Oconee Federal Financial Corp.
Form 10-Q
November 09, 2018

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

# FORM 10-Q

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

**For the Quarterly Period ended September 30, 2018**

**Or**

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

**For transition period from to**

**Commission File Number 001-35033**

**Oconee Federal Financial Corp.**

**(Exact Name of Registrant as Specified in Charter)**

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

**(864) 882-2765**

**Registrant's telephone number, including area code**

**Not Applicable**

**(Former name or former address, if changed since last report)**

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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 definitions of "large accelerated filer," "accelerated filer," smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date.

There were 5,762,245 shares of Common Stock, par value $0.01 per share, outstanding as of November 5, 2018.

**OCONEE FEDERAL FINANCIAL CORP.**

Form 10-Q Quarterly Report

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OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share and per share data)

**PART I**

ITEM 1. FINANCIAL STATEMENTS

| | September 30, 2018 (unaudited) | June 30, 2018 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 3,538 | $ 3,681 |
| Interest-earning deposits | 3,405 | 6,193 |
| Fed funds sold | 114 | 36 |
| Total cash and cash equivalents | 7,057 | 9,910 |
| Securities available-for-sale | 111,479 | 115,146 |
| Loans | 341,960 | 327,758 |
| Allowance for loan losses | (1,151) | (1,097) |
| Net loans | 340,809 | 326,661 |
| Loans held for sale, at fair value | 69 | — |
| Premises and equipment, net | 7,658 | 6,817 |
| Real estate owned, net | 775 | 1,074 |
| Accrued interest receivable | | |
| Loans | 1,050 | 961 |
| Investments | 543 | 615 |
| Restricted equity securities, at cost | 1,745 | 1,639 |
| Bank owned life insurance | 18,668 | 18,554 |
| Goodwill | 2,593 | 2,593 |
| Core deposit intangible | 387 | 417 |
| Loan servicing rights | 1,050 | 1,093 |
| Deferred tax assets | 2,153 | 1,982 |
| Other assets | 444 | 497 |
| Total assets | $ 496,480 | $ 487,959 |
| | | |
| LIABILITIES | | |
| Deposits | | |
| Noninterest - bearing | $ 34,273 | $ 31,189 |
| Interest - bearing | 360,147 | 356,399 |
| Total deposits | 394,420 | 387,588 |

| | | |
|---|---|---|
| FHLB advances | 17,000 | 14,500 |
| Accrued interest payable and other liabilities | 783 | 1,006 |
| Total liabilities | 412,203 | 403,094 |
| | | |
| SHAREHOLDERS' EQUITY | | |
| Common stock, $0.01 par value, 100,000,000 shares authorized; 6,495,066 and 6,488,975 shares outstanding, respectively | 65 | 65 |
| Treasury stock, at par, 730,168 and 714,386 shares, respectively | (7) | (7) |
| Additional paid-in capital | 11,582 | 12,000 |
| Retained earnings | 76,442 | 76,136 |
| Accumulated other comprehensive loss | (3,053) | (2,528) |
| Unearned ESOP shares | (752) | (801) |
| Total shareholders' equity | 84,277 | 84,865 |
| Total liabilities and shareholders' equity | $ 496,480 | $ 487,959 |

See accompanying notes to the consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(Amounts in thousands, except share and per share data)

| | Three Months Ended | |
|---|---|---|
| | September 30, 2018 | September 30, 2017 |
| Interest and dividend income: | | |
| Loans, including fees | $3,767 | $ 3,555 |
| Securities, taxable | 414 | 369 |
| Securities, tax-exempt | 209 | 206 |
| Other interest-earning assets | 31 | 35 |
| Total interest income | 4,421 | 4,165 |
| | | |
| Interest expense: | | |
| Deposits | 565 | 362 |
| Other borrowings | 85 | 11 |
| Total interest expense | 650 | 373 |
| | | |
| Net interest income | 3,771 | 3,792 |
| | | |
| Provision for loan losses | 72 | 46 |
| | | |
| Net interest income after provision for loan losses | 3,699 | 3,746 |
| | | |
| Noninterest income: | | |
| Service charges on deposit accounts | 100 | 108 |
| Income on bank owned life insurance | 114 | 119 |
| Mortgage servicing income | 58 | 68 |
| Gain on sale of mortgage loans | 26 | — |
| ATM & debit card income | 73 | 68 |
| Gain on sale of securities, net | 1 | 10 |
| Other | 36 | 31 |
| Total noninterest income | 408 | 404 |
| | | |
| Noninterest expense: | | |
| Salaries and employee benefits | 1,686 | 1,556 |
| Occupancy and equipment | 415 | 397 |
| Data processing | 255 | 230 |
| ATM & debit card expense | 54 | 44 |
| Professional and supervisory fees | 196 | 206 |

| | | |
|---|---|---|
| Office expense | 45 | 42 |
| Advertising | 50 | 45 |
| FDIC deposit insurance | 33 | 34 |
| Foreclosed assets, net | 13 | 50 |
| Change in loan servicing asset | 43 | 52 |
| Other | 207 | 211 |
| Total noninterest expense | 2,997 | 2,867 |
| | | |
| Income before income taxes | 1,110 | 1,283 |
| Income tax expense | 226 | 426 |
| | | |
| Net income | $884 | $ 857 |
| | | |
| Other comprehensive income/(loss) | | |
| Unrealized ains/(losses) on securities available-for-sale | $(665 ) | $ 136 |
| Tax effect | 141 | (50 ) |
| Reclassification adjustment for (gains)/losses realized in net income | (1 ) | (10 ) |
| Tax effect | — | 4 |
| Total other comprehensive income/(loss) | (525 ) | 80 |
| | | |
| Comprehensive income | $359 | $ 937 |
| | | |
| Basic net income per share: (Note 3) | $0.16 | $ 0.15 |
| Diluted net income per share: (Note 3) | $0.15 | $ 0.15 |
| Dividends declared per share: | $0.10 | $ 0.10 |

See accompanying notes to the consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

