Oconee Federal Financial Corp.
Form 10-K
September 24, 2018

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, 2018

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 No

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

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.
Yes 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 such shorter period that the registrant was required to submit and post such files). Yes
No

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.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

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

As of September 13, 2018 there were 5,756,157 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, 2017 was $45.5 million.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2018 Annual Meeting of Stockholders. (Part III)

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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 in response to changes in 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 by 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;
- our ability to successfully implement our business strategies;
- risks related to a 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 allowance 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;

changes in laws or government regulations or policies affecting financial institutions, which could result in, among other things, increased deposit insurance premiums and assessments, capital requirements, regulatory fees and compliance costs and the resources we have available to address such changes;

technological changes that may be more difficult or expensive than expected;

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;

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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 Federal Home Loan Bank ("FHLB") of Atlanta; and
other economic, competitive, governmental, regulatory and operational factors affecting our operations, pricing, products and services.

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 ("Association") in connection with the mutual holding company reorganization of Oconee Federal Savings and Loan Association.

As of June 30, 2018, Oconee Federal Financial Corp. had 5,774,589 shares outstanding and a market capitalization of approximately $167.1 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, 2018, we had total assets of $488.0 million, total deposits of $387.6 million and total equity of $84.9 million. We recorded net income of $3.0 million for the year ended June 30, 2018.

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 and in 1991 it converted to a federal charter.

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 lesser extent, nonresidential mortgage, construction and land, agricultural and other loans. We also invest in U.S. Government and federal agency securities, mortgage-backed securities, municipal 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 executive office, seven full service branch offices and two loan production offices. Our branch offices are located in Oconee County, South Carolina, Stephens County, Georgia and Rabun County, Georgia. Our loan production offices are located in Pickens County and Greenville County, South Carolina. Our primary market area consists of the counties where we have offices and the nearby communities and townships in adjacent counties in South Carolina and Georgia.

Oconee Federal Savings and Loan Association is subject to comprehensive regulation and examination by the Office of the Comptroller of the Currency. 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 holding company reorganization of Oconee Federal Savings and Loan Association. As a mutual non-stock holding company, Oconee Federal, MHC has as its members all current holders of deposit accounts at Oconee Federal Savings and Loan Association and certain borrowers of as of October 21, 1991, whose borrowings remain outstanding. 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.

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Market Area

We conduct business through our executive office, four full service branches in Seneca, Walhalla, and Westminster South Carolina, three full service branches in Toccoa and Clayton, Georgia, and two loan production offices in Clemson and Greer, South Carolina. All five of our South Carolina full service branches 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 South Carolina full service branches are also located approximately 40 miles south of Greenville, South Carolina, and 10 miles from Clemson, South Carolina. Two of our Georgia branches are located in Stephens County and one is located in Rabun County. Both counties border Oconee County, South Carolina. We also have a loan production office in both Clemson and Greer South Carolina.

Our primary market area, which consists of Oconee County, South Carolina and Stephens and Rabun Counties, Georgia and their nearby communities and townships in adjacent counties in both South Carolina and Georgia, is mostly rural and suburban in nature. Our primary market area economy has historically been concentrated in manufacturing. 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.

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 our primary markets and the relatively large number of institutions that maintain a presence in the area. 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 investment services, 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, 2018 the most recent date of available data, our market share of deposits represented 23.0%, 24.8%, and 8.0% of FDIC-insured deposits in Oconee County, South Carolina, Stephens County, Georgia, and Rabun County, Georgia, respectively.

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 lesser extent, home equity loans and lines of credit, nonresidential real estate loans, construction and land loans, commercial loans, agricultural loans, and other loans. We increased our loan portfolio of nonresidential real estate loans, home equity loans and lines of credit, and added agricultural loans and to a much lesser extent than the other segments, commercial and industrial loans through a prior year acquisition. We plan to continue to maintain in our portfolio the loans we acquired that are of sound credit quality and to increase our lending in nonresidential real estate loans and commercial loans to a modest extent in our primary market area.

