Oconee Federal Financial Corp.
Form 10-K
September 29, 2014

Use these links to rapidly review the document
Table of Contents
ITEM 8. Financial Statements and Supplementary Data

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended June 30, 2014

OR

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

For the transition period from to

Commission File Number: 001-35033

Oconee Federal Financial Corp.

(Exact Name of Registrant as Specified in its Charter)

Federal	**32-0330122**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
201 East North Second Street, Seneca, South Carolina	**29678**
(Address of Principal Executive Offices)	(Zip Code)

(864) 882-2765
(Registrant's Telephone Number Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	The NASDAQ Stock Market, LLC

Securities Registered Pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No ý

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 reports), and (2) has been subject to such requirements for the past 90 days. (1) Yes ý No o (2) Yes ý No o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

As of September 12, 2014 there were 5,834,395 shares outstanding of the registrant's common stock. The aggregate value of the voting and non-voting common stock held by non-affiliates of the registrant, computed by reference to the closing price of the common stock as of December 31, 2013 was $25.0 million.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2014 Annual Meeting of Stockholders. (Part III)

Table of Contents

Table of Contents

Table of Contents

PART I

ITEM 1. *Business*

Forward Looking Statements

This annual report contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on our current beliefs and expectations 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. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Annual Report.

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:

- our ability to manage our operations under the current adverse economic conditions (including real estate values, loan demand, inflation, commodity prices and employment levels) nationally and in our market areas;
- adverse changes in the financial industry, securities, credit and national and local real estate markets (including real estate values);
- significant increases in our delinquencies and loan losses, including as a result of our inability to resolve classified assets, changes in the underlying cash flows of our borrowers, and management's assumptions in determining the adequacy of the allowance for loan losses;
- credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and in our allowance and provision for loan losses;
- use of estimates for determining the fair value of certain of our assets, which may prove to be incorrect and result in significant declines in valuations;
- increased competition among depository and other financial institutions;

our ability to attract and maintain deposits, including attracting and maintaining deposits and introducing new deposit products;

changes in interest rates generally, including changes in the relative differences between short term and long term interest rates and in deposit interest rates, that may affect our net interest margin and funding sources;

fluctuations in the demand for loans, which may be affected by the number of unsold homes, land and other properties in our market areas and by declines in the value of real estate in our market area;

declines in the yield on our assets resulting from the current low interest rate environment;

Table of Contents

our ability to successfully implement our business strategies, including attracting and maintaining deposits and introducing new financial products;

risks related to high concentration of loans secured by real estate located in our market areas;

changes in the level of government support of housing finance;

the results of examinations by our regulators, including the possibility that our regulators may, among other things, require us to increase our reserve for loan losses, write down assets, change our regulatory capital position, limit our ability to borrow funds or maintain or increase deposits, or prohibit us from paying dividends, which could adversely affect our dividends and earnings;

our ability to enter new markets successfully and capitalize on growth opportunities;

our businesses may not be combined successfully, or such combination may take longer to accomplish than expected;

the growth opportunities and cost savings from the acquisition of Stephens Federal Bank may not be fully realized or may take longer to realize than expected;

our ability to manage increased expenses following the acquisition of Stephens Federal Bank, including salary and employee benefit expenses and occupation expenses;

operating costs, customer losses and business disruption following the acquisition of Stephens Federal Bank, including adverse effects of relationships with employees, may be greater than expected;

our ability to attract and maintain deposits, including former depositors of Stephens Federal Bank;

changes in laws or government regulations or policies affecting financial institutions, including the Dodd-Frank Act and the JOBS Act, which could result in, among other things, increased deposit insurance premiums and assessments, capital requirements (particularly the new capital regulations), regulatory fees and compliance costs and the resources we have available to address such changes;

our reliance on a small executive staff;

changes in our compensation and benefit plans, and our ability to retain key members of our senior management team and to address staffing needs to implement our strategic plan;

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 and the Public Company Accounting Oversight Board;

our ability to control costs and expenses, particularly those related to operating as a publicly traded company;

other changes in our financial condition or results of operations that reduce capital available to pay dividends;

other changes in the financial condition or future prospects of issuers of securities that we own, including our stock in the FHLB of Atlanta; and

other economic, competitive, governmental, regulatory and operational factors affecting our operations, pricing, products and services.