(Amounts in thousands, except share and per share data)

| | Common Stock | Treasury Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (loss) | Unearned ESOP Shares | Total |
|---|---|---|---|---|---|---|---|
| Balance at June 30, 2017 | $ 65 | $ (7 ) | $ 11,940 | $ 75,169 | $ (202 ) | $ (1,004 ) | $ 85,961 |
| Net income | — | — | — | 857 | — | — | 857 |
| Other comprehensive income | — | — | — | — | 80 | — | 80 |
| Purchase of 7,576 shares of treasury stock[(1)] | — | — | (208 ) | — | — | — | (208 ) |
| Stock-based compensation expense | — | — | 6 | — | — | — | 6 |
| Dividends | — | — | — | (575 ) | — | — | (575 ) |
| ESOP shares earned | — | — | 96 | — | — | 52 | 148 |
| Balance at September 30, 2017 | $ 65 | $ (7 ) | $ 11,834 | $ 75,451 | $ (122 ) | $ (952 ) | $ 86,269 |
| | | | | | | | |
| Balance at June 30, 2018 | $ 65 | $ (7 ) | $ 12,000 | $ 76,136 | $ (2,528 ) | $ (801 ) | $ 84,865 |
| Net income | — | — | — | 884 | — | — | 884 |
| Other comprehensive loss | — | — | — | — | (525 ) | — | (525 ) |
| Purchase of 15,782 shares of treasury stock[(2)] | — | — | (521 ) | — | — | — | (521 ) |
| Stock-based compensation expense | — | — | 36 | — | — | — | 36 |
| Dividends | — | — | 1 | (578 ) | — | — | (577 ) |
| ESOP shares earned | — | — | 66 | — | — | 49 | 115 |
| Balance at September 30, 2018 | $ 65 | $ (7 ) | $ 11,582 | $ 76,442 | $ (3,053 ) | $ (752 ) | $ 84,277 |

(1) The weighted average cost of treasury shares purchased during the three months ended was $27.46 per share. Treasury stock repurchases were accounted for using the par value method.

(2) The weighted average cost of treasury shares purchased during the three months ended was $27.44 per share. Treasury stock repurchases were accounted for using the par value method.

See accompanying notes to the consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in thousands, except share and per share data)

| | Three Months Ended | |
|---|---|---|
| | September 30, 2018 | September 30, 2017 |
| Cash Flows From Operating Activities | | |
| Net income | $ 884 | $ 857 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 72 | 46 |
| Provision for real estate owned | 18 | 26 |
| Depreciation and amortization, net | 298 | 345 |
| Net (accretion)/amortization of purchase accounting adjustments | (56) | (39) |
| Deferred income tax expense/(benefit) | (30) | (19) |
| Net gain on sale of real estate owned | (12) | (4) |
| Net gain on sale of fixed assets | (29) | — |
| Change in loan servicing asset | 43 | 52 |
| Net gain on sales of securities | (1) | (10) |
| Mortgage loans originated for sale | (1,723) | (1,082) |
| Mortgage loans sold | 1,680 | 1,337 |
| Gain on sales of mortgage loans | (26) | (10) |
| Increase in cash surrender value of bank owned life insurance | (114) | (120) |
| ESOP compensation expense | 115 | 148 |
| Stock based compensation expense | 36 | 6 |
| Net change in operating assets and liabilities: | | |
| Accrued interest receivable and other assets | 36 | 192 |
| Accrued interest payable and other liabilities | (223) | (102) |
| Net cash provided by operating activities | 968 | 1,623 |
| | | |
| Cash Flows From Investing Activities | | |
| Purchases of premises and equipment | (957) | (103) |
| Disposal of premises and equipment | 29 | — |
| Purchases of securities available-for-sale | (1,173) | (10,624) |
| Proceeds from maturities, paydowns and calls of securities available-for-sale | 2,830 | 4,186 |
| Proceeds from sales of securities available-for-sale | 1,193 | 3,997 |
| Purchases of restricted equity securities | (106) | (2) |
| Redemptions of restricted equity securities | — | (422) |
| Proceeds from sale of real estate owned | 293 | 42 |
| Loan originations and repayments, net | (14,164) | (5,410) |
| Net cash used in investing activities | (12,055) | (8,336) |

| | | |
|---|---|---|
| Cash Flows from Financing Activities | | |
| Net change in deposits | 6,832 | (16,827 ) |
| Proceeds from notes payable to FHLB | 2,500 | 10,000 |
| Dividends paid | (577 ) | (575 ) |
| Purchase of treasury stock | (521 ) | (208 ) |
| Net cash (used in)/provided by financing activities | 8,234 | (7,610 ) |
| Change in cash and cash equivalents | (2,853 ) | (14,323 ) |
| Cash and cash equivalents, beginning of period | 9,910 | 20,745 |
| Cash and cash equivalents, end of period | $ 7,057 | $ 6,422 |

See accompanying notes to the consolidated financial statements

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OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

**(1) BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements of Oconee Federal Financial Corp., which include the accounts of its wholly owned subsidiary Oconee Federal Savings and Loan Association (the “Association”) (referred to herein as “the Company,” “we,” “us,” or “our”), have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Intercompany accounts and transactions are eliminated during consolidation. The Company is majority owned (72.24%) by Oconee Federal, MHC. These financial statements do not include the transactions and balances of Oconee Federal, MHC.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company’s financial position as of September 30, 2018 and June 30, 2018 and the results of operations and cash flows for the interim periods ended September 30, 2018 and 2017. All interim amounts have not been audited, and the results of operations for the interim periods herein are not necessarily indicative of the results of operations to be expected for the year ending June 30, 2019 or any other period. These consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended June 30, 2018.

Certain amounts have been reclassified to conform to the current period presentation. The reclassifications had no effect on net income or shareholders’ equity as previously reported.

*Cash Flows:* Cash and cash equivalents include cash on hand, federal funds sold, overnight interest-bearing deposits and amounts due from other depository institutions.

*Use of Estimates:* To prepare financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and actual results could differ.

**(2) NEW ACCOUNTING STANDARDS**

Accounting Standards Update ("ASU") 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement". Issued in August 2018, ASU 2018-13 provides guidance about fair value measurement disclosures. The amendment requires numerous removals, modifications and additions of fair value disclosure information. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years; early adoption is permitted. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this Update and delay adoption of the additional disclosures until their effective date. The Company does not expect these amendments to have a material effect on its consolidated financial statements.