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,					
	2018		2017		2016	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Real estate loans:						
One-to-four family	$269,868	82.34 %	$259,854	84.49 %	$241,079	82.55 %
Multi-family	1,735	0.53	1,864	0.61	1,994	0.68
Home equity	3,914	1.19	4,900	1.59	6,575	2.25
Nonresidential	17,591	5.37	19,176	6.23	20,299	6.95
Agricultural	1,272	0.39	1,441	0.47	2,957	1.01
Construction and land	27,513	8.39	15,254	4.96	14,083	4.82
Total real estate loans	321,893	98.21	302,489	98.35	286,987	98.26
Commercial and industrial	326	0.10	51	0.02	176	0.06
Consumer and other loans	5,539	1.69	5,018	1.63	4,900	1.68
Total loans	$327,758	100.00 %	$307,558	100.00 %	$292,063	100.00%
Allowance for loan losses	(1,097)		(1,016)		(922)	
Loans, net	$326,661		$306,542		$291,141	

	At June 30,			
	2015		2014	
	Amount	**Percent**	**Amount**	**Percent**
	(Dollars in thousands)			
Real estate loans:				
One-to-four family	$255,219	82.52 %	$213,585	92.55 %
Multi-family	2,572	0.83	252	0.11
Home equity	8,198	2.65	227	0.10
Nonresidential	25,839	8.35	8,398	3.62
Construction and land	14,510	4.69	7,578	3.30
Total real estate loans	306,338	99.05	230,039	99.68
Consumer and other loans	2,929	0.95	747	0.32
Total loans	$309,267	100.00 %	$230,786	100.00 %
Allowance for loan losses	(1,008)		(855)	
Loans, net	$308,259		$229,931	

Contractual Maturities and Interest Rate Sensitivity. The following table summarizes the scheduled repayments of our loan portfolio at June 30, 2018. 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.

	Real Estate Loans								
	One-to-Four Family	Multi-family	Home Equity	Non-Residential	Agricultural	Construction and Land	Commercial and Industrial	Consumer and Other	Total
	(Dollars in thousands)								
Amounts due in:									
One year or less	$2,058	$ —	$1,498	$ 28	$ 199	$ 5,499	$ —	$4,282	$13,564
More than one to five years	13,408	177	672	5,269	39	4,949	209	1,065	25,788
More than five to ten years	28,829	1,558	1,651	6,081	349	6,402	117	34	45,021
More than ten years	225,573	—	93	6,213	685	10,663	—	158	243,385
Total	$269,868	$ 1,735	$3,914	$ 17,591	$ 1,272	$ 27,513	$ 326	$5,539	$327,758

For loans with maturities greater than one year from June 30, 2018, $25.2 million have variable rates and $289.0 million have fixed rates.

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, 2018, based on the 15% limitation, Oconee Federal Savings and Loan Association's loans-to-one-borrower limit was approximately $11.4 million. At June 30, 2018, our largest loan relationship with one borrower was for approximately $3.5 million secured by a brokerage account 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.

Our lending officers do not have individual lending authority. We have a tiered approval process requiring multiple officers and/or committee approval depending on the size of the loan credit exposure. Total credit exposure is the sum total of all loans that a customer has directly or guarantees with Oconee Federal. 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. 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. These loans are made in amounts generally 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. At June 30, 2018, $269.9 million, or 82.3% of our total loan portfolio, consisted of one-to-four family residential mortgage loans. Virtually all of the residential mortgage loans we originate are secured by properties located in our market area.

The repayment 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 repayment 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. 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. Due to consumer demand in the current low market interest rate environment, most of our recent originations are 15- to 30-year fixed-rate loans secured by one-to-four family residential real estate.

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.

Multi-family. Multi-family real estate loans generally have a maximum term of five years with a 30-year amortization period and a final balloon payment and are secured by properties containing five or more units in our 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. Our 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. We 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.

