(In Thousands)					
Mortgage-backed securities	$-	$ -	$2,177	$ (3)	$2,177	$ (3)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	-	-	-	-	-	-
Municipal securities	6,603	(6)	-	-	6,603	(6)
Other debt securities	-	-	9,372	(628)	9,372	(628)
Certificates of deposit	-	-	-	-	-	-
	$6,603	$ (6)	$11,549	$ (631)	$18,152	$ (637)

	December 31, 2015					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(In Thousands)					
Mortgage-backed securities	$18,488	$ (163)	$5,577	$ (85)	$24,065	$ (248)
Collateralized mortgage obligations:						
Government sponsored enterprise issued	48,281	(300)	-	-	48,281	(300)
Government sponsored enterprise bonds	3,246	(4)	-	-	3,246	(4)
Municipal securities	9,409	(18)	5,555	(62)	14,964	(80)
Other debt securities	14,363	(647)	-	-	14,363	(647)
Certificates of deposit	976	(4)	-	-	976	(4)
	$94,763	$ (1,136)	$11,132	$ (147)	$105,895	$ (1,283)

The Company reviews the investment securities portfolio on a quarterly basis to monitor its exposure to other-than-temporary impairment. In evaluating whether a security's decline in market value is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, the financial condition of the issuer and the underlying obligors, quality of credit enhancements, volatility of the fair value of the security, the expected recovery period of the security and ratings agency evaluations. In addition, the Company may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds and the value of any underlying collateral.

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

As of June 30, 2016, the Company had two mortgage-backed securities and one other debt security which had been in an unrealized loss position for twelve months or longer. These securities were determined not to be other-than-temporarily impaired as of June 30, 2016. The Company has determined that the decline in fair value of these securities is primarily attributable to an increase in market interest rates compared to the stated rates on these securities and is not attributable to credit deterioration. As the Company does not intend to sell nor is it more likely than not that it will be required to sell these securities before recovery of the amortized cost basis, these securities are not considered other-than-temporarily impaired.

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

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

Note 3 - Loans Receivable

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

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

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

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

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

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

	As of June 30, 2016					
	1-59 Days Past Due [1]	60-89 Days Past Due [2]	90 Days or Greater	Total Past Due	Current [3]	Total Loans
	(In Thousands)					
Mortgage loans:						
Residential real estate:						
One- to four-family	$1,064	$99	$5,441	$6,604	$376,425	$383,029
Multi-family	379	-	700	1,079	543,674	544,753
Home equity	30	-	58	88	23,085	23,173
Construction and land	-	-	66	66	16,776	16,842
Commercial real estate	-	-	209	209	134,328	134,537
Consumer	-	-	-	-	342	342
Commercial loans	-	2	26	28	27,332	27,360
Total	$1,473	$101	$6,500	$8,074	$1,121,962	$1,130,036

As of December 31, 2015

	1-59 Days Past Due [1]	60-89 Days Past Due [2]	90 Days or Greater	Total Past Due	Current [3]	Total Loans
	(In Thousands)					
Mortgage loans:						
Residential real estate:						
One- to four-family	$851	$1,133	$6,503	$8,487	$373,505	$381,992
Multi-family	—	207	1,858	2,065	545,185	547,250
Home equity	255	96	110	461	23,865	24,326
Construction and land	-	-	238	238	18,910	19,148
Commercial real estate	57	-	223	280	118,540	118,820
Consumer	-	-	-	-	361	361
Commercial loans	-	-	-	-	23,037	23,037
Total	$1,163	$1,436	$8,932	$11,531	$1,103,403	$1,114,934

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

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

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

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

	One- to Four-Family	Multi-Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
Six months ended June 30, 2016								
Balance at beginning of period	$7,763	$ 5,000	$ 433	$ 904	$ 1,680	$ 9	$ 396	$16,185
Provision (credit) for loan losses	(103)	(5)	(2)	(13)	52	1	275	205
Charge-offs	(464)	(445)	(62)	(3)	-	-	-	(974)
Recoveries	178	59	19	33	-	-	-	289
Balance at end of period	$7,374	$ 4,609	$ 388	$ 921	$ 1,732	$ 10	$ 671	$15,705

Six months ended June 30, 2015								
Balance at beginning of period	$9,877	$5,358	$422	$687	$1,951	$8	$403	$18,706
Provision (credit) for loan losses	1,402	(147)	(54)	47	(115)	(2)	9	1,140
Charge-offs	(1,220)	(1,304)	(48)	(47)	(45)	-	-	(2,664)
Recoveries	289	753	95	33	5	3	-	1,178
Balance at end of period	$10,348	$4,660	$415	$720	$1,796	$9	$412	$18,360

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

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

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

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

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

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

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

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

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

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

The following tables present data on impaired loans at June 30, 2016 and December 31, 2015.

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

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

	As of or for the Year Ended December 31, 2015					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
	(In Thousands)					
Total Impaired with Reserve						
One- to four-family	$7,903	$8,923	$1,114	$ 1,020	$ 8,113	$393
Multi-family	1,055	1,055	242	-	1,044	42
Home equity	169	169	108	-	174	10
Construction and land	156	269	3	113	155	-
Commercial real estate	314	723	106	409	367	23
Consumer	-	-	-	-	-	-
Commercial	3	3	3	-	5	1
	9,600	11,142	1,576	1,542	9,858	469
Total Impaired with no Reserve						
One- to four-family	10,482	11,991	-	1,509	10,676	500
Multi-family	4,045	5,090	-	1,045	4,106	245
Home equity	303	303	-	-	307	13
Construction and land	1,639	1,639	-	-	1,827	62
Commercial real estate	1,452	1,452	-	-	1,458	72
Consumer	-	-	-	-	-	-
Commercial	24	24	-	-	29	2
	17,945	20,499	-	2,554	18,403	894
Total Impaired						
One- to four-family	18,385	20,914	1,114	2,529	18,789	893
Multi-family	5,100	6,145	242	1,045	5,150	287
Home equity	472	472	108	-	481	23
Construction and land	1,795	1,908	3	113	1,982	62
Commercial real estate	1,766	2,175	106	409	1,825	95
Consumer	-	-	-	-	-	-
Commercial	27	27	3	-	34	3
	$27,545	$31,641	$1,576	$ 4,096	$ 28,261	$1,363

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

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

The determination as to whether an allowance is required with respect to impaired loans is based upon an analysis of the value of the underlying collateral and/or the borrower's intent and ability to make all principal and interest payments in accordance with contractual terms. The evaluation process is subject to the use of significant estimates and actual results could differ from estimates. This analysis is primarily based upon third party appraisals and/or a discounted cash flow analysis. In those cases in which no allowance has been provided for an impaired loan, the Company has determined that the estimated value of the underlying collateral exceeds the remaining outstanding balance of the loan. Of the total $15.4 million of impaired loans as of June 30, 2016 for which no allowance has been

provided, $2.5 million in charge-offs have been recorded to reduce the unpaid principal balance to an amount that is commensurate with the loans' net realizable value, using the estimated fair value of the underlying collateral. To the extent that further deterioration in property values continues, the Company may have to reevaluate the sufficiency of the collateral servicing these impaired loans resulting in additional provisions to the allowance for loans losses or charge-offs.

At June 30, 2016, total impaired loans included $11.6 million of troubled debt restructurings. Troubled debt restructurings involve granting concessions to a borrower experiencing financial difficulty by modifying the terms of the loan in an effort to avoid foreclosure. The vast majority of debt restructurings include a modification of terms to allow for an interest only payment and/or reduction in interest rate. The restructured terms are typically in place for six to twelve months. At December 31, 2015, total impaired loans included $17.5 million of troubled debt restructurings.

The following presents data on troubled debt restructurings:

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

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

At June 30, 2016, $11.6 million in loans had been modified in troubled debt restructurings and $4.1 million of these loans were included in the non-accrual loan total. The remaining $7.5 million, while meeting the internal requirements for modification in a troubled debt restructuring, were current with respect to payments under their original loan terms at the time of the restructuring and, therefore, continued to be included with accruing loans. Provided these loans perform in accordance with the modified terms, they will continue to be accounted for on an accrual basis.

All loans that have been modified in a troubled debt restructuring are considered to be impaired. As such, an analysis has been performed with respect to all of these loans to determine the need for a valuation reserve. When a loan is expected to perform in accordance with the restructured terms and ultimately return to and perform under contract terms, a valuation allowance is established for an amount equal to the excess of the present value of the expected future cash flows under the original contract terms as compared with the modified terms, including an estimated default rate. When there is doubt as to the borrower's ability to perform under the restructured terms or ultimately return to and perform under market terms, a valuation allowance is established equal to the impairment when the carrying amount exceeds fair value of the underlying collateral. As a result of the impairment analysis, a $442,000 valuation allowance has been established as of June 30, 2016 with respect to the $11.6 million in troubled debt restructurings. As of December 31, 2015, a $996,000 valuation allowance had been established with respect to the $17.5 million in troubled debt restructurings.

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

The following presents troubled debt restructurings by concession type:

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

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

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

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

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

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

Note 4— Real Estate Owned

Real estate owned is summarized as follows:

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

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

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

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

Note 5— Mortgage Servicing Rights

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

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

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

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

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

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

Note 6— Deposits

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

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

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

Note 7— Borrowings

Borrowings consist of the following:

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

The short-term repurchase agreement represents the outstanding portion of a total $35.0 million commitment with one unrelated bank. The short-term repurchase agreement is utilized by Waterstone Mortgage Corporation to finance loans originated for sale. This agreement is secured by the underlying loans being financed. Related interest rates are based upon the note rate associated with the loans being financed. The short-term repurchase agreement had a $745,000 balance at June 30, 2016 and a $7.2 million balance at December 31, 2015.