ASU 2018-02, "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income". Issued in February 2018, ASU 2018-02 provides guidance with regard to the reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for certain stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years; early adoption is permitted. The Company adopted this standard effective March 31, 2018 and elected to reclassify the income tax effects of the Tax Cuts and Jobs Act from AOCI to retained earnings.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

ASU 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting”. Issued in May 2017, ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The amendments are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied prospectively to an award modified on or after the adoption date. The Company has determined that this guidance does not have a material effect on its consolidated financial statements.

ASU 2017-08, “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities”. Issued in March 2017, ASU 2017-08 amends the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is assessing the impact of ASU 2017-08 on its consolidated financial statements.

ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment”. Issued in January 2017, ASU 2017-04 amendments eliminate Step 2 from the goodwill impairment test. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The guidance is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. ASU 2017-04 should be adopted on a prospective basis. The Company does not believe that this new guidance will have a material effect on its consolidated financial statements.

ASU 2016-15, “Statement of Cash Flows (Topic 230)”. Issued in August 2016, ASU 2016-15 provides guidance on the classification of certain cash receipts and cash payments for presentation in the statement of cash flows. The amendment is effective for the Company for fiscal years beginning after December 15, 2017, and interim periods within those years. The amendments will be applied using a retrospective transition method to each period presented unless impracticable. The Company has determined that this guidance does not have a material effect on its consolidated financial statements.

ASU 2016-13, “Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”. Issued in June 2016, ASU 2016-13 provides financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. ASU 2016-13 requires that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in ASU 2016-13 eliminate the probable incurred loss recognition in current GAAP and reflect an entity’s current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets. For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security. ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company has formed a management committee to address this issue, including consideration of third party vendor support. The Company is currently evaluating the impact of ASU 2016-13 on its consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities”. Issued in January 2016, ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The ASU affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. This ASU is now effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has determined that this guidance does not have a material effect on its consolidated financial statements. However, the Company measured the fair value of its loan portfolio as of September 30, 2018 using an exit price notion.

ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)”. Issued in May 2014, ASU 2014-09 provides a framework for revenue recognition that replaces the existing industry and transaction specific requirements under the existing standards. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the Financial Accounting Standards Board (“FASB”) approved amendments deferring the effective date by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In March and April 2016, the FASB issued final amendments (ASU 2016-08 and ASU 2016-10) to clarify the implementation guidance for principal versus agent considerations, identifying performance obligations and the accounting for licenses of intellectual property. In May 2016, the FASB issued final amendments (ASU-11) to clarify guidance related to collectability, noncash considerations, presentation of sales tax, and transition. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. The Company adopted the new guidance effective July 1, 2018 and intends to utilize the modified retrospective method. Under the modified retrospective method the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the Company does not expect the new guidance to have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The Company has completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including deposit related fees, interchange fees, and merchant income. Based on this assessment, the Company concluded that ASU 2014-09 does not materially change the method in which the Company currently recognizes revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on its evaluation, the Company determined that the classification of certain debit and credit card related revenues should change (i.e., revenue previously recorded as contra-expense will be recorded as revenue). These classification changes are expected to result in an immaterial net increase of both revenue and expense. This change is not expected to have a material effect to noninterest income or expense. The Company adopted ASU 2014-09 on its required effective date of July 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. The Company did reclassify prior period amounts for the debit and credit card costs noted above.

There have been no accounting standards that have been issued or proposed by the FASB or other standards-setting bodies during this quarter that are expected to have a material impact on the Company's financial position, results of operations or cash flows. The Company continues to evaluate the impact of standards previously issued and not yet effective, and have no changes in our assessment to disclose since filing of the Form 10-K.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

**(3) EARNINGS PER SHARE ("EPS")**

Basic EPS is based on the weighted average number of common shares outstanding and is adjusted for ESOP shares not yet committed to be released. Unvested restricted stock awards, which contain rights to non-forfeitable dividends, are considered participating securities and the two-class method of computing basic and diluted EPS is applied. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as outstanding stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted EPS is calculated by adjusting the weighted average number of shares of common stock outstanding to include the effect of contracts or securities exercisable (such as stock options) or which could be converted into common stock, if dilutive, using the treasury stock method. The factors used in the earnings per common share computation follow:

| | Three Months Ended | |
|---|---|---|
| | September 30, 2018 | September 30, 2017 |
| Earnings per share | | |
| Net income | $884 | $857 |
| Less: distributed earnings allocated to participating securities | (2) | (2) |
| Less: (undistributed income) dividends in excess of earnings allocated to participating securities | — | (1) |
| Net earnings available to common shareholders | $882 | $854 |
| | | |
| Weighted average common shares outstanding including participating securities | 5,774,160 | 5,786,109 |
| Less: participating securities | (15,355) | (21,910) |
| Less: average unearned ESOP shares | (74,939) | (83,090) |
| Weighted average common shares outstanding | 5,683,866 | 5,681,109 |
| | | |
| Basic earnings per share | $0.16 | $0.15 |
| | | |
| Weighted average common shares outstanding | 5,683,866 | 5,681,109 |
| Add: dilutive effects of assumed exercises of stock options | 127,375 | 119,447 |
| Average shares and dilutive potential common shares | 5,811,241 | 5,800,556 |
| | | |
| Diluted earnings per share | $0.15 | $0.15 |

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

During the three months ended September 30, 2018, 22,400 shares were considered anti-dilutive as the exercise price was in excess of the average market price for the respective periods. During the three months ended September 30, 2017 no shares were considered anti-dilutive.

**(4) SECURITIES AVAILABLE-FOR-SALE**

Debt, mortgage-backed and equity securities have been classified in the consolidated balance sheets according to management's intent. U.S. Government agency mortgage-backed securities consist of securities issued by U.S. Government agencies and U.S. Government sponsored enterprises. Investment securities at September 30, 2018 and June 30, 2018 are as follows:

| September 30, 2018 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available-for-sale: | | | | |
| FHLMC common stock | $ 20 | $ 94 | $ — | $ 114 |
| Certificates of deposit | 5,735 | — | (88) | 5,647 |
| Municipal securities | 42,080 | 1 | (1,366) | 40,715 |
| SBA loan pools | 375 | 2 | — | 377 |
| CMOs | 9,828 | — | (493) | 9,335 |
| U.S. Government agency mortgage-backed securities | 43,284 | — | (1,412) | 41,872 |
| U.S. Government agency bonds | 14,022 | — | (603) | 13,419 |
| Total available-for-sale | $ 115,344 | $ 97 | $ (3,962) | $ 111,479 |

| June 30, 2018 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available-for-sale: | | | | |
| FHLMC common stock | $ 20 | $ 109 | $ — | $ 129 |
| Certificates of deposit | 5,485 | — | (94) | 5,391 |
| Municipal securities | 43,393 | 14 | (1,069) | 42,338 |
| SBA loan pools | 401 | 2 | — | 403 |
| CMOs | 10,529 | — | (445) | 10,084 |

| | | | | |
|---|---|---|---|---|
| U.S. Government agency mortgage-backed securities | 44,490 | 6 | (1,206 ) | 43,290 |
| U.S. Government agency bonds | 14,027 | — | (516 ) | 13,511 |
| Total available-for-sale | $ 118,345 | $ 131 | $ (3,330 ) | $ 115,146 |