Table of Contents

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

Oconee Federal Financial Corp.

Oconee Federal Financial Corp. (the "Company") is a federally-chartered corporation that was incorporated in January 2011 to be the mid-tier stock holding company for Oconee Federal Savings and Loan Association in connection with the mutual-to-stock conversion of Oconee Federal Savings and Loan Association. As of June 30, 2014, Oconee Federal Financial Corp. had 5,834,395 shares outstanding and a market capitalization of approximately $105.4 million.

The executive offices of Oconee Federal Financial Corp. are located at 201 East North Second Street, Seneca, South Carolina 29678, and the telephone number is (864) 882-2765. Our website address is www.oconeefederal.com. Information on our website should not be considered a part of this annual report. Oconee Federal Financial Corp. is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System.

At June 30, 2014, we had total assets of $360.5 million, total deposits of $281.0 million and total equity of $77.0 million. We recorded net income of $3.6 million for the year ended June 30, 2014.

Oconee Federal Savings and Loan Association

Oconee Federal Savings and Loan Association is a federally chartered savings and loan association headquartered in Seneca, South Carolina. Oconee Federal Savings and Loan Association was originally chartered by the State of South Carolina in 1924 as Seneca Building and Loan Association. In 1958, it changed its name to "Oconee Savings and Loan Association," and in 1991 it converted to a federal charter under the name "Oconee Federal Savings and Loan Association."

Our principal business consists of attracting retail deposits from the general public in our market area and investing those deposits, together with funds generated from operations, in one-to-four family residential mortgage loans and, to a much lesser extent, non-residential mortgage, construction and land and other loans. We also invest in U.S. Government and federal agency securities, mortgage-backed securities and short-term deposits. We have also used borrowed funds as a source of funds, and we borrow principally from the Federal Home Loan Bank of Atlanta. We conduct our business from our main office, our executive office annex and three branch offices. All of our offices are located in Oconee County, South Carolina. Our primary market area consists of Oconee County and the nearby communities and townships in adjacent counties in South Carolina.

Oconee Federal Savings and Loan Association is subject to comprehensive regulation and examination by the Office of the Comptroller of the Currency and by the Federal Deposit Insurance Corporation. Oconee Federal Savings and Loan Association is a member of the Federal Home Loan Bank system.

Oconee Federal, MHC

Oconee Federal, MHC is a federally-chartered mutual holding company formed in January 2011 to become the mutual holding company of Oconee Federal Financial Corp. in connection with the mutual-to-stock conversion of Oconee Federal Savings and Loan Association. As a mutual non-stock holding company, Oconee Federal, MHC has as its members all holders of deposit accounts at, and certain borrowers of, Oconee Federal Savings and Loan Association as of October 21, 1991. As a mutual holding company, Oconee Federal, MHC is required by law to own a majority of the voting stock of Oconee Federal Financial Corp. Oconee Federal, MHC is not currently, and at no time has been, an operating company.

Table of Contents

Market Area

We conduct business through our main office, our executive office annex and one branch office located in Seneca, South Carolina and one additional branch office located in each of Walhalla, South Carolina and Westminster, South Carolina. All five of our offices are located in Oconee County, which is located on the I-85 corridor between the Charlotte and Atlanta metropolitan areas, approximately 120 miles south of Charlotte and approximately 120 miles north of Atlanta. Our offices are also located approximately 40 miles south of Greenville, South Carolina, and 10 miles from Clemson, South Carolina.

Our primary market area, which consists of Oconee County and the nearby communities and townships in adjacent counties in South Carolina, is mostly rural and suburban in nature. The Oconee County economy has historically been concentrated in manufacturing. Plant closings and layoffs in this sector, particularly in light manufacturing industries, in recent years have contributed to high unemployment in Oconee County. The regional economy is fairly diversified, with services, wholesale/retail trade, manufacturing and government providing the primary support. In addition, Oconee County and nearby counties are experiencing an increase in retiree populations. Oconee County's and South Carolina's respective June 2014 unemployment rates of 6.2% and 5.3% compare favorably to the national unemployment rate of 6.1% for June 2014.