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

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

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

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

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

The Company selects loans that meet underwriting criteria established by the FHLBC as collateral for outstanding advances. The Company's borrowings from the FHLBC are limited to 80% of the carrying value of unencumbered one- to four-family mortgage loans, 51% of the carrying value of home equity loans and 75% of the carrying value of multi-family loans. In addition, these advances are collateralized by FHLBC stock of $14.9 million at June 30, 2016 and $19.5 million at December 31, 2015. In the event of prepayment, the Company is obligated to pay all remaining contractual interest on the advance.

Note 8 – Regulatory Capital

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

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

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

The actual and required capital amounts and ratios for the Bank as of June 30, 2016 and December 31, 2015 are presented in the table below:

	June 30, 2016							
	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.	$412,262	33.17%	$99,442	8.00%	$107,211	8.625%	$N/A	N/A
WaterStone Bank	383,720	30.91%	99,307	8.00%	107,065	8.625%	124,133	10.00%
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	396,723	31.92%	74,581	6.00%	82,350	6.625%	N/A	N/A
WaterStone Bank	368,202	29.66%	74,480	6.00%	82,238	6.625%	99,307	8.00 %

Common Equity Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	396,723	31.92 %	55,936	4.50 %	63,705	5.125 %	N/A	N/A
WaterStone Bank	368,202	29.66 %	55,860	4.50 %	63,618	5.125 %	80,687	6.50 %
Tier 1 Capital (to average assets)								
Consolidated Waterstone Financial, Inc.	396,723	22.63 %	70,112	4.00 %	N/A	N/A	N/A	N/A
WaterStone Bank	368,202	21.06 %	69,919	4.00 %	N/A	N/A	87,399	5.00 %
State of Wisconsin (to total assets)								
WaterStone Bank	368,202	20.52 %	107,654	6.00 %	N/A	N/A	N/A	N/A

	December 31, 2015 (Dollars In Thousands)							
Total Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	$405,947	33.41%	$97,207	8.00%	$N/A	N/A	$N/A	N/A
WaterStone Bank	374,435	30.92%	96,885	8.00%	N/A	N/A	121,106	10.00%
Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	390,747	32.16%	72,905	6.00%	N/A	N/A	N/A	N/A
WaterStone Bank	359,284	29.67%	72,664	6.00%	N/A	N/A	96,885	8.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)								
Consolidated Waterstone Financial, Inc.	390,747	32.16%	54,679	4.50%	N/A	N/A	N/A	N/A
WaterStone Bank	359,284	29.67%	54,498	4.50%	N/A	N/A	78,719	6.50 %
Tier 1 Capital (to average assets)								
Consolidated Waterstone Financial, Inc.	390,747	22.20%	70,417	4.00%	N/A	N/A	N/A	N/A
WaterStone Bank	359,284	20.45%	70,286	4.00%	N/A	N/A	87,857	5.00 %
State of Wisconsin (to total assets)								
WaterStone Bank	359,284	20.43%	105,493	6.00%	N/A	N/A	N/A	N/A

Note 9 – Income Taxes

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

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

Note 10 – Offsetting of Assets and Liabilities

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

The following table presents the liabilities subject to an enforceable master netting agreement as of June 30, 2016 and December 31, 2015.

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

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

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

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

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

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

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

The Company has determined that there are no probable losses related to commitments to extend credit or the standby letters of credit as of June 30, 2016 and December 31, 2015.

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

Note 12 – Derivative Financial Instruments

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

Forward commitments to sell mortgage loans represent commitments obtained by the Company from a secondary market agency to purchase mortgages from the Company at specified interest rates and within specified periods of time. Commitments to sell loans are made to mitigate interest rate risk on interest rate lock commitments to originate loans and loans held for sale. At June 30, 2016, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of approximately $476.0 million and interest rate lock commitments with an aggregate notional amount of approximately $273.8 million. The fair value of the forward commitments to sell mortgage loans at June 30, 2016 included a loss of $2.9 million that is reported as a component of other liabilities on the Company's consolidated statement of financial condition. The fair value of the interest rate locks at June 30, 2016 included a gain of $5.5 million that is reported as a component of other assets on the Company's consolidated statements of financial condition.

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

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

Note 13 – Earnings Per Share

Earnings per share are computed using the two-class method. Basic earnings per share is computed by dividing net income allocated to common shares by the weighted average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include unvested restricted stock awards. Unvested restricted stock awards issued in 2012 are considered participating securities because holders of these securities have the right to receive dividends at the same rate as holders of the Company's common stock. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding adjusted for the dilutive effect of all potential common shares.

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(In Thousands, except per share amounts)			
Net income	$7,767	$5,284	$11,628	$8,300
Net income available to unvested restricted shares	5	83	7	126
Net income available to common stockholders	$7,762	$5,201	$11,621	$8,174
Weighted average shares outstanding	26,919	29,841	26,942	31,098
Effect of dilutive potential common shares	285	350	301	315
Diluted weighted average shares outstanding	27,204	30,191	27,243	31,413
Basic earnings per share	$0.29	$0.17	$0.43	$0.26
Diluted earnings per share	$0.29	$0.17	$0.43	$0.26

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 position at their fair value on a recurring basis as of June 30, 2016 and December 31, 2015, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

		Fair Value Measurements Using		
	June 30, 2016	Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$86,830	$-	$86,830	$-
Collateralized mortgage obligations				
Government sponsored enterprise issued	68,967	-	68,967	-
Government sponsored enterprise bonds	3,778	-	3,778	-
Municipal securities	75,520	-	75,520	-

Other debt securities	16,900	2,467	14,433	-
Certificates of deposit	1,731	-	1,731	-
Loans held for sale	208,807	-	208,807	-
Mortgage banking derivative assets	5,488	-	-	5,488
Mortgage banking derivative liabilities	2,917	-	-	2,917

	December 31, 2015	Fair Value Measurements Using Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$96,667	$-	$96,667	$-
Collateralized mortgage obligations				
Government sponsored enterprise issued	70,428	-	70,428	-
Government sponsored enterprise bonds	3,746	-	3,746	-
Municipal securities	79,159	-	79,159	-
Other debt securities	16,963	2,600	14,363	-
Certificates of deposit	2,695	-	2,695	-
Loans held for sale	166,516	-	166,516	-
Mortgage banking derivative assets	2,313	-	-	2,313
Mortgage banking derivative liabilities	125	-	-	125

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

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

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

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

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The table below presents reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2016 and 2015.

	Mortgage banking derivatives, net (In Thousands)
Balance at December 31, 2014	$ 999
Mortgage derivative gain, net	1,189
Balance at December 31, 2015	$ 2,188
Mortgage derivative gain, net	383
Balance at June 30, 2016	$ 2,571

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 position at their fair value on a non-recurring basis as of June 30, 2016 and December 31, 2015, and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value.

		Fair Value Measurements Using		
	June 30, 2016	Level 1	Level 2	Level 3
	(In Thousands)			
Impaired loans, net (1)	$2,731	$-	$ -	$2,731
Real estate owned	8,637	-	-	8,637
Impaired mortgage servicing rights	1,564	-	-	1,564

		Fair Value Measurements Using		
	December 31, 2015	Level 1	Level 2	Level 3
	(In Thousands)			
Impaired loans, net (1)	$8,024	$-	$ -	$8,024
Real estate owned	9,190	-	-	9,190

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

Loans – We do not record loans at fair value on a recurring basis. On a non-recurring basis, loans determined to be impaired are analyzed to determine whether a collateral shortfall exists, and if such a shortfall exists, are recorded on our consolidated statements of financial condition at net realizable value of the underlying collateral. Fair value is determined based on third party appraisals. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of impaired loans, loans that have been deemed to be impaired are considered to be Level 3 in the fair value hierarchy of valuation techniques. At June 30, 2016, loans determined to be impaired with an outstanding balance of $3.5 million were carried net of specific reserves of $0.8 million for a fair value of $2.7 million. At December 31, 2015, loans determined to be impaired with an outstanding balance of $9.6 million were carried net of specific reserves of $1.6 million for a fair value of $8.0 million. Impaired loans collateralized by assets which are valued in excess of the net investment in the loan do not require any specific reserves.

Real estate owned – On a non-recurring basis, real estate owned, is recorded in our consolidated statements of financial condition at the lower of cost or fair value. Fair value is determined based on third party appraisals and, if less than the carrying value of the foreclosed loan, the carrying value of the real estate owned is adjusted to the fair value. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of the properties, real estate owned is considered to be Level 3 in the fair value hierarchy of valuation techniques. Changes in the value of real estate owned totaled $351,000 and $1.2 million during the six months ended June 30, 2016 and 2015, respectively and are recorded in real estate owned expense. At June 30, 2016 and December 31, 2015, real estate owned totaled $8.6 million and $9.2 million, respectively.

Mortgage servicing rights - The Company utilizes an independent valuation from a third party which uses a discounted cash flow model to estimate the fair value of mortgage servicing rights. The model utilizes prepayment assumptions to project cash flows related to the mortgage servicing rights based upon the current interest rate environment, which is then discounted to estimate an expected fair value of the mortgage servicing rights. The model considers characteristics specific to the underlying mortgage portfolio, such as: contractually specified servicing fees, prepayment assumptions, delinquency rates, late charges and costs to service. Given the significance of the unobservable inputs utilized in the estimation process, mortgage servicing rights are classified as Level 3 within the fair value hierarchy. The Company records the mortgage servicing rights at the lower of amortized cost or fair value. At June 30, 2016, the Company determined that $1.6 million of mortgage servicing rights were temporarily impaired, and as a result, recorded an impairment valuation allowance of $150,000. At December 31, 2015, there was no impairment identified for mortgage servicing rights.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2016, the significant unobservable inputs used in the fair value measurements were as follows:

				Significant Unobservable Input Value	
	Fair Value at June 30, 2016	Valuation Technique	Significant Unobservable Inputs	Minimum Value	Maximum Value
Mortgage banking derivatives	$2,571	Pricing models	Pull through rate	38.0 %	100.0 %
Impaired loans	2,731	Market approach	Discount rates applied to appraisals	15.0 %	30.0 %
Real estate owned	8,637	Market approach	Discount rates applied to appraisals	0.0 %	85.7 %
Impaired mortgage servicing rights	1,564	Pricing models	Prepayment rate	7.8 %	37.5 %
			Discount rate	10.0 %	11.0 %
			Cost to service	$75.76	$ 571.60

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

through rate is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. The pull through rate is computed using historical data and the ratio is periodically reviewed by the Company.