Securities pledged at September 30, 2018 and June 30, 2018 had fair values of $40,217 and $42,098, respectively. These securities were pledged to secure public deposits and FHLB advances.

At September 30, 2018 and June 30, 2018, there were no holdings of securities of any one issuer, other than U.S. Government agencies and U.S. Government sponsored enterprises, in an amount greater than 10% of shareholders' equity.

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The following tables show the fair value and unrealized loss of securities that have been in unrealized loss positions for less than twelve months and for twelve months or more at September 30, 2018 and June 30, 2018. The tables also show the number of securities in an unrealized loss position for each category of investment security as of the respective dates.

| | Less than 12 Months | | | 12 Months or More | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Number in Unrealized Loss[(1)] | Fair Value | Unrealized Loss | Number in Unrealized Loss[(1)] | Fair Value | Unrealized Loss | Number in Unrealized Loss[(1)] |
| September 30, 2018 | | | | | | | | | |
| Available-for-sale: | | | | | | | | | |
| Certificates of deposit | $5,398 | $ (88 ) | 22 | $— | $ — | — | $5,398 | $ (88 ) | 22 |
| Municipal securities | 20,953 | (411 ) | 58 | 19,307 | (955 ) | 46 | 40,260 | (1,366 ) | 104 |
| CMOs | — | — | — | 9,335 | (493 ) | 16 | 9,335 | (493 ) | 16 |
| U.S. Government agency mortgage-backed securities | 13,761 | (308 ) | 22 | 28,111 | (1,104 ) | 37 | 41,872 | (1,412 ) | 59 |
| U.S. Government agency bonds | 3,326 | (123 ) | 4 | 10,093 | (480 ) | 10 | 13,419 | (603 ) | 14 |
| | $43,438 | $ (930 ) | 106 | $66,846 | $ (3,032 ) | 109 | $110,284 | $ (3,962 ) | 215 |

| | Less than 12 Months | | | 12 Months or More | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Number in Unrealized Loss[(1)] | Fair Value | Unrealized Loss | Number in Unrealized Loss[(1)] | Fair Value | Unrealized Loss | Number in Unrealized Loss[(1)] |
| June 30, 2018 | | | | | | | | | |
| Available-for-sale: | | | | | | | | | |
| Certificates of deposit | $5,391 | $ (94 ) | 22 | $— | $ — | — | $5,391 | $ (94 ) | 22 |
| Municipal securities | 28,305 | (587 ) | 75 | 10,789 | (482 ) | 25 | 39,094 | (1,069 ) | 100 |
| CMOs | 1,334 | (38 ) | 2 | 8,750 | (407 ) | 14 | 10,084 | (445 ) | 16 |
| U.S. Government agency mortgage-backed securities | 30,997 | (773 ) | 43 | 10,887 | (433 ) | 13 | 41,884 | (1,206 ) | 56 |
| | 5,789 | (177 ) | 7 | 7,722 | (339 ) | 7 | 13,511 | (516 ) | 14 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| U.S. Government agency bonds | $71,816 | $(1,669) | 149 | $38,148 | $(1,661) | 59 | $109,964 | $(3,330) | 208 |

(1) Actual amounts.

The Company evaluates securities for other-than-temporary impairments ("OTTI") at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company considers the length of time and the extent to which the fair value has been less than amortized cost and the financial condition and near-term prospects of the issuer. Additionally, the Company considers its intent to sell or whether it will be more likely than not it will be required to sell the security prior to the security's anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by federal Government agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

None of the unrealized losses at September 30, 2018 were recognized into net income for the three months ended September 30, 2018 because the issuers' bonds are of high credit quality, management does not intend to sell and it is more likely than not that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value of these securities is expected to recover as they approach their maturity date or reset date. None of the unrealized losses at June 30, 2018 were recognized as having OTTI during the year ended June 30, 2018.

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The following table presents the amortized cost and fair value of debt securities classified as available-for-sale at September 30, 2018 and June 30, 2018 by contractual maturity.

| | September 30, 2018 | | June 30, 2018 | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Less than one year | $2,503 | $2,488 | $1,004 | $1,003 |
| Due from one to five years | 20,880 | 20,392 | 19,415 | 19,049 |
| Due after five years to ten years | 29,142 | 28,037 | 33,186 | 32,230 |
| Due after ten years | 9,687 | 9,241 | 9,701 | 9,361 |
| Mortgage-backed securities, CMOs and FHLMC stock (1) | 53,132 | 51,321 | 55,039 | 53,503 |
| Total available for sale | $115,344 | $111,479 | $118,345 | $115,146 |

(1) Actual cash flows may differ from contractual maturities as borrowers may prepay obligations without prepayment penalty. FHLMC common stock is not scheduled because it has no contractual maturity date.

The following table presents the gross proceeds from sales of securities available-for-sale and gains or losses recognized for the three months ended September 30, 2018 and 2017:

| | Three Months Ended | |
|---|---|---|
| Available-for-sale: | September 30, 2018 | September 30, 2017 |
| Proceeds | $1,193 | $ 3,997 |
| Gross gains | 3 | 11 |
| Gross losses | (2 ) | (1 ) |

The tax provision related to these net realized gains for the three months ended September 30, 2018 was less than $1, and for the three months ended September 30, 2017 was $3.