The largest employers in Oconee County are education and health services providers, public utilities and light manufacturing companies, including the Oconee County and Seneca City School Systems, Oconee Medical Center, Duke Energy, an electric utility and provider of nuclear and hydroelectric energy, Schneider Electric-Square D, a manufacturer of electronic components, Itron, a manufacturer of electronic measuring devices and Covidien, a manufacturer of healthcare products. Other employers include the local government, retail trade and the leisure/hospitality industry. Many residents of Oconee County are employed in nearby Greenville, South Carolina, which has major employers such as BMW Motors, Inc. and Greenville Health System, and in Pickens County, which has major employers such as Clemson University and the Pickens County school system. In addition, although we only accept deposits from existing customers and residents of Oconee County, we extend credit to residents of counties adjacent to Oconee County in order to take advantage of the additional lending market located in these areas.

Competition

Competition for making loans and attracting deposits in our primary market area is intense, particularly in light of the relatively modest population base of Oconee County and the relatively large number of institutions that maintain a presence in the county. Financial institution competitors in our primary market area include other locally-based commercial banks, thrifts and credit unions, as well as regional and super-regional banks. We also compete with depository and lending institutions not physically located in our primary market area but capable of doing business remotely, mortgage loan originators and mortgage brokers and other companies in the financial services industry, such as investment firms, mutual funds and insurance companies. Some of our competitors offer products and services that we currently do not offer, such as trust services and private banking. To meet our competition, we seek to emphasize our community orientation, local and timely decision making and superior customer service. As of June 30, 2013 the most recent date of available data, our market share of deposits represented 26.14% of FDIC-insured deposits in Oconee County.

Lending Activities

The principal lending activity of Oconee Federal Savings and Loan Association is originating one-to-four family residential mortgage loans and, to a much lesser extent, home equity loans, non-residential mortgage loans, construction and land loans, and other loans. In recent years we have

Table of Contents

modestly expanded our non-residential mortgage loans in an effort to diversify our overall loan portfolio, increase the yield of our loans and shorten asset duration. In addition, we may modestly increase our home equity loan portfolio.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio by type of loan at the dates indicated.

	At June 30,					
	2014		2013		2012	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Real estate loans:						
One-to-four family(1)	$ 214,735	92.55%	$ 204,397	91.61%	$ 234,125	92.82%
Multi-family	254	0.11	258	0.12	264	0.10
Home equity	227	0.10	292	0.13	395	0.16
Nonresidential	8,408	3.62	8,521	3.82	9,226	3.66
Construction and land	7,661	3.30	8,735	3.91	7,232	2.87
Total real estate loans	231,285	99.68	222,203	99.59	251,242	99.61
Consumer and other loans	747	0.32	925	0.41	987	0.39
Total loans	$ 232,032	100.00%	$ 223,128	100.00%	$ 252,229	100.00%
Net deferred loan fees	(1,246)		(1,214)		(1,540)	
Allowance for loan losses	(855)		(751)		(857)	
Loans, net	$ 229,931		$ 221,163		$ 249,832	

	At June 30,			
	2011		2010	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Real estate loans:				
One-to-four family	$ 249,064	93.16%	$ 250,390	93.81%
Multi-family	269	0.10	380	0.14
Home equity	466	0.17	510	0.19
Nonresidential	9,399	3.52	9,456	3.54
Construction and land	7,156	2.68	5,158	1.94
Total real estate loans	266,354	99.63	265,894	99.62
Consumer and other loans	985	0.37	1,012	0.38

Total loans	$	267,339	100.00%	$	266,906	100.00%
Net deferred loan fees		(1,677)			(1,690)	
Allowance for loan losses		(749)			(888)	
Loans, net	$	264,913		$	264,328	

(1) Includes $1.8 million and $2.0 million of loans secured by modular and manufactured homes as of June 30, 2014 and June 30, 2013, respectively.

Table of Contents

Contractual Maturities and Interest Rate Sensitivity. The following table summarizes the scheduled repayments of our loan portfolio at June 30, 2014. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less. Loans are presented net of loans in process.

	One- to Four-Family	Multi-family	Home Equity	Non-residential	Construction and Land	Consumer and Other	Total
				(Dollars in thousands)			
Amounts due in:							
One year or less	$ 116	$	$ 1	$ 16	$	$ 504	$ 637
More than one to two years	144		1	23		239	407
More than two to three years	630				13	4	647
More than three to five years	4,681		181	51	202		5,115
More than five to ten years	14,463		44	78	2,374		16,959
More than ten to fifteen years	22,387			5,920	64		28,371
More than fifteen years	172,314	254		2,320	5,008		179,896
Total	$ 214,735	$ 254	$ 227	$ 8,408	$ 7,661	$ 747	$ 232,032

The following table summarizes our fixed-rate and adjustable-rate loans that are due after June 30, 2015.