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

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

Fair value information about financial instruments follows, whether or not recognized in the consolidated statements of financial condition, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.
The carrying amounts and fair values of the Company's financial instruments consist of the following:

	June 30, 2016					December 31, 2015				
	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	$82,456	$82,456	$72,456	$10,000	$-	$100,471	$100,471	$100,471	$-	$-
rities able-for-sale	253,726	253,726	2,467	251,259	-	269,658	269,658	2,600	267,058	-
ns held for	208,807	208,807	-	208,807	-	166,516	166,516	-	166,516	-
ns receivable	1,130,036	1,172,946	-	-	1,172,946	1,114,934	1,165,370	-	-	1,165,
B stock	14,850	14,850	-	14,850	-	19,500	19,500	-	19,500	-
ued interest vable	4,129	4,129	4,129	-	-	4,108	4,108	4,108	-	-
gage cing rights	2,005	2,058	-	-	2,058	1,422	1,658	-	-	1,658
gage ing vative assets	5,488	5,488	-	-	5,488	2,313	2,313	-	-	2,313
ncial ilities										
osits	942,709	943,154	260,609	682,545	-	893,361	894,015	243,304	650,711	-
ance nents by owers for s	16,011	16,011	16,011	-	-	3,661	3,661	3,661	-	-
owings	414,745	423,122	-	423,122	-	441,203	463,238	-	463,238	-
ued interest ble	1,431	1,431	1,431	-	-	1,642	1,642	1,642	-	-
gage ing vative lities	2,917	2,917	-	-	2,917	125	125	-	-	125

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

Cash and Cash Equivalents

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

Securities

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

Loans Held for Sale

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

Loans Receivable

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

FHLB Stock

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

Deposits and Advance Payments by Borrowers for Taxes

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

Borrowings

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

Accrued Interest Payable and Accrued Interest Receivable

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

Commitments to Extend Credit and Standby Letters of Credit

Commitments to extend credit and standby letters of credit are generally not marketable. Furthermore, interest rates on any amounts drawn under such commitments would be generally established at market rates at the time of the draw. Fair values for the Company's commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the counterparty's credit standing, and discounted cash flow analyses. The fair value of the Company's commitments to extend credit was not material at June 30, 2016 and December 31, 2015.

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 21 states.

	As of or for the three months ended June 30, 2016			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$9,962	$132	$71	$10,165
Provision for loan losses	-	-	-	-
Net interest income after provision for loan losses	9,962	132	71	10,165
Noninterest income	1,203	35,400	(252)	36,351
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	4,037	21,787	(115)	25,709
Occupancy, office furniture and equipment	816	1,603	-	2,419
FDIC insurance premiums	155	-	-	155
Real estate owned	163	-	-	163
Other	1,264	4,615	(94)	5,785
Total noninterest expenses	6,435	28,005	(209)	34,231
Income before income taxes	4,730	7,527	28	12,285
Income tax expense	1,421	3,087	10	4,518
Net income	$3,309	$4,440	$18	$7,767
Total assets	$1,793,197	$246,295	$(240,226)	$1,799,266

	As of or for the three months ended June 30, 2015			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$9,742	$230	$88	$10,060
Provision for loan losses	650	155	-	805
Net interest income after provision for loan losses	9,092	75	88	9,255
Noninterest income	920	30,231	(111)	31,040
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	3,807	19,572	(107)	23,272
Occupancy, office furniture and equipment	801	1,468	-	2,269
FDIC insurance premiums	271	-	-	271

Real estate owned	687	(1)	-	686
Other	1,135	4,220	94	5,449
Total noninterest expenses	6,701	25,259	(13)	31,947
Income before income taxes	3,311	5,047	(10)	8,348
Income tax expense	917	2,112	35	3,064
Net income (loss)	$2,394	$2,935	$(45)	$5,284
Total assets	$1,706,005	$231,948	$(200,730)	$1,737,223

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	As of or for the six months ended June 30, 2016			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$ 19,733	$ 277	$ 138	$ 20,148
Provision for loan losses	100	105	-	205
Net interest income after provision for loan losses	19,633	172	138	19,943
Noninterest income	1,925	56,333	(462)	57,796
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	8,392	35,231	(228)	43,395
Occupancy, office furniture and equipment	1,648	3,107	-	4,755
FDIC insurance premiums	360	-	-	360
Real estate owned	307	-	-	307
Other	2,453	8,337	(154)	10,636
Total noninterest expenses	13,160	46,675	(382)	59,453
Income before income taxes	8,398	9,830	58	18,286
Income tax expense	2,604	4,030	24	6,658
Net income	$ 5,794	$ 5,800	$ 34	$ 11,628

	As of or for the six months ended June 30, 2015			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(In Thousands)			
Net interest income	$ 18,975	$ 350	$ 171	$ 19,496
Provision for loan losses	950	190	-	1,140
Net interest income after provision for loan losses	18,025	160	171	18,356
Noninterest income	1,678	51,557	(162)	53,073
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	8,535	33,027	(212)	41,350
Occupancy, office furniture and equipment	1,647	3,065	-	4,712
FDIC insurance premiums	607	-	-	607
Real estate owned	1,214	15	-	1,229
Other	2,104	8,199	174	10,477
Total noninterest expenses	14,107	44,306	(38)	58,375
Income before income taxes	5,596	7,411	47	13,054
Income tax expense	1,582	3,101	71	4,754
Net income (loss)	$ 4,014	$ 4,310	$ (24)	$ 8,300

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

Forward-Looking Information

This 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;
- Estimates of our risks and future costs and benefits.

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

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

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

See also the factors referred to in reports filed by the Company with the Securities and Exchange Commission (particularly those under the caption "Risk Factors" in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2015).

Overview

The following discussion and analysis is presented to assist the reader in understanding and evaluating of the Company's financial condition and results of operations. It is intended to complement the unaudited consolidated financial statements, footnotes, and supplemental financial data appearing elsewhere in this 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 six months ended June 30, 2016 and 2015 and the financial condition as of June 30, 2016 compared to the financial condition as of December 31, 2015.
As described in the notes to 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. 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 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 six months ended June 30, 2016 and 2015, which focuses on noninterest income and noninterest expenses. We have also provided a discussion of the consolidated operations of Waterstone Financial, 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 June 30, 2016 and 2015

Net income for the three months ended June 30, 2016 totaled $3.3 million compared to net income of $2.4 million for the three months ended June 30, 2015. Net interest income increased $220,000 to $10.0 million for the three months ended June 30, 2016 compared to $9.7 million for the three months ended June 30, 2015. The provision for loan losses decreased $650,000 compared to the prior year comparable period. Compensation, payroll taxes, and other employee benefits expense increased due primarily to increases in variable compensation and stock compensation. The Bank also reported increases in occupancy, office furniture, and equipment expense and other noninterest expense for the three months ended June 30, 2016 compared to the three months ended June 30, 2015. FDIC insurance premiums and real estate owned expense decreased for the second quarter of 2016 compared to the previous year period.

Comparison of Mortgage Banking Segment Results of Operations for the Three Months Ended June 30, 2016 and 2015

Net income totaled $4.4 million for the three months ended June 30, 2016 compared to net income of $2.9 million for the three months ended June 30, 2015. Mortgage banking segment revenue increased $5.2 million, or 17.1%, to $35.4 million for the three months ended June 30, 2016 compared to $30.2 million for the three months ended June 30, 2015. The increase in revenue was attributable to an increase in origination volume and an increase in margin. While mortgage segment revenue increased 17.1%, total noninterest expenses increased $2.7 million, or 10.9%, to $28.0 million for the three months ended June 30, 2016 compared to $25.3 million for the three months ended June 30, 2015. The increase in noninterest expenses resulted from an increase in commissions paid, which correlates to the increase in origination volume, resulting in $2.2 million additional compensation, payroll taxes, and other employee benefits expense.

Loans originated by the mortgage banking segment for the purpose of sale in the secondary market increased $79.0 million, or 13.3%, to $675.1 million during the three months ended June 30, 2016, compared to $596.1 million for the three months ended June 30, 2015. The increase in originations was driven by an increase in the origination of loans made for the purpose of residential purchases, which yield a higher margin than refinance loans, partially offset by a decrease in the origination of mortgage refinance loans. Our origination efforts continue to be focused on loans made for the purpose of residential purchases, as opposed to mortgage refinance. Origination volume related to purchase activity accounted for 88% and 86% of total originations for the three months ended June 30, 2016 and 2015, respectively.