**(5) LOANS**

The components of loans at September 30, 2018 and June 30, 2018 were as follows:

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Real estate loans: | | |
| One-to-four family | $ 275,577 | $ 269,868 |
| Multi-family | 1,712 | 1,735 |
| Home equity | 4,303 | 3,914 |
| Nonresidential | 17,807 | 17,591 |
| Agricultural | 1,215 | 1,272 |
| Construction and land | 35,311 | 27,513 |
| Total real estate loans | 335,925 | 321,893 |
| Commercial and industrial | 302 | 326 |
| Consumer and other loans | 5,733 | 5,539 |
| Total loans | $ 341,960 | $ 327,758 |

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The following table presents the activity in the allowance for loan losses for the three months ended September 30, 2018 by portfolio segment:

| Three Months Ended September 30, 2018 | Beginning Balance | Provision | Charge-offs | Recoveries | Ending Balance |
|---|---|---|---|---|---|
| Real estate loans: | | | | | |
| One-to-four family | $939 | $35 | $(18) | $— | $956 |
| Multi-family | 4 | — | — | — | 4 |
| Home equity | 8 | 5 | — | — | 13 |
| Nonresidential | 66 | 3 | — | — | 69 |
| Agricultural | 1 | — | — | — | 1 |
| Construction and land | 74 | 24 | — | — | 98 |
| Total real estate loans | 1,092 | 67 | (18) | — | 1,141 |
| Commercial and industrial | 4 | (1) | — | — | 3 |
| Consumer and other loans | 1 | 6 | — | — | 7 |
| Total loans | $1,097 | $72 | $(18) | $— | $1,151 |

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at September 30, 2018:

| At September 30, 2018 | Ending Allowance on Loans: Individually Evaluated for Impairment | Ending Allowance on Loans: Collectively Evaluated for Impairment | Loans: Individually Evaluated for Impairment | Loans: Collectively Evaluated for Impairment |
|---|---|---|---|---|
| Real estate loans: | | | | |
| One-to-four family | $— | $ 956 | $2,403 | $ 273,174 |
| Multi-family | — | 4 | — | 1,712 |
| Home equity | — | 13 | — | 4,303 |
| Nonresidential | — | 69 | 656 | 17,151 |
| Agricultural | — | 1 | 413 | 802 |
| Construction and land | — | 98 | — | 35,311 |

| | | | | |
|---|---|---|---|---|
| Total real estate loans | — | 1,141 | 3,472 | 332,453 |
| Commercial and industrial | — | 3 | — | 302 |
| Consumer and other loans | — | 7 | — | 5,733 |
| Total loans | $ — | $ 1,151 | $ 3,472 | $ 338,488 |

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The following table presents the activity in the allowance for loan losses for the three months ended September 30, 2017 by portfolio segment:

| Three Months ended September 30, 2017 | Beginning Balance | Provision | Charge-offs | Recoveries | Ending Balance |
|---|---|---|---|---|---|
| Real estate loans: | | | | | |
| One-to-four family | $900 | $(11) | $— | $— | $889 |
| Multi-family | 4 | — | — | — | 4 |
| Home equity | 2 | 14 | (13) | — | 3 |
| Nonresidential | 63 | (3) | — | — | 60 |
| Agricultural | 1 | — | — | — | 1 |
| Construction and land | 35 | 45 | (25) | — | 55 |
| Total real estate loans | 1,005 | 45 | (38) | — | 1,012 |
| Commercial and industrial | 4 | 2 | — | — | 6 |
| Consumer and other loans | 7 | (1) | — | — | 6 |
| Total loans | $1,016 | $46 | $(38) | $— | $1,024 |

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at June 30, 2018:

| At June 30, 2018 | Ending Allowance on Loans: | | Loans: | |
|---|---|---|---|---|
| | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Individually Evaluated for Impairment | Collectively Evaluated for Impairment |
| Real estate loans: | | | | |
| One-to-four family | $— | $ 939 | $2,434 | $ 267,434 |
| Multi-family | — | 4 | — | 1,735 |
| Home equity | — | 8 | — | 3,914 |
| Nonresidential | — | 66 | 671 | 16,920 |
| Agricultural | — | 1 | 424 | 848 |
| Construction and land | — | 74 | — | 27,513 |

| | | | | |
|---|---|---|---|---|
| Total real estate loans | — | 1,092 | 3,529 | 318,364 |
| Commercial and industrial | — | 4 | — | 326 |
| Consumer and other loans | — | 1 | — | 5,539 |
| Total loans | $ — | $ 1,097 | $ 3,529 | $ 324,229 |

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The tables below present loans that were individually evaluated for impairment by portfolio segment at September 30, 2018 and June 30, 2018, including the average recorded investment balance and interest earned for the three months ended September 30, 2018 and the year ended June 30, 2018:

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| | Unpaid Principal Balance | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With no recorded allowance: | | | | | |
| Real estate loans: | | | | | |
| One-to-four family | $2,481 | $ 2,403 | $ — | $ 2,419 | $ 15 |
| Multi-family | — | — | — | — | — |
| Home equity | — | — | — | — | — |
| Nonresidential | 692 | 656 | — | 664 | — |
| Agricultural | 962 | 413 | — | 419 | — |
| Construction and land | — | — | — | — | — |
| Total real estate loans | 4,135 | 3,472 | — | 3,502 | 15 |
| Commercial and industrial | — | — | — | — | — |
| Consumer and other loans | — | — | — | — | — |
| Total | $4,135 | $ 3,472 | $ — | $ 3,502 | $ 15 |

| | | | | | |
|---|---|---|---|---|---|
| With recorded allowance: | | | | | |
| 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 | $— | $— | $— | $— | $— |

| | | | | | |
|---|---|---|---|---|---|
| Totals: | | | | | |
| Real estate loans | $4,135 | $3,472 | $— | $3,502 | $15 |
| Consumer and other loans | — | — | — | — | — |
| Total | $4,135 | $3,472 | $— | $3,502 | $15 |