Interest rate terms on amounts due after one year:							
Fixed-rate loans	$ 200,115	$	$ 226	$ 8,392	$ 7,661	$ 243	$ 216,637
Adjustable-rate loans	14,504	254					14,758
Total	$ 214,619	$ 254	$ 226	$ 8,392	$ 7,661	$ 243	$ 231,395

Loan Approval Procedures and Authority. Pursuant to federal law, the aggregate amount of loans that Oconee Federal Savings and Loan Association is permitted to make to any one borrower or a group of related borrowers is generally limited to 15% of Oconee Federal Savings and Loan Association's unimpaired capital and surplus (25% if the amount in excess of 15% is secured by "readily marketable collateral" or 30% for certain residential development loans). At June 30, 2014, based on the 15% limitation, Oconee Federal Savings and Loan Association's loans-to-one-borrower limit was approximately $11.5 million. On the same date, Oconee Federal Savings and Loan Association had no borrowers with outstanding balances in excess of this amount. At June 30, 2014, our largest loan relationship with one borrower was for approximately $3.1 million secured by a church building located in Seneca, South Carolina, and was performing in accordance with its terms on that date.

Our lending is subject to written underwriting standards and origination procedures. Decisions on loan applications are made on the basis of detailed applications submitted by the prospective borrower, credit histories that we obtain, and property valuations (consistent with our appraisal policy) prepared by outside independent licensed appraisers approved by our board of directors as well as internal evaluations, where permitted by regulations. The loan applications are designed primarily to determine the borrower's ability to repay the requested loan, and the more significant items on the application are verified through use of credit reports, financial statements and tax returns.

Under our loan policy, the loan officer processing an application is responsible for ensuring proposals and approval of any extensions of credit are in compliance with internal policies and procedures and applicable laws and regulations, and for establishing and maintaining credit files and documentation sufficient to support the loan and to perfect any collateral position. The Loan

Table of Contents

Committee of the board of directors reviews all loan applications, and may override the risk analysis of loan officers.

Our lending officers do not have individual lending authority. The Loan Committee has approval authority for loans up to $250 thousand. Real estate loans over $250 thousand must be approved by the Loan Committee and ratified by the board of directors. Our board of directors must approve all loans in excess of $500 thousand. To ensure adequate liquidity, under our loan policy, aggregate loans outstanding should not exceed our total deposits and advances from the Federal Home Loan Bank of Atlanta.

Generally, we require title insurance or abstracts on our mortgage loans as well as fire and extended coverage casualty insurance in amounts at least equal to the principal amount of the loan or the value of improvements on the property, depending on the type of loan.

One-to-four Family Residential Real Estate Lending. The cornerstone of our lending program has long been the origination of long-term loans secured by mortgages on owner-occupied one-to-four family residences. At June 30, 2014, $214.7 million, or 92.6% of our total loan portfolio, consisted of one-to-four family residential mortgage loans. At that date, our average outstanding one-to-four family residential mortgage loan balance was $116 thousand and our largest outstanding residential loan had a principal balance of $1.5 million. At June 30, 2014, our ten largest loans in our portfolio totaled $14.8 million, of which five loans totaling $5.8 million were one-to-four residential mortgages and three loans totaling $4.7 million were one-to-four residential construction mortgages. Virtually all of the residential mortgage loans we originate are secured by properties located in our market area.

The terms of our mortgage loans are generally up to 30 years for traditional homes and up to 15 years for manufactured or modular homes. The terms of non-owner-occupied homes are generally up to 15 years for fixed-rate loans and up to 30 years for adjustable-rate loans. Due to consumer demand in the current low market interest rate environment, many of our recent originations are 15- to 30-year fixed-rate loans secured by one-to-four family residential real estate. Although we typically retain in our portfolio the loans we originate, we generally originate our fixed-rate one-to-four family residential loans in accordance with secondary market standards. At June 30, 2014, we had in our portfolio $20.0 million of residential mortgage loans with original contractual maturities of 10 years or less, $22.4 million of residential mortgage loans with original contractual maturities between 10 and 15 years and $172.3 million of residential mortgage loans with original contractual maturities in excess of 15 years.