Consolidated Waterstone Financial, Inc. Results of Operations

	Three months ended June 30,	
	2016	2015
	(Dollars in Thousands, except per share amounts)	
Net income	$7,767	$5,284
Earnings per share - basic	0.29	0.17
Earnings per share - diluted	0.29	0.17
Annualized return on average assets	1.78 %	1.21 %
Annualized return on average equity	7.86 %	5.04 %

Net Interest Income

Average Balance Sheets, Interest and Yields/Costs

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

	Three months ended June 30,							
	2016				2015			
	Average Balance	Interest	Yield/Cost		Average Balance	Interest	Yield/Cost	
	(Dollars in Thousands)							
Assets								
Interest-earning assets:								
Loans receivable and held for sale (1)	$1,261,199	$14,073	4.49	%	$1,240,703	$14,065	4.55	%
Mortgage related securities (2)	160,613	790	1.98	%	175,498	820	1.87	%
Debt securities, federal funds sold and short-term investments (2)(3)	212,545	1,110	2.10	%	225,319	1,090	1.94	%
Total interest-earning assets	1,634,357	15,973	3.93	%	1,641,520	15,975	3.90	%
Noninterest-earning assets	119,033				112,600			
Total assets	$1,753,390				$1,754,120			
Liabilities and equity								
Interest-bearing liabilities:								
Demand accounts	$33,681	5	0.06	%	$31,335	5	0.06	%
Money market and savings accounts	163,219	106	0.26	%	131,716	30	0.09	%
Time deposits	675,306	1,724	1.03	%	630,230	1,323	0.84	%
Total interest-bearing deposits	872,206	1,835	0.85	%	793,281	1,358	0.69	%
Borrowings	388,933	3,748	3.88	%	446,983	4,324	3.88	%
Total interest-bearing liabilities	1,261,139	5,583	1.78	%	1,240,264	5,682	1.84	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	70,273				66,399			
Other noninterest-bearing liabilities	24,358				26,992			
Total noninterest-bearing liabilities	94,631				93,391			
Total liabilities	1,355,770				1,333,655			
Equity	397,620				420,465			
Total liabilities and equity	$1,753,390				$1,754,120			
Net interest income / Net interest rate spread (4)		10,390	2.15	%		10,293	2.07	%
Less: taxable equivalent adjustment		225	0.06	%		233	0.06	%
Net interest income / Net interest rate spread, as reported		$10,165	2.09	%		$10,060	2.01	%
Net interest-earning assets (5)	$373,218				$401,256			
Net interest margin (6)			2.50	%			2.46	%
Tax equivalent effect			0.06	%			0.06	%
			2.56	%			2.52	%

Net interest margin on a fully tax equivalent basis (6)				
Average interest-earning assets to average interest-bearing liabilities	129.59	%	132.35	%

(1) Interest income includes net deferred loan fee amortization income of $190,000 and $163,000 for the three months ended June 30, 2016 and 2015, respectively.
(2) Average balance of mortgage related and debt securities are based on amortized historical cost.
(3) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented. The yields on debt securities, federal funds sold and short-term investments before tax-equivalent adjustments were 1.67% and 1.53% for the three months ended June 30, 2016 and 2015, respectively.
(4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities and is presented on a fully tax equivalent basis.
(5) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
(6) Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

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

	Three months ended June 30, 2016 versus 2015 Increase (Decrease) due to		
	Volume	Rate	Net
	(In Thousands)		
Interest income:			
Loans receivable and held for sale (1)(2)	$37	$(29)	$8
Mortgage related securities (3)	(88)	58	(30)
Other earning assets (3)(4)	(65)	85	20
Total interest-earning assets	(116)	114	(2)
Interest expense:			
Demand accounts	-	-	-
Money market and savings accounts	8	68	76
Time deposits	99	302	401
Total interest-earning deposits	107	370	477
Borrowings	(571)	(5)	(576)
Total interest-bearing liabilities	(464)	365	(99)
Net change in net interest income	$348	$(251)	$97

(1) Interest income includes net deferred loan fee amortization income of $190,000 and $163,000 for the three months ended June 30, 2016 and 2015, respectively.
(2) Non-accrual loans have been included in average loans receivable balance.
(3) Includes available for sale securities. Average balance of available for sale securities is based on amortized historical cost.
(4) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented.

Net interest income increased $105,000, or 1.0%, to $10.2 million during the three months ended June 30, 2016 compared to $10.1 million during the three months ended June 30, 2015.

- Interest income on loans increased $8,000 due primarily to an increase of $20.5 million in average loans offset by an six basis point decrease in average yield on loans. The increase in average loan balance was driven by a $43.2 million increase in the average balance of loans held in portfolio, partially offset by a $22.7 million decrease in the average balance of loans held for sale.
- Interest income from mortgage-related securities decreased $30,000 year over year as the average balance decreased $14.9 million, which was offset by an increase in rate. As securities have paid down in 2015 and 2016, less purchases have occurred to replace those securities due to current market conditions.
- Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) increased $28,000 due to a 14 basis point increase in the average yield. The increase in average yield was driven by a 25 basis point increase in the Federal Funds rate in December 2015, as well as an increase in the cash dividend paid by the FHLB on its stock. The increase in interest income due to an increase in rate was partially offset by a $12.8 million decrease in average balance, as liquid funds were utilized to fund loan growth and pay off maturing FHLB advances.
- Interest expense on time deposits increased $401,000 primarily due to a 19 basis point increase in the average cost of funds, as maturing time deposits have repriced, or have been replaced at a higher rate in the current competitive market. In addition, to an increase in rate, the average balance of time deposits increased compared to the prior year, which reflects the Company's decision to raise funds through our retail delivery channels to pay off FHLB advances that matured during the first half of 2016.
- Interest expense on money market and savings accounts increased $76,000 due to an increase in both rate and average balance. Increases in both rate and volume reflect the Company's strategy to target this segment of retail funds for more aggressive growth.
- Interest expense on borrowings decreased $576,000 due primarily to the maturity of $70.0 million of fixed rate borrowings that were paid off during the current year with lower rate long term fixed borrowings and funds raised through our retail delivery channels.
- A total of $20.0 million FHLB borrowings at a weighted average rate of 4.49% matured during the three months ended June 30, 2016. A total of $50.0 million FHLB borrowings at a weighted rate of 4.01% matured in the first quarter of 2016. During the three months ended June 30, 2016, $50.0 million of FHLB borrowings replaced the maturities in 2016 at a weighted average rate of 0.70%.

Provision for Loan Losses

Our provision for loan losses decreased $805,000 as no provision was necessary during the three months ended June 30, 2016, compared to $805,000 during the three months ended June 30, 2015, as asset quality metrics continued to improve.

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

Noninterest Income

	Three months ended June 30,			
	2016	2015	$ Change	% Change
	(Dollars in Thousands)			

Service charges on loans and deposits	$616	$443	$ 173	39.1 %
Increase in cash surrender value of life insurance	471	352	119	33.8 %
Mortgage banking income	34,980	29,577	5,403	18.3 %
Gain on sale of available for sale securities	-	-	-	N/M
Other	284	668	(384)	(57.5)%
Total noninterest income	$36,351	$31,040	$ 5,311	17.1 %

N/M - Not meaningful

Total noninterest income increased $5.3 million, or 17.1%, to $36.4 million during the three months ended June 30, 2016 compared to $31.0 million during the three months ended June 30, 2015. The increase resulted primarily from an increase in mortgage banking income.

- Service charges on loans and deposits increased primarily due to an increase in loan prepayment penalties.
- The increase in cash surrender value of life insurance was due to the purchase of a $10.0 million policy in March 2016.
- The increase in mortgage banking income was the result of an increase in origination volumes. The volume increased $79.0 million, or 13.3%, to $675.1 million during the three months ended June 30, 2016 compared to $596.1 million during the three months ended June 30, 2015. Along with the increase in origination volume, margin increased as higher margin purchase products performed well.
- The decrease in other noninterest income was due to a decrease in the servicing fees earned on loans sold with mortgage servicing rights retained and a decrease in gain on mortgage servicing rights sold. Servicing fees decreased as the balance of loans serviced decreased from $443.6 million at June 30, 2015 to $291.6 million at June 30, 2016. Gain on mortgage servicing rights sold decreased because such gain, which was treated as a sale and included in other noninterest income in the prior year has been treated as mortgage banking income in the current year.

Noninterest Expenses

	Three months ended June 30,			
	2016	2015	$ Change	% Change
	(Dollars in Thousands)			
Compensation, payroll taxes, and other employee benefits	$25,709	$23,272	$2,437	10.5 %
Occupancy, office furniture and equipment	2,419	2,269	150	6.6 %
Advertising	655	712	(57)	(8.0)%
Data processing	638	630	8	1.3 %
Communications	372	351	21	6.0 %
Professional fees	489	632	(143)	(22.6)%
Real estate owned	163	686	(523)	(76.2)%
FDIC insurance premiums	155	271	(116)	(42.8)%
Other	3,631	3,124	507	16.2 %
Total noninterest expenses	$34,231	$31,947	$2,284	7.1 %

Total noninterest expenses increased $2.3 million, or 7.1%, to $34.2 million during the three months ended June 30, 2016 compared to $31.9 million during the three months ended June 30, 2015.

- Compensation, payroll taxes and other employee benefit expense increased $230,000, or 7.9%, at the Community Banking segment during the three months ended June 30, 2016. This was primarily due to variable compensation being higher in 2016 and stock compensation increasing with grants awarded in the second quarter of 2016.
- Compensation, payroll taxes and other employee benefit expense increased $2.2 million, or 11.3%, at our mortgage banking subsidiary. An increase in loan origination activity resulted in more commission-based compensation for the quarter. Total compensation, payroll taxes and other employee benefits also increased at our mortgage banking subsidiary as branch managers earned more with increased profitability and new branches were added. Offsetting those increases was a decrease in health insurance expense.
- Net real estate owned expense decreased $523,000, to $163,000 of expense during the three months ended June 30, 2016 compared to the three months ended June 30, 2015. Property management expense (other than gains/losses) decreased $264,000 during the three months ended June 30, 2016 compared to the three months ended June 30, 2015

due to a reduction in the number of properties under management during 2016. Net gains on sales of REO decreased $589,000 to $199,000 for the three months ended June 30, 2016 compared to $788,000 for the three months ended June 30, 2015. Real estate owned writedowns were $221,000 for the three months ended June 30, 2016 compared to $1.1 million for the three months ended June 30, 2015.