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| | June 30, 2018 | | | | |
|---|---|---|---|---|---|
| | Unpaid Principal Balance | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With no recorded allowance: | | | | | |
| Real estate loans: | | | | | |
| One-to-four family | $2,516 | $ 2,434 | $ — | $ 2,251 | $ 67 |
| Multi-family | — | — | — | — | — |
| Home equity | — | — | — | — | — |
| Nonresidential | 707 | 671 | — | 336 | 3 |
| Agricultural | 972 | 424 | — | 436 | 7 |
| Construction and land | — | — | — | 131 | — |
| Total real estate loans | 4,195 | 3,529 | — | 3,154 | 77 |
| Commercial and industrial | — | — | — | — | — |
| Consumer and other loans | — | — | — | — | — |
| Total | $4,195 | $ 3,529 | $ — | $ 3,154 | $ 77 |
| | | | | | |
| With recorded allowance: | | | | | |
| Real estate loans: | | | | | |
| One-to-four family | $— | $— | $— | $484 | $— |
| Multi-family | — | — | — | — | — |
| Home equity | — | — | — | — | — |
| Nonresidential | — | — | — | — | — |
| Agricultural | — | — | — | — | — |
| Construction and land | — | — | — | — | — |
| Total real estate loans | — | — | — | 484 | — |
| Commercial and industrial | — | — | — | — | — |
| Consumer and other loans | — | — | — | — | — |
| Total | $— | $— | $— | $484 | $— |
| | | | | | |
| Totals: | | | | | |
| Real estate loans | $4,195 | $3,529 | $— | $3,638 | $77 |
| Consumer and other loans | — | — | — | — | — |
| Total | $4,195 | $3,529 | $— | $3,638 | $77 |

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The following tables present the aging of past due loans as well as nonaccrual loans. Nonaccrual loans and accruing loans past due 90 days or more include both smaller balance homogenous loans and larger balance loans that are evaluated either collectively or individually for impairment.

Total past due loans and nonaccrual loans at September 30, 2018:

| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans | Nonaccrual Loans | Accruing Loans Past Due 90 Days or More |
|---|---|---|---|---|---|---|---|---|
| Real estate loans: | | | | | | | | |
| One-to-four family | $6,772 | $1,806 | $865 | $9,443 | $266,134 | $275,577 | $ 3,682 | $ — |
| Multi-family | — | — | — | — | 1,712 | 1,712 | — | — |
| Home equity | 84 | 39 | 40 | 163 | 4,140 | 4,303 | 40 | — |
| Nonresidential | 384 | 154 | — | 538 | 17,269 | 17,807 | 884 | — |
| Agricultural | — | 413 | — | 413 | 802 | 1,215 | 413 | — |
| Construction and land | 175 | 49 | — | 224 | 35,087 | 35,311 | 11 | — |
| Total real estate loans | 7,415 | 2,461 | 905 | 10,781 | 325,144 | 335,925 | 5,030 | — |
| Commercial and industrial | — | — | — | — | 302 | 302 | — | — |
| Consumer and other loans | — | — | 4 | 4 | 5,729 | 5,733 | 4 | — |
| Total | $7,415 | $2,461 | $909 | $10,785 | $331,175 | $341,960 | $ 5,034 | $ — |

Total past due and nonaccrual loans by portfolio segment at June 30, 2018:

| | 30-59 Days | 60-89 Days | 90 Days | Total | Total | Nonaccrual | Accruing Loans Past Due 90 |
|---|---|---|---|---|---|---|---|

| | Past Due | Past Due | or More Past Due | Past Due | Current | Loans | Loans | Days or More |
|---|---|---|---|---|---|---|---|---|
| Real estate loans: | | | | | | | | |
| One-to-four family | $5,180 | $1,787 | $897 | $7,864 | $262,004 | $269,868 | $ 3,969 | $ — |
| Multi-family | — | — | — | — | 1,735 | 1,735 | — | — |
| Home equity | 106 | 84 | 40 | 230 | 3,684 | 3,914 | 40 | — |
| Nonresidential | 376 | 179 | — | 555 | 17,036 | 17,591 | 908 | — |
| Agricultural | — | 424 | — | 424 | 848 | 1,272 | 445 | — |
| Construction and land | 50 | 34 | — | 84 | 27,429 | 27,513 | 19 | — |
| Total real estate loans | 5,712 | 2,508 | 937 | 9,157 | 312,736 | 321,893 | 5,381 | — |
| Commercial and industrial | — | — | — | — | 326 | 326 | — | — |
| Consumer and other loans | — | — | — | — | 5,539 | 5,539 | 1 | — |
| Total | $5,712 | $2,508 | $937 | $9,157 | $318,601 | $327,758 | $ 5,382 | $ — |

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**Troubled Debt Restructurings:**

At September 30, 2018 and June 30, 2018, total loans that have been modified as troubled debt restructurings were $3,082 and $3,016, respectively, which consisted of one construction loan, two agricultural loans, two nonresidential real estate and five one-to-four family first lien loans at September 30, 2018 and one construction loan, two agricultural loans, two non-residential real estate loans and four one-to-four family first lien loans at June 30, 2018. There was no specific allowance for loss established for these loans at September 30, 2018 or June 30, 2018. Additionally, there were no commitments to lend any additional amounts on any loan after the modification. The one-to-four family first lien troubled debt restructured during the three months ended September 30, 2018 involved renewing an existing loan with a term concession. No loans modified as troubled debt restructurings during the twelve months ended September 30, 2018 have defaulted since restructuring. All of these loans are on non-accrual at September 30, 2018 and June 30, 2018. At September 30, 2018 and June 30, 2018, $2,470 and $2,521, respectively, were individually evaluated for impairment.

**Loan Grades:**

The Company utilizes a grading system whereby all loans are assigned a grade based on the risk profile of each loan. Loan grades are determined based on an evaluation of relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. All loans, regardless of size, are analyzed and are given a grade based upon the management's assessment of the ability of borrowers to service their debts.

Pass: Loan assets of this grade conform to a preponderance of our underwriting criteria and are acceptable as a credit risk, based upon the current net worth and paying capacity of the obligor. Loans in this category also include loans secured by liquid assets and secured loans to borrowers with unblemished credit histories.

Pass-Watch: Loan assets of this grade represent our minimum level of acceptable credit risk. This grade may also represent obligations previously rated "Pass", but with significantly deteriorating trends or previously rated.

Special Mention: Loan assets of this grade have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of repayment prospects for the loan or of the institution's credit position at some future date.

Substandard: Loan assets of this grade are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

**Portfolio Segments:**

**One-to-four family:** One-to-four family residential loans consist primarily of loans secured by first or second deeds of trust on primary residences, and are originated as adjustable-rate or fixed-rate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. The Company currently originates residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes.