In order to reduce the term to repricing of our loan portfolio, we also originate one-year adjustable-rate one-to-four family residential mortgage loans. Our current adjustable-rate mortgage loans have fixed rates for the first 12 months, and then carry interest rates that adjust annually at a rate based on the change, between closing of the loan and the adjustment date, of the Federal Home Loan Bank Board's published contract interest rate, which represents the national average rate for purchases of previously occupied homes. Such loans carry terms to maturity of up to 30 years. The adjustable-rate mortgage loans currently offered by us generally provide for a 100 basis point annual interest rate change cap, a lifetime cap of 500 basis points over the initial rate and a lifetime floor of 200 basis points under the initial rate.

Although adjustable-rate mortgage loans may reduce to an extent our vulnerability to changes in market interest rates because they periodically reprice, as interest rates increase, the required payments due from the borrower also increase (subject to rate caps), increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustments of the contractual interest rate are also limited by the maximum periodic and lifetime rate adjustments permitted by our loan documents. At June 30, 2014, $14.5 million, or 6.8% of our one-to-four family residential loans, had adjustable rates of interest.

Table of Contents

During the year ended June 30, 2014, we originated 7 one-to-four family residential loans totaling $1.2 million with adjustable rates of interest.

We evaluate both the borrower's ability to make principal, interest and escrow payments and the value of the property that will secure the loan. Our one-to-four family residential mortgage loans do not currently include prepayment penalties and do not produce negative amortization. Our one-to-four family residential mortgage loans customarily include due-on-sale clauses giving us the right to declare the loan immediately due and payable in the event that, among other things, the borrower sells the property subject to the mortgage.

We currently originate residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes. For traditional homes, we may originate loans with loan-to-value ratios in excess of 80% if the borrower obtains mortgage insurance or provides readily marketable collateral. We may make exceptions for special loan programs that we offer. For example, we currently offer mortgages of up to $95 thousand with loan-to-value ratios of up to 95% to low- to moderate-income borrowers solely for the purchase of their primary residence. We also originate residential mortgage loans for non-owner-occupied homes with loan-to-value ratios of up to 75%.

We also originate residential mortgage loans with loan-to-value ratios of up to 75% for manufactured or modular homes. We require lower loan-to-value ratios for manufactured and modular homes because such homes tend to depreciate over time. Manufactured or modular homes must be permanently affixed to a lot to make them more difficult to move without our permission. Such homes must be "de-titled" by the State of South Carolina so that they are taxed and must be transferred as residential homes rather than vehicles. We also obtain a mortgage on the real estate to which such homes are affixed. At June 30, 2014, the balance of loans secured by manufactured or modular homes was $1.8 million, representing 0.83% of our one-to-four family residential loans and 0.77% of our total loans.

At June 30, 2014, we had $1.9 million of one-to-four family residential mortgage loans that were 60 days or more delinquent and $4.9 million of one-to four-family residential mortgage loans that were 30-59 days delinquent. Among delinquent loans past due more than 60 days, only one loan exceeded $250 thousand in outstanding principal, or 41.5%, of total loans in this category. For loans past due 30-59 days past due, three loans with outstanding balances greater than $300 thousand totaled $1.1 million, or 22.7%, of the total balance of loans in this category.

Multi-family. Multi-family real estate loans generally have a maximum term of 30 years with a five year balloon payment and are secured by properties containing five or more units in the Company's market area. These loans are generally made in amounts of up to 75% of the lesser of the appraised value or the purchase price of the property with an appropriate projected debt service coverage ratio. The Company's underwriting analysis includes considering the borrower's expertise and requires verification of the borrower's credit history, income and financial statements, banking relationships, independent appraisals, references and income projections for the property. The Company generally obtains personal guarantees on these loans.

Multi-family real estate loans generally present a higher level of risk than loans secured by one-to-four family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family residential real estate is typically dependent upon the successful operation of the related real estate project.