- FDIC insurance expense decreased during the three month period ended June 30, 2016. This was driven by a decrease in the FDIC assessment rate as a result of the Bank's improved CAMELS ratings and continued improvement in asset quality ratios.
- Other noninterest expense increased primarily due to a increased expense at our mortgage banking subsidiary associated with the increase of loan origination activity and mortgage servicing rights impairment.

Income Taxes

Driven by an increase in pre-tax income, income tax expense increased $1.5 million, or 47.5%, to $4.5 million during the three months ended June 30, 2016, compared to $3.1 million during the three months ended June 30, 2015. Income tax expense was recognized during the three months ended June 30, 2016 at an effective rate of 36.8% compared to an effective rate of 36.7% during the three months ended June 30, 2015.

Comparison of Community Banking Segment for the Six Months Ended June 30, 2016 and 2015

Net income for the six months ended June 30, 2016 totaled $5.8 million compared to net income of $4.0 million for the six months ended June 30, 2015. Net interest income increased $758,000 to $19.7 million for the six months ended June 30, 2016 compared to $19.0 million for the six months ended June 30, 2015. Provision for loan loss decreased $850,000. Compensation, payroll taxes, and other employee benefits expense decreased $143,000 primarily due to the grant of stock awards during 2015 offset by additional salary expense due to the two additional branches added in late 2015. In addition, FDIC premiums and real estate owned expense decreased. Those decreases were partially offset by an increase in other noninterest expense for the six months ended June 30, 2016 compared to the six months ended June 30, 2015.

Comparison of Mortgage Banking Segment Operations for the Six Months Ended June 30, 2016 and 2015

Net income totaled $5.8 million for the six months ended June 30, 2016, compared to $4.3 million during the six months ended June 30, 2015. Mortgage banking segment revenues increased $4.8 million, or 9.3%, to $56.3 million for the six months ended June 30, 2016 compared to $51.6 million for the six months ended June 30, 2015. The increase in revenue was attributable to a 5.1% increase in volume origination to $1.05 billion during the six months ended June 30, 2016 compared to $995.1 million during the six months ended June 30, 2015. While revenue increased 9.3%, noninterest expenses increased $2.4 million, or 5.3%, to $46.7 million for the six months ended June 30, 2016 compared to $44.3 million for the six months ended June 30, 2015. The improvement was due to ongoing expense control efforts.

Loans originated by the mortgage banking segment for the purpose of sale in the secondary market increased $51.2 million, or 5.1%, to $1.05 billion during the six months ended June 30, 2016, compared to $995.1 million for the six months ended June 30, 2015. The increase in originations was driven by an increase in the origination of loans made for the purpose of residential purchases, which yield a higher margin than refinance loans, partially offset by a decrease in the origination of mortgage refinance products. Our origination efforts continue to be focused on loans made for the purpose of residential purchases, as opposed to mortgage refinance. Origination volume relative to purchase activity accounted for 87% and 82% of total originations for the six months ended June 30, 2016 and 2015, respectively.

Consolidated Waterstone Financial, Inc. Results of Operations

	Six months ended June 30,	
	2016	2015
	(Dollars in Thousands, except per share amounts)	
Net income	$11,628	$8,300
Earnings per share - basic	0.43	0.26
Earnings per share - diluted	0.43	0.26
Annualized return on average assets	1.34 %	0.95 %
Annualized return on average equity	5.89 %	3.83 %

Average Balance Sheets, Interest and Yields/Costs

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

	Six months ended June 30,							
	2016				2015			
	Average Balance	Interest	Yield/Cost		Average Balance	Interest	Yield/Cost	
	(Dollars in Thousands)							
Assets								
Interest-earning assets:								
Loans receivable and held for sale (1)	$1,244,431	$27,857	4.50	%	$1,207,251	$27,378	4.57	%
Mortgage related securities (2)	162,931	1,628	2.01	%	175,957	1,659	1.90	%
Debt securities, federal funds sold and short-term investments (2)(3)	219,633	2,318	2.12	%	266,301	2,190	1.66	%
Total interest-earning assets	1,626,995	31,803	3.93	%	1,649,509	31,227	3.82	%
Noninterest-earning assets	113,314				112,021			
Total assets	$1,740,309				$1,761,530			
Liabilities and equity								
Interest-bearing liabilities:								
Demand accounts	$32,979	9	0.05	%	$30,206	10	0.07	%
Money market and savings accounts	156,962	197	0.25	%	129,224	58	0.09	%
Time deposits	666,960	3,348	1.01	%	638,025	2,643	0.84	%
Total interest-bearing deposits	856,901	3,554	0.83	%	797,455	2,711	0.69	%
Borrowings	394,508	7,642	3.90	%	440,711	8,553	3.91	%
Total interest-bearing liabilities	1,251,409	11,196	1.80	%	1,238,166	11,264	1.83	%
Noninterest-bearing liabilities								
Noninterest-bearing deposits	70,502				64,909			
Other noninterest-bearing liabilities	21,400				21,655			
Total noninterest-bearing liabilities	91,902				86,564			
Total liabilities	1,343,311				1,324,730			
Equity	396,998				436,800			
Total liabilities and equity	$1,740,309				$1,761,530			
Net interest income / Net interest rate spread (4)		20,607	2.13	%		19,963	1.98	%
Less: taxable equivalent adjustment		459	0.06	%		467	0.05	%
Net interest income / Net interest rate spread, as reported		$20,148	2.07	%		$19,496	1.93	%
Net interest-earning assets (5)	$375,586				$411,343			
Net interest margin (6)			2.49	%			2.38	%
Tax equivalent effect			0.06	%			0.06	%
Net interest margin on a fully tax equivalent basis (6)			2.55	%			2.44	%

Average interest-earning assets to average interest-bearing liabilities	130.01	%	133.22	%

(1) Interest income includes net deferred loan fee amortization income of $367,000 and $281,000 for the six months ended June 30, 2016 and 2015, respectively.
(2) Average balance of mortgage related and debt securities are based on amortized historical cost.
(3) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented. The yields on debt securities, federal funds sold and short-term investments before tax-equivalent adjustments were 1.70% and 1.30% for the six months ended June 30, 2016 and 2015, respectively.
(4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities and is presented on a fully tax equivalent basis.
(5) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
(6) Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

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

	Six months ended June 30, 2016 versus 2015 Increase (Decrease) due to		
	Volume	Rate	Net
	(In Thousands)		
Interest income:			
Loans receivable and held for sale (1)(2)	$890	$(411)	$479
Mortgage related securities (3)	(125)	94	(31)
Other earning assets (3) (4)	(427)	555	128
Total interest-earning assets	338	238	576
Interest expense:			
Demand accounts	1	(2)	(1)
Money market and savings accounts	10	129	139
Time deposits	126	579	705
Total interest-earning deposits	137	706	843
Borrowings	(869)	(42)	(911)
Total interest-bearing liabilities	(732)	664	(68)
Net change in net interest income	$1,070	$(426)	$644

(1) Interest income includes net deferred loan fee amortization income of $376,000 and $281,000 for the six months ended June 30, 2016 and 2015, respectively.

(2) Non-accrual loans have been included in average loans receivable balance.

(3) Includes available for sale securities. Average balance of available for sale securities is based on amortized historical cost.

(4) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 35% for all periods presented.

Net interest income increased $652,000, or 3.3%, to $20.1 million during the six months ended June 30, 2016 compared to $19.5 million during the six months ended June 30, 2015.

- Interest income on loans increased due to an increase in average balance of $37.2 million offset by a seven basis point decrease in average yield on loans. The increase in average loan balance was driven by a $37.5 million increase in the average balance of loans held in portfolio, while the average balance of loans held for sale remained relatively flat.
- Interest income from mortgage related securities decreased as securities have paid down in 2015 and 2016, and less purchases have occurred to replace those securities due to current market conditions.
- Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) increased due to a 40 basis point increase in the average yield due to an increase in higher yielding corporate securities balance, along with an increase in FHLB stock balance and dividend rate, offset by a $46.7 million decrease in the average balance.
- Interest expense on time deposits increased $705,000 primarily due to a 17 basis point increase in the average cost of funds, as maturing time deposits have repriced, or have been replaced at a higher rate in the current competitive market. In addition to an increase in rate, the average balance of time deposits increased compared to the prior year, which reflects the Company's decision to raise funds through our retail delivery channels to pay off FHLB advances that matured during the first half of 2016.
- Interest expense on money market and savings accounts increased $139,000 due to an increase in both rate and average balance. Increases in both rate and volume reflect the Company's strategy to target this segment of retail funds for more aggressive growth.
- Interest expense on borrowings decreased $911,000 due primarily to the maturity of $70.0 million of fixed rate borrowings that were paid off during the current year with lower rate long term fixed borrowings and funds raised through our retail delivery channels.
- A total of $70.0 million FHLB borrowings matured at a weighted average rate of 4.15% during the six months ended June 30, 2016. A total of $50.0 million FHLB borrowings replaced the maturities at a weighted average rate of 0.70%.

Provision for Loan Losses

Our provision for loan losses decreased $935,000, or 82.0%, to $205,000 during the six months ended June 30, 2016, from $1.1 million during the six months ended June 30, 2015 as asset quality metrics continued to improve.

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

Noninterest Income

	Six months ended June 30,			
	2016	2015	$ Change	% Change
	(Dollars in Thousands)			
Service charges on loans and deposits	$953	$849	$104	12.2 %
Increase in cash surrender value of life insurance	712	559	153	27.4 %
Mortgage banking income	55,594	50,616	4,978	9.8 %
Gain on sale of available for sale securities	-	44	(44)	N/M
Other	537	1,005	(468)	(46.6)%
Total noninterest income	$57,796	$53,073	$4,723	8.9 %

N/M - Not meaningful

Total noninterest income increased $4.7 million, or 8.9%, to $57.8 million during the six months ended June 30, 2016 compared to $53.1 million during the six months ended June 30, 2015. The increase resulted primarily from an increase in mortgage banking income offset by a decrease in other noninterest income.