Home Equity. We offer home equity loans and lines of credit secured by first or second deeds of trust on primary residences in our market area. Our home equity loans and lines of credit are limited to an 80% loan-to-value ratio (including all prior liens). Standard residential mortgage underwriting requirements are used to evaluate these loans. We offer adjustable-rate and fixed-rate options for these loans with a maximum term of 10 years. The repayment terms on lines of credit are interest only monthly with principle due at maturity. Home equity loans have a more traditional repayment structure with principal and interest due monthly. The maximum term on home equity loans is 10 years with an amortization schedule not to exceed 20 years.

Nonresidential Real Estate. Nonresidential loans include those secured by real estate mortgages on churches, owner-occupied and non-owner occupied commercial buildings of various types, retail and office buildings, hotels, and other business and industrial properties. The nonresidential real estate loans that we originate generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of our nonresidential real estate loans is generally 75%.

We consider a number of factors in originating nonresidential 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). The collateral underlying all nonresidential real estate loans is appraised by outside independent appraisers approved by our board of directors. Personal guarantees may be obtained from the principals of nonresidential real estate borrowers.

Loans secured by nonresidential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Nonresidential 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. Our nonresidential real estate lending includes a significant amount of loans to churches. Because a church's financial stability often depends on donations from congregation members 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 nonresidential real estate. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

Agricultural. Agricultural loans are secured by farmland and related improvements in our market area. These loans generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of these loans is generally 75%.

Loans secured by agricultural real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Agricultural 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.

Construction and Land. We generally make construction loans to individuals for the construction of their primary residences and to commercial businesses for their real estate needs. These loans generally have maximum terms of twelve months, and upon completion of construction convert to conventional amortizing mortgage loans. Residential construction loans have rates and terms comparable to one-to-four family residential mortgage loans that we originate. Commercial construction loans have rates and terms comparable to other commercial real estate 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. Commercial construction loans are generally underwritten pursuant to the same guidelines used for originating other commercial real estate loans. 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.

The application process for a construction loan includes a submission 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 or architects 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.

Commercial and Industrial. Commercial and industrial loans are offered to businesses and professionals in our market area. These loans generally have short and medium terms on both a collateralized and uncollateralized basis. The structure of these loans are largely determined by the loan purpose and collateral. Sources of collateral can include a lien on furniture, fixtures, equipment, inventory, receivables and other assets of the company. A UCC-1 is typically filed to perfect our lien on these assets.

Commercial and industrial loans and leases typically are underwritten on the basis of the borrower’s or lessee’s ability to make repayment from the cash flow of its business and generally are collateralized by business assets. As a result, such loans and leases involve additional complexities, variables and risks and require more thorough underwriting and servicing than other types of loans and leases.

Consumer. We offer installment loans for various consumer purposes, including the purchase of automobiles, boats, 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 to 60 months for loans secured by a vehicle, depending on the age of the vehicle. We generally only extends consumer loans to existing customers or their immediate family members, and these loans generally have relatively low balances. To date, our consumer lending, apart from home equity loans, has been quite limited.

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.

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.

Secondary Mortgage Lending

We have access to secondary mortgage lending programs. As such we originated and sold $4.5 million of conforming one-to-four residential real estate mortgage loans for the year ended June 30, 2018.

Delinquencies and Nonperforming Assets

Delinquency Procedures. It is the policy of the Association to promptly identify all delinquent loan accounts and use all reasonable and legal means either to cure the delinquencies or to take prompt legal action to foreclose, repossess or liquidate the collateral.

When we acquire real estate as a result of foreclosure, the real estate is classified as real estate owned. Real estate owned is initially recorded at fair value less costs to sell. Thereafter, it 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. Subsequent impairments in value of real estate owned are recorded as an impairment loss.