Non-Residential Real Estate Lending. Our non-residential real estate loans are secured primarily by churches and, to a much lesser extent, office buildings, and retail and mixed-use properties located in our primary market area. We believe that focusing on loans to churches enables us to maintain our

Table of Contents

status as a community-oriented institution, and build our customer base as congregation members become familiar with us. At June 30, 2014, we had $8.4 million in non-residential real estate loans, representing 3.6% of our total loan portfolio.

The non-residential real estate loans that we originate generally have maximum terms of 5 years with amortization periods of 30 years. For loans secured by church property, our loans generally have maximum terms of 20 years with amortization periods of up to 20 years. The maximum loan-to-value ratio of our non-residential real estate loans is generally 75%. At June 30, 2014, our average outstanding non-residential mortgage loan balance was $311 thousand. Our largest non-residential real estate relationship totaled $3.1 million, of which $2.9 million related to one loan. This loan is secured by a mortgage on a church building in Seneca, South Carolina, and, at June 30, 2014, this loan was performing in accordance with its terms. At June 30, 2014, of our ten largest loans in our total portfolio, two loans totaling $4.3 million were non-residential real estate loans.

Set forth below is information regarding our non-residential real estate loans at June 30, 2014.

Type of Loan	**Number of Loans**	**Balance (Dollars in thousands)**
Church	21	$ 8,306
Other non-residential	5	102
Total	26	$ 8,408

We consider a number of factors in originating non-residential real estate loans. We evaluate the qualifications and financial condition of the borrower, including credit history, cash flows, the applicable business plan, the financial resources of the borrower, the borrower's experience in owning or managing similar property and the borrower's payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service). For church loans, we also consider the length of time the church has been in existence, the size and financial strength of the denomination with which it is affiliated, attendance figures and growth projections and current and pro forma operating budgets. The collateral underlying all non-residential real estate loans is appraised by outside independent appraisers approved by our board of directors. Personal guarantees may be obtained from the principals of non-residential real estate borrowers, and in the case of church loans, guarantees from the applicable denomination may be obtained.

Loans secured by non-residential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Non-residential real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. In addition, because a church's financial stability often depends on donations from congregation members, some of whom may not reside in our market area, rather than income from business operations, repayment may be affected by economic conditions that affect individuals located both in our market area and in other market areas with which we are not as familiar. In addition, due to the unique nature of church buildings and properties, the real estate securing church loans may be less marketable than other non-residential real estate. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate. At June 30, 2014, all of our non-residential real estate loans were performing in accordance with their terms.

Table of Contents

Construction Lending. We make construction loans to individuals for the construction of their primary residences. These loans generally have maximum terms of eight months, and upon completion of construction convert to conventional amortizing mortgage loans. These construction loans have rates and terms comparable to one-to-four family residential mortgage loans that we originate. During the construction phase, the borrower generally pays interest only. The maximum loan-to-value ratio of our owner-occupied construction loans is 80%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential mortgage loans.

We also make interim construction loans for non-residential properties. In addition, we occasionally make loans for the construction of homes "on speculation," but we generally permit a borrower to have only one such loan at a time. These loans generally have a maximum term of eight months, and upon completion of construction convert to conventional amortizing non-residential real estate loans. These construction loans have rates and terms comparable to permanent loans secured by property of the type being constructed that we originate. The maximum loan-to-value ratio of these construction loans is 80%.

We make loans secured by land to complement our construction lending activities. These loans have terms of up to 10 years, and maximum loan-to-value ratios of 75% for improved lots and 65% for unimproved land.

	Number of Loans	Loans in Process	Principal Balance
	(Dollars in thousands)		
One-to-four family	37	$ 10,557	$ 5,024
Nonresidential	1	$ 102	$ 48
Land	41		2,589
Total construction and land loans	79	$ 10,659	$ 7,661

At June 30, 2014, our largest residential construction loan was for $1.6 million, of which $0 was outstanding. This loan was performing according to its terms at June 30, 2014. At June 30, 2014, all of our construction loans were performing in accordance with their terms.

The application process for a construction loan includes a submission to Oconee Federal Savings and Loan Association of accurate plans, specifications and costs of the project to be constructed or developed, a copy of the deed or plat survey of the real estate involved in the loan and an appraisal of the proposed collateral for the loan. Our construction loan agreements generally provide that loan proceeds are disbursed in increments as construction progresses. Outside independent licensed or certified appraisers inspect the progress of the construction of the dwelling before disbursements are made.