- The $5.0 million increase in mortgage banking income was the result of an increase in origination volumes and margins. The volume increased $51.2 million, or 5.1%, to $1.05 billion during the six months ended June 30, 2016 compared to $995.1 million during the six months ended June 30, 2015.
- The increase in service charges on loans and deposits was related to an increase in loan prepayment penalties.
- The increase in cash surrender value of life insurance was due to the purchase of a $10.0 million policy in March 2016.
- The Company sold one municipal security at a gain in the prior period compared to none in the current year period.
- The decrease in other noninterest income was primarily due to a decrease in gain on mortgage servicing rights as there were no sales of mortgage servicing rights during the six months ended June 30, 2016 compared to a $262,000 gain on sales of mortgage servicing rights during the six months ended June 30, 2015. Gain on mortgage servicing rights sold decreased because such gain, which was treated as a sale and included in other noninterest income in the prior year has been treated as mortgage banking income in the current year. Also, other noninterest income decreased due to a decrease in the servicing fees earned on loans sold with mortgage servicing rights retained. Servicing fees decreased as the balance of loans serviced decreased from $441.5 million at June 30, 2015 to $291.6 million at June 30, 2016.

Noninterest Expenses

	Six months ended June 30,			
	2016	2015	$ Change	% Change
	(Dollars in Thousands)			
Compensation, payroll taxes, and other employee benefits	$43,395	$41,350	$2,045	4.9 %
Occupancy, office furniture and equipment	4,755	4,712	43	0.9 %
Advertising	1,313	1,365	(52)	(3.8)%
Data processing	1,281	1,205	76	6.3 %
Communications	714	721	(7)	(1.0)%
Professional fees	1,012	1,129	(117)	(10.4)%
Real estate owned	307	1,229	(922)	(75.0)%
FDIC insurance premiums	360	607	(247)	(40.7)%
Other	6,316	6,057	259	4.3 %
Total noninterest expenses	$59,453	$58,375	$1,078	1.8 %

Total noninterest expenses increased $1.1 million, or 1.8%, to $59.5 million during the six months ended June 30, 2016 compared to $58.4 million during the six months ended June 30, 2015.

- Compensation, payroll taxes and other employee benefit expense increased $2.0 million primarily due to a $2.2 million increase in compensation, payroll taxes and other benefits within our mortgage banking segment. The increase in compensation within our mortgage banking segment correlates to the increase in mortgage banking income due to the commission-based compensation structure in place for our mortgage banking loan officers.
- Compensation, payroll taxes and other employee benefit expense decreased $143,000 within the community banking segment primarily due to stock awards granted in 2015, offset by salary increases due to adding two branches in the second half of 2015 and annual raises.
- Occupancy, office furniture and equipment expense increased resulting from additional rent expense in the current year compared to prior year due to adding mortgage banking segment branches during 2016. Offsetting the rent increase, there was less depreciation expense in the six months ended June 30, 2016 compared to the same period during the prior year.
- Advertising expense decreased as a result of mortgage banking segment branches advertising less with mortgage demand remaining high.
- Data processing increased as the mortgage banking segment brought its hedging operations inhouse.
- Professional fees expense decreased as a result of a decrease in legal fees.
- Net real estate owned expense decreased $922,000, to $307,000 of expense during the six months ended June 30, 2016 compared to the six months ended June 30, 2015. Property management expense (other than gains/losses) decreased $545,000 during the six months ended June 30, 2016 compared to the six months ended June 30, 2015 due to a reduction in the number of properties under management during 2016. Net gains on sales of REO decreased $517,000 to $348,000 for the six months ended June 30, 2016 compared to $865,000 for the six months ended June 30, 2015. Real estate owned writedowns were $351,000 for the six months ended June 30, 2016 compared to $1.2 million for the six months ended June 30, 2015.
- FDIC insurance expense decreased during the six month period ended June 30, 2016. This was driven by a decrease in the FDIC assessment rate as a result of the Bank's improved CAMELS ratings and continued improvement in asset quality ratios.
- Other noninterest expense increased primarily due to a increased expense at our mortgage banking subsidiary associated with the increase of loan origination activity and mortgage servicing rights impairment.

Income Taxes

Driven by an increase in pre-tax income, income tax expense increased $1.9 million, or 40.1%, to $6.7 million during the six months ended June 30, 2016, compared to $4.8 million during the six months ended June 30, 2015. Income tax expense was recognized during the six months ended June 30, 2016 at an effective rate of 36.4% consistent with the effective rate during the six months ended June 30, 2015.

Comparison of Financial Condition at June 30, 2016 and December 31, 2015

Total Assets - Total assets increased by $36.5 million, or 2.1%, to $1.80 billion at June 30, 2016 from $1.76 billion at December 31, 2015. The increase in total assets primarily reflects an increase in loans and loans held for sale. Funding needed for the loans receivable and loans held for sale was raised through an increase in deposits.

Cash and Cash Equivalents – Cash and cash equivalents decreased $18.0 million, or 17.9%, to $82.5 million at June 30, 2016, compared to $100.5 million at December 31, 2015. The decrease in cash and cash equivalents primarily reflects the increase in loans receivable and loans held for sale. In addition, cash was used to pay down borrowings and other liabilities, purchase bank owned life insurance, and repurchase shares since December 31, 2015.

Securities Available for Sale – Securities available for sale decreased $15.9 million at June 30, 2016 compared to December 31, 2015. The decrease was due to paydowns in mortgage related securities exceeding the purchases for the quarter along with maturities of debt securities.

Loans Held for Sale - Loans held for sale increased at June 30, 2016 due to increased funding volumes in the second quarter of 2016 at our mortgage subsidiary compared to the fourth quarter of 2015. The total fundings were $675.0 million for the second quarter of 2016 compared to $441.0 for the fourth quarter of 2015.

Loans Receivable - Loans receivable held for investment increased $15.1 million to $1.13 billion at June 30, 2016 from $1.11 billion at December 31, 2015. The increase in total loans receivable was primarily attributable to increases in the one- to four-family, commercial real estate, and commercial loan categories. Offsetting those increases, multi-family, home equity, and construction and land categories decreased.

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

	As of or for the Six months ended June 30,		As of or for the Year Ended December 31, 2015
	2016	2015	
	(In Thousands)		
Total gross loans receivable and held for sale at beginning of period	$1,281,450	$1,220,063	$1,220,063
Real estate loans originated for investment:			
Residential			
One- to four-family	34,757	17,253	41,835
Multi-family	55,763	57,540	117,657
Home equity	2,086	2,837	7,265
Construction and land	4,915	1,985	11,085
Commercial real estate	11,420	15,019	43,138
Total real estate loans originated for investment	108,941	94,634	220,980
Consumer loans originated for investment	-	673	688
Commercial business loans originated for investment	5,530	13,121	23,467
Total loans originated for investment	114,471	108,428	245,135
Principal repayments	(95,272)	(97,099)	(203,271)
Transfers to real estate owned	(3,123)	(9,066)	(15,580)
Loan principal charged-off	(974)	(2,664)	(6,340)

Net activity in loans held for investment	15,102	(401)	19,944
Loans originated for sale	1,046,354	995,131	1,986,147
Loans sold	(1,004,063)	(912,284)	(1,944,704)
Net activity in loans held for sale	42,291	82,847	41,443
Total gross loans receivable and held for sale at end of period	$1,338,843	$1,302,509	$1,281,450

Allowance for Loan Losses - The allowance for loan losses decreased at June 30, 2016 from December 31, 2015. The decrease resulted from the charge-off of specific reserves and improvement of key loan quality metrics decreasing the allowance related to the loans collectively reviewed. The overall decrease was primarily related to the one- to four-family and multi-family categories. Offsetting those decreases, amounts for the commercial loan category increased as more commercial loans entered the watch risk rating. The other remaining categories were relatively consistent with the amounts at December 31, 2015.

Cash surrender value of life insurance – Total cash surrender value of life insurance increased $10.9 million from December 31, 2015. During the six months ended June 30, 2016, the Company purchased a $10 million bank owned life insurance policy. Continued earnings aided in increasing the policy values.

Federal Home Loan Bank stock – Total Federal Home Loan Bank stock decreased $4.7 million from December 31, 2015. During the six months ended June 30, 2016, $6.9 million of stock was sold as $70.0 million of Federal Home Loan Bank borrowings matured. A total of $2.3 million of stock was purchased when $50.0 million of new borrowings were made with the Federal Home Loan Bank.

Real Estate Owned – Total real estate owned decreased $553,000 from December 31, 2015. During the six months ended June 30, 2016, $3.1 million was transferred from loans receivable to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled $3.3 million and writedowns were $351,000.

Deposits – Total deposits increased $49.3 million to $942.7 million at June 30, 2016 from December 31, 2015. The increase was driven by an increase in more cost effective transaction accounts along with an increase in time deposits to help fund loan and loans held for sale growth.

Borrowings – Total borrowings decreased $26.5 million to $414.7 million at June 30, 2016 from December 31, 2015. A total of $70.0 million of fixed rate borrowings matured and were paid off during the current year. These were replaced with $50.0 million of new fixed rate borrowings with the Federal Home Loan Bank and with funds raised through our retail delivery channels. Short term borrowings used by the mortgage banking segment to fund loans held for sale decreased $6.5 million at June 30, 2016 from December 31, 2015.

Advance Payments by Borrowers for Taxes - Advance payments by borrowers for taxes increased $12.4 million. The increase was the result of payments received from borrowers for their real estate taxes and is seasonally normal, as balances increase during the course of the calendar year until real estate tax obligations are paid out in the fourth quarter.