For traditional homes, the Company may originate loans with loan-to-value ratios in excess of 80% if the borrower obtains mortgage insurance or provides readily marketable collateral. The Company may make exceptions for special loan programs that we offer. The Company also originates residential mortgage loans for non-owner-occupied homes with loan-to-value ratios of up to 80%.

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The Company historically originated residential mortgage loans with loan-to-value ratios of up to 75% for manufactured or modular homes. The Company no longer offers residential mortgage loans for manufactured or modular homes as of December 1, 2014. However, renewals of existing performing credits that meet the Company's underwriting requirements will be considered. The Company requires 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 the Company's permission. Such homes must be "de-titled" by the State of South Carolina or Georgia so that they are taxed and must be transferred as residential homes rather than vehicles. The Company also obtains a mortgage on the real estate to which such homes are affixed.

**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 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.

**Home Equity:** The Company offers home equity loans and lines of credit secured by first or second deeds of trust on primary residences in our market area. The Company's 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. The Company offers 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 principal 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 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 the Company originates 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%.

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.

The Company considers a number of factors in originating nonresidential real estate loans. The Company evaluates 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 the Company and other financial institutions. In evaluating the property securing the loan, the factors the Company considers 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, the Company also considers 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 operating budgets. 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, and in the case of church loans, guarantees from the applicable denomination may be obtained.

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**Agricultural:** These loans are secured by farmland and related improvements in the Company's 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%. The Company is managing a small number of these loans in our portfolio. We continue to closely monitor our existing relationships.

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:** The Company makes 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 the Company originates. Commercial construction loans have rate and terms comparable to commercial loans that we originate. During the construction phase, the borrower generally pays interest only. Generally, 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 commercial loans.

The Company also makes interim construction loans for nonresidential properties. In addition, the Company occasionally makes loans for the construction of homes "on speculation," but the Company generally permits a borrower to have only two such loans at a time. These loans generally have a maximum term of eight months, and upon completion of construction convert to conventional amortizing nonresidential 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. Generally, the maximum loan-to-value ratio of these construction loans is 85%.

**Commercial and Industrial Loans:** Commercial and industrial loans are offered to businesses and professionals in the Company's 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 and Other Loans:** The Company offers 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 and 18 to 60 months for loans secured by a vehicle, depending on the age of the vehicle. The Company generally only extends consumer loans to existing customers or their immediate family members, and these loans generally have relatively low balances.

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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.

Based on the most recent analysis performed, the risk grade of loans by portfolio segment are presented in the following tables.

Total loans by risk grade and portfolio segment at September 30, 2018:

| | Pass | Pass-Watch | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|---|
| Real estate loans: | | | | | | |
| One-to-four family | $260,581 | $ 5,171 | $ 3,164 | $ 6,661 | $ — | $275,577 |
| Multi-family | 1,712 | — | — | — | — | 1,712 |
| Home equity | 3,658 | 344 | 127 | 174 | — | 4,303 |
| Nonresidential | 13,759 | 1,771 | 1,128 | 1,149 | — | 17,807 |
| Agricultural | 201 | 343 | 258 | 413 | — | 1,215 |
| Construction and land | 34,368 | 761 | 113 | 69 | — | 35,311 |
| Total real estate loans | 314,279 | 8,390 | 4,790 | 8,466 | — | 335,925 |
| Commercial and industrial | 302 | — | — | — | — | 302 |
| Consumer and other loans | 5,729 | — | — | 4 | — | 5,733 |
| Total | $320,310 | $ 8,390 | $ 4,790 | $ 8,470 | $ — | $341,960 |

Total loans by risk grade and portfolio segment at June 30, 2018:

| | Pass | Pass-Watch | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| Real estate loans: | | | | | | |
| One-to-four family | $254,721 | $ 5,051 | $ 3,350 | $ 6,746 | $ — | $269,868 |
| Multi-family | 1,735 | — | — | — | — | 1,735 |
| Home equity | 3,298 | 311 | 129 | 176 | — | 3,914 |
| Nonresidential | 13,462 | 1,802 | 1,143 | 1,184 | — | 17,591 |
| Agricultural | 217 | 349 | 261 | 445 | — | 1,272 |
| Construction and land | 26,551 | 771 | 115 | 76 | — | 27,513 |
| Total real estate loans | 299,984 | 8,284 | 4,998 | 8,627 | — | 321,893 |
| Commercial and industrial | 326 | — | — | — | — | 326 |
| Consumer and other loans | 5,539 | — | — | — | — | 5,539 |
| Total | $305,849 | $ 8,284 | $ 4,998 | $ 8,627 | $ — | $327,758 |

At September 30, 2018, consumer mortgage loans secured by residential real estate properties totaling $524 were in formal foreclosure proceedings and are included in one-to-four family and land loans.

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**(6) BORROWINGS**

At September 30, 2018 and June 30, 2018, advances from the Federal Home Loan Bank were as follows:

| | September 30, 2018 | |
|---|---|---|
| | Balance | Stated Interest Rate |
| FHLB advances due October 2018 through September 2019 | $17,000 | 2.17% - 2.73% |
| Total | $17,000 | |

| | June 30, 2018 | |
|---|---|---|
| | Balance | Stated Interest Rate |
| FHLB advances due September 2018 through November 2018 | $14,500 | 2.09% - 2.23% |
| Total | $14,500 | |

The average interest rate of all outstanding FHLB advances was 2.41% and 2.14% on September 30, 2018 and June 30, 2018, respectively.

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by $40,217 and $36,248 of investment securities at September 30, 2018 and June 30, 2018, respectively. The Association has also pledged as collateral FHLB stock and has entered into a blanket collateral agreement whereby qualifying mortgages, free of other encumbrances and at various discounted values as determined by the FHLB, will be maintained. Based on this collateral, the Association is eligible to borrow up to a total of $122,406 at September 30, 2018.

Payments over the next five years are as follows:

| | |
|---|---|
| 2018 | $7,500 |
| 2019 | $9,500 |

There were no overnight borrowings at September 30, 2018 or June 30, 2018.

## (7) FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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**Investment Securities:**

The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

**Impaired Loans:**

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

**Real Estate Owned:**

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals, which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, management reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

**Loan Servicing Rights:**

Fair value is determined based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model utilizes assumptions that market participants would use in estimating future net servicing income and that can be validated against available market data and results in a Level 3 classification.