To the extent our construction loans are not made to owner-occupants of single-family homes, they are more vulnerable to changes in economic conditions and the concentration of credit with a limited number of borrowers. Further, the nature of these loans is such that they are more difficult to evaluate and monitor. Our risk of loss on a construction or land loan is dependent largely upon the accuracy of the initial estimate of the property's value upon completion of the project and the estimated cost (including interest) of the project. If the estimate of value proves to be inaccurate, we may be confronted, at or prior to the maturity of the loan, with a project with a value which is insufficient to assure full repayment and/or the possibility of having to make substantial investments to complete and sell the project. Because defaults in repayment may not occur during the construction period, it may be difficult to identify problem loans at an early stage.

Home Equity Lending. We originate fixed-rate home equity loans secured by a lien on the borrower's primary residence, but only where we hold the first mortgage on the property. Our home equity loans are limited to an 80% loan-to-value ratio (including all prior liens), and have terms of up to 10 years with 10-year amortization periods. We use the same underwriting standards for home equity loans as we use for one-to-four family residential mortgage loans. Although we do not currently offer home equity lines of credit, we may offer lines of credit in the future. We expect that any lines of credit that we issue will be originated and underwritten using the same standards that we use for home equity loans and residential mortgage loans. At June 30, 2014, we had $227 thousand of home equity loans outstanding, representing 0.10% of our total loan portfolio.

Consumer Lending. We offer installment loans for various consumer purposes, including the purchase of automobiles, boats, appliances and recreational vehicles, and for other legitimate personal purposes. The maximum terms of consumer loans is 18 months for unsecured loans, 12 months for loans secured by marketable securities and 18-60 months for loans secured by a vehicle, depending on the age of the vehicle.

To date, our consumer lending apart from home equity loans has been quite limited. We generally only extend consumer loans to existing customers or their immediate family members, and these loans generally have relatively low limits. At June 30, 2014, we had $747 thousand of consumer loans outstanding, representing 0.32% of our total loan portfolio. Of these loans, $719 thousand, or 96.3%, were secured by deposits at Oconee Federal Savings and Loan Association.

Consumer loans may entail greater credit risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At June 30, 2014, all of our consumer loans were performing in accordance with their terms.

Originations, Purchases and Sales of Loans

Lending activities are conducted solely by our salaried personnel operating at our main and branch office locations. All loans originated by us are underwritten pursuant to our policies and procedures. We originate both fixed-rate and adjustable-rate loans. Our ability to originate fixed or adjustable-rate loans is dependent upon relative customer demand for such loans, which is affected by current and expected future levels of market interest rates. We originate real estate and other loans through our salaried loan officers, marketing efforts, our customer base, walk-in customers and referrals from real estate brokers, builders and attorneys.

We currently do not purchase whole loans or interests in loans from third parties or sell any of the loans that we originate into the secondary market. However, we may in the future elect to do so, depending on market conditions, in order to supplement our loan production or diversify our risk.

Table of Contents

The following table shows our gross loan origination and principal repayment activity for loans originated for our portfolios during the periods indicated:

	Years Ended June 30, 2014	2013
	(In thousands)	
Total loans at beginning of period	$ 223,128	$ 252,229
Loans originated:		
Real estate loans:		
One-to-four family	29,949	16,632
Multi-family		
Home equity		
Nonresidential	248	62
Construction and land	5,287	18,576
Total real estate loans	35,484	35,270
Consumer and other loans	353	170
Total loans originated	35,837	35,440
Deduct:		
Principal repayments	(26,865)	(63,154)
Transfers to real estate owned	(68)	(1,387)
Net loan activity	8,904	(29,101)
Total loans at end of period	$ 232,032	$ 223,128

Delinquencies and Non-Performing Assets

Delinquency Procedures. When a loan payment becomes 20 days past due, we contact the customer by mailing a late notice. If a loan payment becomes 30 days past due, we mail a "right to cure" letter to the borrower and any co-makers and endorsers. If a loan payment becomes 90 days past due (or a borrower misses three consecutive payments, whichever occurs first), we send a demand letter and generally cease accruing interest. It is our policy to institute legal procedures for collection or foreclosure when a loan becomes 120 days past due, unless management determines that it is in the best interest of Oconee Federal Savings and Loan Association to work further with the borrower to arrange a workout plan. It is our policy to not accept deeds in lieu of foreclosure.