Other Liabilities - Other liabilities decreased $7.4 million at June 30, 2016 compared to December 31, 2015. A total decrease of $12.2 million related to a seasonal decrease in outstanding checks related to advance payments by borrowers for taxes. The Company receives payments from borrowers for their real estate taxes during the course of the calendar year until real estate tax obligations are paid out in the fourth quarter. At the time at which the disbursements are made, the outstanding checks are classified as other liabilities. These amounts remain classified as other liabilities until settled. Offsetting the decrease, the hedging liability increased $2.8 million and accrued compensation increased $2.0 million.

Shareholders' Equity – Shareholders' equity increased by $8.7 million to $400.6 million at June 30, 2016 from December 31, 2015. The increase in shareholders' equity was primarily due to net income along with accumulated other comprehensive income increasing as the fair value of the security portfolio increased. These increases were offset by the repurchase of stock and dividends declared.

ASSET QUALITY

NONPERFORMING ASSETS

	At June 30, 2016	At December 31, 2015
	(Dollars in Thousands)	
Non-accrual loans:		
Residential		
One- to four-family	$ 8,765	$ 13,888
Multi-family	1,757	2,553
Home equity	304	437
Construction and land	66	239
Commercial real estate	439	460
Commercial	48	27
Consumer	-	-
Total non-accrual loans	11,379	17,604
Real estate owned		
One- to four-family	3,834	4,610
Multi-family	402	209
Construction and land	5,346	5,262
Commercial real estate	300	300
Total real estate owned	9,882	10,381
Valuation allowance at end of period	(1,245)	(1,191)
Total real estate owned, net	8,637	9,190
Total nonperforming assets	$ 20,016	$ 26,794
Total non-accrual loans to total loans, net	1.01 %	1.58 %
Total non-accrual loans to total assets	0.63 %	1.00 %
Total nonperforming assets to total assets	1.11 %	1.52 %

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

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

	At or for the Six Months Ended June 30,	
	2016	2015
	(In Thousands)	
Balance at beginning of period	$17,604	$38,011
Additions	1,927	7,176
Transfers to real estate owned	(3,123)	(9,066)
Charge-offs	(662)	(1,003)
Returned to accrual status	(3,559)	(3,188)
Principal paydowns and other	(808)	(3,215)
Balance at end of period	$11,379	$28,715

Total non-accrual loans decreased by $6.2 million, or 35.4%, to $11.4 million as of June 30, 2016 compared to $17.6 million as of December 31, 2015. The ratio of non-accrual loans to total loans receivable was 1.01% at June 30, 2016 compared to 1.58% at December 31, 2015. During the six months ended June 30, 2016, $3.1 million in non-accrual loans were transferred to real estate owned, $662,000 in loan principal was charged off, $3.6 million in loans were returned to accrual status and approximately $808,000 in principal payments were received. Offsetting this activity, $1.9 million in loans were placed on non-accrual status during the six months ended June 30, 2016.

Of the $11.4 million in total non-accrual loans as of June 30, 2016, $10.3 million in loans have been specifically reviewed to assess whether a specific valuation allowance is necessary. A specific valuation allowance is established for an amount equal to the impairment when the carrying value of the loan exceeds the present value of expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral with an adjustment made for costs to dispose of the asset. Based upon these specific reviews, a total of $2.2 million in cumulative partial charge-offs have been recorded over the life of these loans as of June 30, 2016. Partially charged-off loans measured for impairment based upon net realizable collateral value are maintained in a "non-performing" status and are disclosed as impaired loans. In addition, specific reserves totaling $545,000 have been recorded as of June 30, 2016. The remaining $1.1 million of non-accrual loans were reviewed on an aggregate basis and $215,000 in general valuation allowance was deemed necessary related to those loans as of June 30, 2016. The $215,000 in valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

The outstanding principal balance of our five largest non-accrual loans as of June 30, 2016 totaled $2.7 million, which represents 24.0% of total non-accrual loans as of that date. These five loans are carried net of cumulative life-to-date charge-offs of $17,000. Aggregate specific valuation allowances with respect to these five loans total $153,000 as of June 30, 2016.

For the six months ended June 30, 2016, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was $367,000. We received $269,000 of interest payments on such loans during the six months ended June 30, 2016. Interest payments received are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

There were no accruing loans past due 90 days or more during the six months ended June 30, 2016 or 2015.

TROUBLED DEBT RESTRUCTURINGS

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

	As of June 30, 2016		
	Accruing	Non-accruing	Total
	(In Thousands)		
One- to four-family	$3,308	$ 2,502	$5,810
Multi-family	2,530	1,464	3,994
Home equity	-	98	98
Construction and land	437	-	437
Commercial real estate	1,192	65	1,257
	$7,467	$ 4,129	$11,596

	As of December 31, 2015		
	Accruing	Non-accruing	Total
One- to four-family	$3,900	$ 5,739	$9,639
Multi-family	2,546	2,317	4,863
Home equity	-	98	98
Construction and land	1,556	-	1,556
Commercial real estate	1,306	77	1,383
	$9,308	$ 8,231	$17,539

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

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

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

LOAN DELINQUENCY

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

	At June 30, 2016	At December 31, 2015
	(Dollars in Thousands)	
Loans past due less than 90 days	$1,574	$ 2,599
Loans past due 90 days or more	6,500	8,932
Total loans past due	$8,074	$ 11,531
Total loans past due to total loans receivable	0.71 %	1.03 %

Past due loans decreased by $3.5 million, or 30.0%, to $8.1 million at June 30, 2016 from $11.5 million at December 31, 2015. Loans past due 90 days or more decreased by $2.4 million, or 27.2%, during the six months ended June 30, 2016 and loans past due less than 90 days decreased by $1.0 million, or 39.4%. The $2.4 million decrease in loans past due 90 days or more was primarily due to $3.1 million in loans transferred to real estate owned along with charge-offs during the six months ended June 30, 2016 offset by additional loans which were included in the less than 90 day group in the previous period. The $1.0 million decrease in loans past due less than 90 days was primarily attributable to loans entering the 90 days past due category, loans returning to current status, and a decrease of new loans entering past due status.

REAL ESTATE OWNED

Total real estate owned decreased by $553,000, or 6.0%, to $8.6 million at June 30, 2016, compared to $9.2 million at December 31, 2015. During the six months ended June 30, 2016, $3.1 million was transferred from loans to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled $3.3 million. A total of $351,000 in write downs occurred during the six months ended June 30, 2016. New appraisals received on real estate owned and collateral dependent impaired loans are based upon an "as is value" assumption. During the period of time in which we are awaiting receipt of an updated appraisal, loans evaluated for impairment based upon collateral value are measured by the following:

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

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

ALLOWANCE FOR LOAN LOSSES

	At or for the Six Months Ended June 30,	
	2016	2015
	(Dollars in Thousands)	
Balance at beginning of period	$16,185	$18,706
Provision for loan losses	205	1,140
Charge-offs:		
Mortgage		
One- to four-family	464	1,220
Multi-family	445	1,304
Home equity	62	48
Commercial real estate	-	45
Construction and land	3	47
Consumer	-	-
Commercial	-	-
Total charge-offs	974	2,664
Recoveries:		
Mortgage		
One- to four-family	178	289
Multi-family	59	753
Home equity	19	95
Commercial real estate	-	5
Construction and land	33	33
Consumer	-	3
Commercial	-	-
Total recoveries	289	1,178
Net charge-offs	685	1,486
Allowance at end of period	$15,705	$18,360
Ratios:		
Allowance for loan losses to non-accrual loans at end of period	138.02%	63.94 %
Allowance for loan losses to loans receivable at end of period	1.39 %	1.68 %
Net charge-offs to average loans outstanding (annualized)	0.12 %	0.28 %
Current period provision for loan losses to net charge-offs	29.93 %	76.72 %
Net charge-offs (annualized) to beginning of the period allowance	8.51 %	16.02 %

At June 30, 2016, the allowance for loan losses was $15.7 million compared to $16.2 million at December 31, 2015. The decrease in allowance for loan losses during the six months ended June 30, 2016 reflects improvement in both the quality of the loan portfolio as well as stabilization in the overall local real estate market. The Company has experienced improvement in a number of key loan-related loan quality metrics compared to December 31, 2015, including impaired loans, substandard loans, loans contractually past due and non-accrual loans.

Net charge-offs totaled $685,000, or an annualized 0.12% of average loans for the six months ended June 30, 2016, compared to $1.5 million, or an annualized 0.28% of average loans for the six months ended June 30, 2015. Of the $685,000 in charge-offs during the six months ended June 30, 2016, a majority of the activity related to loans secured by multi-family and single-family residential loans.

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

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

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

Liquidity and Capital Resources

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

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

During the six months ended June 30, 2016 primary uses of cash and cash equivalents included: $1.05 billion funding loans held for sale, $70.0 million in the payment of long term debt, $18.9 million increase in loans receivable, purchase of $10.0 million in bank owned life insurance, $3.9 million for the repurchase of common stock, $5.2 million in purchases of mortgage related securities, $6.5 million in short term borrowings, and $2.7 million in dividends paid.

During the six months ended June 30, 2016, primary sources of cash and cash equivalents included: $1.06 billion in proceeds from the sale of loans held for sale, $49.3 million increase in deposits, $50.0 million from long term borrowings, $19.1 million in principal repayments on mortgage related securities, $5.9 from maturities of debt securities, $11.6 million in net income, and $3.7 million from real estate owned sales.