Delinquent Loans. The following table sets forth our loan delinquencies by type and amount at the dates indicated:

	At June 30, 2018				**2017**			
	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	$5,180	$1,787	$897	$7,864	$6,143	$1,109	$1,100	$8,352
Multi-family	—	—	—	—	—	—	—	—
Home equity	106	84	40	230	161	—	40	201
Nonresidential	376	179	—	555	—	43	—	43
Agricultural	—	424	—	424	—	448	—	448
Construction and land	50	34	—	84	40	—	35	75
Total real estate loans	5,712	2,508	937	9,157	6,344	1,600	1,175	9,119

Commercial and industrial	—	—	—	—	—	—	—	—
Consumer and other loans	—	—	—	—	10	1	—	11
Total	$5,712	$2,508	$937	$9,157	$6,354	$1,601	$1,175	$9,130

Total delinquencies increased $27 thousand, or 0.3%, to $9.2 million at June 30, 2018 as compared to total delinquencies of $9.1 million at June 30, 2017. 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.

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,	
	2018	2017
	(Dollars in thousands)	
Special mention assets	$4,998	$4,621
Substandard assets	8,627	7,766
Doubtful assets	—	—
Loss assets	—	—
Real estate owned	1,074	865
Total Special mention and Classified assets	$14,699	$13,252

Real estate owned assets increased by $209 thousand, or 24.2%, to $1.1 million at June 30, 2018 from $865 thousand at June 30, 2017. Our substandard assets increased by $861 thousand, or 11.1%, to $8.6 million at June 30, 2018 from $7.8 million at June 30, 2017. Our overall classified asset totals increased by $1.4 million, or 10.9%, to $14.7 million at June 30, 2018 from $13.3 million at June 30, 2017. Special mention assets at June 30, 2018 consisted primarily of one-to-four family real estate loans of $3.4 million, nonresidential real estate loans of $1.1 million, and $505 thousand of other loans as compared to the June 30, 2017 balances which consisted primarily of one-to-four family real estate loans of $2.7 million, nonresidential real estate loans of $1.4 million, and $569 thousand of other loans. Substandard assets at June 30, 2018 consisted primarily of $6.7 million in one-to-four family residential real estate loans, $1.2 million of nonresidential real estate loans and $697 thousand of other loans as compared to the June 30, 2017 balances which consisted primarily of $6.5 million in one-to-four family residential real estate loans, $710 thousand of nonresidential real estate loans and $514 thousand of other loans.

Loans classified as substandard and doubtful are considered to be impaired loans. Impaired loans are loans that we do not reasonably believe that we will collect all contractual principal and interest payments due on the loans. Those over $250 thousand are individually evaluated to determine if a specific loss reserve is required. All others are collectively evaluated. The recorded investment of these loans at June 30, 2018 was $8.6 million, an increase of $861 thousand from $7.8 million at June 30, 2017. There were no specific allowances reserved for these loans at June 30, 2018. Specific allowances of $8 thousand were reserved for these loans at June 30, 2017.

Nonperforming 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 nonaccrual 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 nonaccrual 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 nonaccrual status in accordance with our policy, which is typically after 90 days of non-payment. Loans for which the terms have been modified and for which (i) the borrower is experiencing financial difficulties and (ii) we have granted a concession to the borrower are considered troubled debt restructurings (“TDRs”) and are included in impaired loans and leases. Income on nonaccrual loans or leases, including impaired loans and leases but excluding certain TDRs which continue to accrue interest, is recognized on a cash basis when and if actually collected. For the year ended June 30, 2018, there were no defaults on any loans that were considered TDRs. At June 30, 2018, all TDRs were on nonaccrual status.