When we acquire real estate as a result of foreclosure, the real estate is classified as real estate owned. The real estate owned is recorded at the lower of carrying amount or fair value, less estimated costs to sell. Soon after acquisition, we order a new appraisal to determine the current market value of the property. Any excess of the recorded value of the loan satisfied over the market value of the property is charged against the allowance for loan losses, or, if the existing allowance is inadequate, charged to expense of the current period. After acquisition, all costs incurred in maintaining the property are expensed. Costs relating to the development and improvement of the property, however, are capitalized to the extent of estimated fair value less estimated costs to sell.

Table of Contents

Delinquent Loans. The following table sets forth our loan delinquencies, including non-accrual loans, by type and amount at the dates indicated.

	At June 30,							
	2014				2013			
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due
	(Dollars in thousands)							
Real estate loans:								
One-to-four family	$ 4,856	$ 893	$ 1,053	$ 6,802	$ 5,932	$ 2,397	$ 1,726	$ 10,055
Multi-family								
Home equity					30			30
Nonresidential	87			87				
Construction and land								
Total real estate loans	4,943	893	1,053	6,889	5,962	2,397	1,726	10,085
Consumer and other loans					1			1
Total	$ 4,943	$ 893	$ 1,053	$ 6,889	$ 5,963	$ 2,397	$ 1,726	$ 10,086

Total delinquencies declined $3.2 million, or 31.7%, to $6.9 million at June 30, 2014 as compared with total delinquencies of $10.1 million at June 30, 2013. The decline in our delinquencies is a reflection of improving asset quality and a stronger economy in our market area during 2014 as compared with 2013. We count loans with partial payments due as delinquent.

Classified Assets. Federal regulations provide for the classification of loans and other assets, such as debt and equity securities considered to be of lesser quality, as "substandard," "doubtful" or "loss." An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard," with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss allowance is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated as "special mention" by our management.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances in an amount deemed prudent by management to cover probable accrued losses. General allowances represent loss allowances which have been established to cover probable accrued losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as "loss," it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge-off such amount. An institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the regulatory authorities, which may require the establishment of additional general or specific loss allowances.

In connection with the filing of our periodic reports to our regulators and in accordance with our classification of assets policy, we regularly review the problem loans in our portfolio to determine whether any loans require classification in accordance with applicable regulations.

Table of Contents

On the basis of this review of our assets, our classified or special mention assets at the dates indicated were as set forth below. Special mention and substandard assets are presented gross of allowance, and doubtful assets are presented net of allowance.

	At June 30,	
	2014	2013
	(Dollars in thousands)	
Special mention assets	$	$
Substandard assets	1,647	1,986
Doubtful assets(1)	744	1,047
Loss assets		
Total classified assets	$ 2,391	$ 3,033

(1) Consists solely of real estate owned.

Doubtful assets or real estate owned assets decreased by $303, thousand, or 28.9%, to $744 thousand at June 30, 2014 from $1.0 million at June 30, 2013. Our substandard assets decreased by $339 thousand, or 17.1%, to $1.6 million at June 30, 2014 from $2.0 million at June 30, 2013, and our overall classified asset totals decreased by $642 thousand, or 21.2%, to $2.4 million at June 30, 2014 from $3.0 million at June 30, 2013 due to improving credit quality in our loan portfolio.

Non-Performing Assets. We generally cease accruing interest on our loans when contractual payments of principal or interest have become 90 days delinquent unless the loan is well-secured and in the process of collection. Loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not received for loans placed on non-accrual are reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until the loans qualify for return to accrual. Generally, loans are restored to accrual status when all the principal and interest amounts contractually due are brought current, and future payments are reasonably assured. Loans are moved to non-accrual status in accordance with our policy, which is typically after 90 days of non-payment.

Table of Contents

The table below sets forth the amounts and categories of our non-performing assets at the dates indicated.

	At June 30,				
	2014	2013	2012	2011	2010
	(Dollars in thousands)				
Non-accrual loans:					
Real estate loans:					
One- to four-family	$ 1,647	$ 1,493	$ 2,157	$ 1,567	$ 3,214
Multi-family					
Home equity					
Non-residential					
Construction and land					