During the six months ended June 30, 2015 primary uses of cash and cash equivalents included: $995.1 million funding loans held for sale, $55.6 million for the purchase of common stock, $15.9 million in purchases of mortgage related securities, $10.2 million increase in net fundings of loans receivable (irrespective of loans transferred to real estate owned), $10.0 million in purchases of debt securities, and $13.6 million related to a decrease in deposits. During the six months ended June 30, 2015, primary sources of cash and cash equivalents included: $960.8 million in proceeds from the sale of loans held for sale, $20.7 million in principal repayments on mortgage related securities, $5.7 million from maturities and calls of debt securities, $10.0 million increase in borrowings, and $13.5 million from real estate owned sales.

A portion of our liquidity consists of cash and cash equivalents, which are a product of our operating, investing and financing activities. At June 30, 2016 and 2015, respectively, $82.5 million and $48.1 million of our assets were invested in cash and cash equivalents. At June 30, 2016, cash and cash equivalents are comprised of the following: $40.9 million in cash held at the Federal Reserve Bank and other depository institutions and $41.6 million in federal funds sold and short-term investments. Our primary sources of cash are principal repayments on loans, proceeds from the calls and maturities of debt and mortgage-related securities, increases in deposit accounts and advances from the FHLBC.

Liquidity management is both a daily and longer-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLBC which provide an additional source of funds. At June 30, 2016, we had $330.0 million in advances from the FHLBC with contractual maturity dates in 2016, 2017, 2018, and 2021. The advances with maturity dates in 2016, 2017, and 2018 are callable quarterly until maturity. The 2021 advance maturity has a one-time call option in June 2018. As an additional source of funds, we also enter into repurchase agreements. At June 30, 2016, we had $84.0 million in repurchase agreements. The repurchase agreements mature at various times in 2017, however, all are callable quarterly until maturity.

At June 30, 2016, we had outstanding commitments to originate loans receivable of $27.1 million. In addition, at June 30, 2016, we had unfunded commitments under construction loans of $32.7 million, unfunded commitments under business lines of credit of $15.1 million and unfunded commitments under home equity lines of credit and standby letters of credit of $14.1 million At June 30, 2016, certificates of deposit scheduled to mature in one year or less totaled $479.4 million. Based on prior experience, management believes that, subject to the Bank's funding needs, a significant portion of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits is not retained by us, we will have to utilize other funding sources, such as FHLBC advances, in order to maintain our level of assets. However, we cannot assure that such borrowings would be available on attractive terms, or at all, if and when needed. Alternatively, we could reduce our level of liquid assets, such as our cash and cash equivalents and securities available-for-sale in order to meet funding needs. In addition, the cost of such deposits may be significantly higher if market interest rates are higher or there is an increased amount of competition for deposits in our market area at the time of renewal.

Capital

Shareholders' equity increased by $8.7 million to $400.6 million at June 30, 2016 from $391.9 million December 31, 2015. The increase in shareholders' equity was primarily due to net income along with accumulated other comprehensive income increasing as the fair value of the security portfolio increased. These increases were offset by the repurchase of stock and dividends declared.

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

As of June 30, 2016, the Company repurchased 5,847,153 shares at an average price of $12.96 under previously approved stock repurchase plans. As of June 30, 2016, the Company is authorized to purchase up to 989,500 additional shares under the current approved stock repurchase program.

WaterStone Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning assets and off-balance sheet items to broad risk categories. At June 30, 2016, WaterStone Bank exceeded all regulatory capital requirements and is considered "well capitalized" under regulatory guidelines. See "Notes to Consolidated Financial Statements - Regulatory Capital."

The net proceeds from the stock offering significantly increased our liquidity and capital resources. Over time, the initial level of liquidity will be reduced as net proceeds from the stock offering are used for general corporate purposes. Our financial condition and results of operations will be enhanced by the net proceeds from the stock offering, resulting in increased net interest-earning assets and net interest income. However, due to the increase in

equity resulting from the net proceeds from the stock offering, our return on equity will continue to be adversely affected following the stock offering.

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

The following tables present information indicating various contractual obligations and commitments of the Company as of June 30, 2016 and the respective maturity dates.

	Total	One Year or Less	More than One Year Through Three Years	More than Three Years Through Five Years	Over Five Years
	(In Thousands)				
Demand deposits (4)	$106,059	$106,059	$-	$-	$-
Money market and savings deposits (4)	154,550	154,550	-	-	-
Time deposit (4)	682,100	479,358	196,891	5,851	-
Bank lines of credit (4)	745	745	-	-	-
Federal Home Loan Bank advances (1)	330,000	150,000	130,000	50,000	-
Repurchase agreements (2)(4)	84,000	24,000	60,000	-	-
Operating leases (3)	10,748	2,950	4,001	1,836	1,961
Salary continuation agreements	170	170	-	-	-
	$1,368,372	$917,832	$390,892	$57,687	$1,961

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

Herrington, et al. v. Waterstone Mortgage Corporation

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

Off-Balance Sheet Commitments

The following table details the amounts and expected maturities of significant off-balance sheet commitments as of June 30, 2016.

	Total	One Year or Less	More than One Year Through Three Years	More than Three Years Through Five Years	Over Five Years
	(In Thousands)				
Real estate loan commitments (1)	$27,130	$27,130	$ -	$ -	$ -
Unused portion of home equity lines of credit (2)	13,736	13,736	-	-	-
Unused portion of construction loans (3)	32,725	32,725	-	-	-
Unused portion of business lines of credit	15,134	15,134	-	-	-
Standby letters of credit	392	392	-	-	-
Total Other Commitments	$89,117	$89,117	$ -	$ -	$ -

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

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

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

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Management of Market Risk

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

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

Income Simulation. Simulation analysis is an estimate of our interest rate risk exposure at a particular point in time. At least quarterly we review the potential effect changes in interest rates may have on the repayment or repricing of rate sensitive assets and funding requirements of rate sensitive liabilities. Our most recent simulation uses projected repricing of assets and liabilities at June 30, 2016 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rate assumptions may have a significant impact on interest income simulation results. Because of the large percentage of loans and mortgage-backed securities we hold, rising or falling interest rates may have a significant impact on the actual prepayment speeds of our fixed-rate mortgage related assets that may in turn affect our interest rate sensitivity position.

	Percentage Increase (Decrease) in Estimated Annual Net Interest Income Over 12 Months	
400 basis point gradual rise in rates	6.14	%
300 basis point gradual rise in rates	4.70	%
200 basis point gradual rise in rates	3.43	%
100 basis point gradual rise in rates	1.68	%
Unchanged rate scenario	0.00	%
100 basis point gradual decline in rates (1)	(2.00	%)

(1) Given the current low point in the interest rate cycle, rate decline scenarios in excess of 100 basis points are not meaningful.

WaterStone Bank's Asset/Liability policy limits projected changes in net average annual interest income to a maximum decline of 25% for various levels of interest rate changes measured over a 12-month period when compared to the flat rate scenario. In addition, projected changes in the economic value of equity are limited to a maximum decline of 30% for interest rate movements of up to 400 basis points when compared to the flat rate scenario. These limits are re-evaluated on a periodic basis and may be modified, as appropriate. At June 30, 2016, a 100 basis point gradual increase in interest rates had the effect of increasing forecast net interest income by 1.68% while a 100 basis point decrease in rates had the effect of decreasing net interest income by 2.00%. At June 30, 2016, a 100 basis point gradual increase in interest rates had the effect of decreasing the economic value of equity by 1.01% while a 100 basis point decrease in rates had the effect of increasing the economic value of equity by 1.07%. While we believe the assumptions used are reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.

Item 4. Controls and Procedures

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

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Other than as disclosed below, the Company is not involved in any pending legal proceedings as a defendant other than routine legal proceedings occurring in the ordinary course of business. At June 30, 2016, the Company believes that any liability arising from the resolution of any pending legal proceedings will not be material to its financial condition or results of operations.
Herrington, et al. v. Waterstone Mortgage Corporation

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

Item 1A. Risk Factors
There have been no changes in risk factors applicable to the Company from those disclosed in "Risk Factors" in Item 1A of the Company's annual report on Form 10-K for the year ended December 31, 2015.

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

Following are the Company's monthly common stock purchases during the second quarter of 2016:

Period	Total Number of Shares Purchased[b]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under the Plan[a]
April 1, 2016 - April 30, 2016	10,700	$ 13.63	10,700	989,500
May 1, 2016 - May 31, 2016	-	-	-	989,500
June 1, 2016 - June 30, 2016	1,518	15.13	-	989,500
Total	12,218	$ 13.81	10,700	989,500

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

(b) During the second quarter of 2016, the Company repurchased 1,518 shares for minimum tax withholding settlements on equity compensation. These purchases are included in the monthly common stock purchases table above but do not count against the maximum number of shares that may yet be purchased under the Board of Directors' authorization.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

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

Signatures

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

WATERSTONE FINANCIAL, INC.
(Registrant)

Date: July 29, 2016

/s/ Douglas S. Gordon
Douglas S. Gordon
Chief Executive Officer
Principal Executive Officer

Date: July 29, 2016

/s/ Mark R. Gerke
Mark R. Gerke
Chief Financial Officer
Principal Financial Officer

EXHIBIT INDEX

WATERSTONE FINANCIAL, INC.

Form 10-Q for Quarter Ended June 30, 2016

Exhibit No.	Description	Filed Herewith
31.1	Sarbanes-Oxley Act Section 302 Certification signed by the Chief Executive Officer of Waterstone Financial, Inc.	X
31.2	Sarbanes-Oxley Act Section 302 Certification signed by the Chief Financial Officer of Waterstone Financial, Inc.	X
32.1	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Executive Officer of Waterstone Financial, Inc.	X
32.2	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Financial Officer of Waterstone Financial, Inc.	X
101	The following financial statements from Waterstone Financial, Inc. Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statements of financial condition, (ii) consolidated statements of income, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of changes in shareholders' equity, (v) consolidated statements of cash flows and (vi) the notes to consolidated financial statements.	X