The table below sets forth the amounts and categories of our nonperforming assets at the dates indicated:

	At June 30,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Nonaccrual loans:					
Real estate loans:					
One-to-four family	$3,969	$2,762	$2,133	$2,311	$1,647
Multi-family	—	—	—	—	—
Home equity	40	89	126	—	—
Nonresidential	908	43	942	1,379	—
Agricultural	445	514	531	487	—
Construction and land	19	75	25	—	—
Total real estate loans	5,381	3,483	3,757	4,177	1,647
Commercial and industrial	—	—	—	—	—
Consumer and other loans	1	—	—	—	—
Total nonaccrual loans	$5,382	$3,483	$3,757	$4,177	$1,647
Accruing loans past due 90 days or more:					
Real estate loans:					
One-to-four family	$—	$—	$—	$—	$—
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	—	—	—	—	—
Agricultural	—	—	—	—	—
Construction and land	—	—	—	—	—
Total real estate loans	—	—	—	—	—
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total accruing loans past due 90 days or more	—	—	—	—	—
Total of nonaccrual and 90 days or more past due loans	$5,382	$3,483	$3,757	$4,177	$1,647
Real estate owned:					
One-to-four family	$91	$152	$899	$1,335	$744
Multi-family	—	—	—	—	—
Home equity	—	—	267	—	—
Nonresidential	983	713	188	365	—
Construction and land	—	—	—	392	—
Total real estate owned	1,074	865	1,354	2,092	744
Other nonperforming assets	—	—	—	—	—
Total nonperforming assets	$6,456	$4,348	$5,111	$6,269	$2,391
Accruing troubled debt restructurings	$—	$—	$—	$—	$—
Accruing troubled debt restructurings and total nonperforming assets	$6,456	$4,348	$5,111	$6,269	$2,391
Total nonperforming loans to total loans	1.64 %	1.13 %	1.29 %	1.35 %	0.71 %
Total nonperforming assets to total assets	1.32 %	0.90 %	1.05 %	1.32 %	0.66 %
Total nonperforming assets to loans and real estate owned	1.96 %	1.41 %	1.74 %	2.01 %	1.03 %

All nonperforming loans in the table above were classified either as substandard or doubtful. There were no other loans that are not already disclosed where there is information about possible credit problems of borrowers that caused us serious doubts about the ability of the borrowers to comply with present loan repayment terms and that may result in disclosure of such loans in the future.

Interest income that would have been recorded had our nonaccrual loans been current in accordance with their original terms was $323 thousand for the year ended June 30, 2018. Interest of $43 thousand was recognized on these loans and is included in net income for the year ended June 30, 2018. Interest income that would have been recorded had our trouble debt restructured loans been current in accordance with their original terms was $163 thousand for the year ended June 30, 2018. Interest recognized on TDRs during the year ended June 30, 2018 totaled $17 thousand.

Allowance for Loan Losses

Analysis and Determination of the Allowance for Loan Losses. Our allowance for loan losses is the amount considered necessary to reflect probable losses inherent in our loan portfolio. We evaluate the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of two key elements: (a) specific allowances for identified problem loans; and (b) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio.

Specific Allowances for Identified Problem Loans. We establish a specific allowance when loans are determined to be impaired. Loss is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. Factors in identifying a specific problem loan include:

- the strength of the customer's personal or business cash flows;
- the availability of other sources of repayment;
- the amount due or past due;
- the type and value of collateral;
- the strength of our collateral position;
- the estimated cost to sell the collateral; and
- the borrower's effort to cure the delinquency.

In addition, for loans secured by real estate, we consider the extent of any past due and unpaid property taxes applicable to the property serving as collateral on the mortgage.

General Valuation Allowance of the Loan Portfolio. We establish a general allowance for smaller balance, homogenous loans that are not otherwise specifically impaired to recognize the probable incurred losses within our portfolio, but which, unlike specific allowances, has not been allocated to particular problem loans. In estimating this portion of the allowance, we apply loss factors to each loan portfolio segment. Loans not identified as impaired are aggregated into homogenous pools of loans, or segments, which share similar risk characteristics, primarily based on the type of loan, the purpose of the loan, and the underlying collateral supporting the loan. We estimate our loss factors taking into consideration both quantitative and qualitative aspects that would affect our estimation of probable incurred losses. These aspects include, but are not limited to historical charge-offs; loan delinquencies and foreclosure trends; current economic trends and demographic data within our primary market area such as unemployment rates and population trends; current trends in real estate values within our market area; charge-off trends of other comparable institutions; the results of any internal loan reviews; loan to value ratios; our historically conservative credit risk policy; the strength of our underwriting and ongoing credit monitoring function; and other relevant factors.

We evaluate our loss factors quarterly to ensure their relevance in the current real estate and economic environment, and we review the allowance for loan losses (as a percentage of total loans) maintained by us relative to other thrift institutions within our peer group, taking into consideration the other institutions' delinquency trends, charge-offs, nonperforming loans, and portfolio composition as a basis for validation for the adequacy of our overall allowance for loan loss.

Acquired Loans. We separate loans that we have acquired through a business combination from loans that we have originated when computing the general valuation allowance. We do this as loans that we have acquired have a completely different risk profile as these loans were originated from a different demographic market from ours and underwritten and collateralized according to different lending policies and practices. Therefore, we apply different loss factors to those loans in determining the general valuation allowance. These loss factors represent the credit discounts used in the original fair value determinations made on the date of acquisition of these loans. We will continue to evaluate these factors on a quarterly basis based on both quantitative and qualitative considerations and revise these factors as necessary.

Acquired loans that are identified as purchased credit impaired (PCI) will continue to be classified as PCI for their remaining lives, even if modified, extended or renewed, unless they meet the criteria for a TDR. We perform the same type of evaluation for these loans as any other loan that we believe to be impaired. Each PCI loan is evaluated on an individual basis quarterly.

Overall Allowance. Our allowance at June 30, 2018 reflects a general valuation component of $1.1 million and no specific component of specific loans determined to be impaired. In comparison, our allowance at June 30, 2017 consisted of a general valuation component of $1.0 million and a specific component of $8 thousand. The overall allowance increased $81 thousand and remained stable as a percentage of total loans at 0.33% June 30, 2018 and 2017. Impaired loans increased from $7.8 million to $8.6 million from June 30, 2017 to June 30, 2018.

At June 30, 2018, all individually evaluated impaired loans were within our acquired loan portfolio and totaled $3.5 million, all of which were purchased credit impaired. There was no impairment measured on these loans. At June 30, 2017, within our acquired loan portfolio, we had a total of $3.7 million in individually evaluated impaired loans, all of which were purchased credit impaired. The amount of impairment measured on these loans was $8 thousand.

Within our originated portfolio, there were no loans specifically identified as impaired at June 30, 2018 or June 30, 2017. To the best of our knowledge, we have recorded all losses that are both probable and reasonably estimable for the years ended June 30, 2018 and 2017. Net charge-offs for the year ended June 30, 2018 were $27 thousand compared to $109 thousand for the year ended June 30, 2017.

Allowance for Loan Losses. The following table sets forth activity in our allowance for loan losses for the years indicated:

	Year Ended June 30,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Allowance at beginning of year	$1,016	$922	$1,008	$855	$751
Provision for loan losses	108	203	451	195	108
Charge-offs:					
Real estate loans					
One-to-four family	—	(33)	(447)	—	(4)
Multi-family	—	—	—	—	—
Home equity	(13)	—	(72)	(40)	—
Nonresidential	—	(77)	—	—	—
Agricultural	—	—	—	—	—
Construction and land	(26)	—	(9)	—	—
Commercial and industrial	—	—	—	—	—
Consumer and other loans	(1)	(1)	(9)	(2)	—
Total charge-offs	(40)	(111)	(537)	(42)	(4)
Recoveries:					
Real estate loans					
One-to-four family	—	2	—	—	—
Multi-family	—	—	—	—	—
Home equity	13	—			