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Assets and liabilities measured at fair value on a recurring basis at September 30, 2018 and June 30, 2018 are summarized below:

| | Fair Value Measurements | | | |
|---|---|---|---|---|
| | September 30, 2018 | | June 30, 2018 | |
| | (Level 2) | (Level 3) | (Level 2) | (Level 3) |
| Financial assets: | | | | |
| Securities available-for-sale: | | | | |
| FHLMC common stock | $114 | $— | $129 | $— |
| Certificates of deposit | 5,647 | — | 5,391 | — |
| Municipal securities | 40,715 | — | 42,338 | — |
| SBA loan pools | 377 | — | 403 | — |
| CMOs | 9,335 | — | 10,084 | — |
| U.S. Government agency mortgage-backed securities | 41,872 | — | 43,290 | — |
| U.S. Government agency bonds | 13,419 | — | 13,511 | — |
| Total securities available-for-sale | 111,479 | — | 115,146 | — |
| Loan servicing rights | — | 1,050 | — | 1,093 |
| Total financial assets | $111,479 | $1,050 | $115,146 | $1,093 |

Presented in the table below are assets measured at fair value on a nonrecurring basis using level 3 inputs at September 30, 2018 and June 30, 2018:

| | Fair Value Measurements | |
|---|---|---|
| | September 30, 2018 (Level 3) | June 30, 2018 (Level 3) |
| Financial assets: | | |
| Impaired loans, with specific allocations: | | |
| One-to-four family | $— | $— |
| Nonresidential | — | — |

| | | |
|---|---|---|
| Construction and land | — | — |
| Total financial assets | — | — |
| Non-financial assets: | | |
| Real estate owned, net: | | |
| One-to-four family | 41 | 91 |
| Nonresidential | 464 | 983 |
| Construction and land | 270 | — |
| Total non-financial assets | 775 | 1,074 |
| Total assets measured at fair value on a non-recurring basis | $775 | $1,074 |

The Company's impaired loans at September 30, 2018 and June 30, 2018 were measured at fair value based primarily upon the estimated value of real estate collateral less costs to sell. There were no such loans as of September 30, 2018 or June 30, 2018.

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Real estate owned is carried at the lower of carrying value or fair value less costs to sell. The carrying value of real estate owned at September 30, 2018 and June 30, 2018 were $775 and $1,074, respectively. There was no valuation allowances associated with these properties at September 30, 2018 or June 30, 2018.

The table below presents a reconciliation of all Level 3 assets measured at fair value on a recurring basis using significant unobservable inputs for the three months ended September 30, 2018 and 2017:

| | Fair Value Measurements (Level 3) Three Months Ended | |
|---|---|---|
| | September 30 2018 Loan Servicing Rights | September 30, 2017 Loan Servicing Rights |
| Balance at beginning of period: | $1,093 | $1,141 |
| Purchases | — | — |
| Unrealized net gains (losses) included in net income | (43) | (52) |
| Balance at end of period: | $1,050 | $1,089 |

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The table below presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at September 30, 2018 and June 30, 2018.

| | Level 3 Quantitative Information | | | | |
|---|---|---|---|---|---|
| | September 30, 2018 Fair Value | June 30, 2018 Fair Value | Valuation Technique | Unobservable Inputs | Range |
| Loan servicing rights | $1,050 | $ 1,093 | Discounted cash flows | Discount rate, estimated timing of cash flows | 10.13% to 10.38% |
| Impaired real estate loans net, with specific allocations: One-to-four family | $— | $ — | Sales comparison approach | Adjustment for differences between the comparable sales | 0% to 30% |
| Real estate owned net: One-to-four family | $41 | $ 91 | Sales comparison approach | Adjustment for differences between the comparable sales | 0% to 20% |
| Nonresidential | $464 | $ 983 | Sales comparison approach | Adjustment for differences between the comparable sales | 0% to 20% |
| Construction and land | $270 | $ — | Sales comparison approach | Adjustment for differences between the comparable sales | 0% to 20% |

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Many of the Company's assets and liabilities are short-term financial instruments whose carrying amounts reported in the consolidated balance sheet approximate fair value. These items include cash and cash equivalents, accrued interest receivable and payable balances, variable rate loan and deposits that re-price frequently and fully. The estimated fair values of the Company's remaining on-balance sheet financial instruments at September 30, 2018 and June 30, 2018 are summarized below:

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| | Carrying Amount | Fair Value (Level 1) | (Level 2) | (Level 3) | Total |
| Financial assets | | | | | |
| Securities available-for-sale | $111,479 | $— | $111,479 | $— | $111,479 |
| Loans, net [(1)(2)] | 340,809 | — | — | 330,407 | 330,407 |
| Loan servicing rights | 1,050 | — | — | 1,050 | 1,050 |
| Restricted equity securities | 1,745 | N/A | N/A | N/A | N/A |
| Financial liabilities | | | | | |
| Deposits | $394,420 | $177,813 | $209,945 | $— | $387,758 |
| FHLB Advances | 17,000 | — | 16,993 | — | 16,993 |

| | June 30, 2018 | | | | |
|---|---|---|---|---|---|
| | Carrying Amount | Fair Value (Level 1) | (Level 2) | (Level 3) | Total |
| Financial assets | | | | | |
| Securities available-for-sale | $115,146 | $— | $115,146 | $— | $115,146 |
| Loans, net [(1)(2)] | 326,661 | — | — | 319,958 | 319,958 |
| Loans held for sale | — | — | — | — | — |
| Loan servicing rights | 1,093 | — | — | 1,093 | 1,093 |
| Restricted equity securities | 1,639 | N/A | N/A | N/A | N/A |
| Financial liabilities | | | | | |
| Deposits | $387,588 | $174,192 | $208,967 | $— | $383,159 |
| FHLB Advances | 14,500 | — | 14,494 | — | 14,494 |

(1) Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors and result in a Level 3 classification.

(2) Carrying amount of loans is net of unearned income and the allowance. In accordance with the adoption of ASU No. 2016-01, the fair value of loans as of September 30, 2018 was measured using an exit price notion. The fair value of loans as of June 30, 2018 was measured using an entry price notion.

**(8) EMPLOYEE STOCK OWNERSHIP PLAN**

Employees participate in an Employee Stock Ownership Plan (“ESOP”). The ESOP borrowed from the Company to purchase 248,842 shares of the Company’s common stock at $10.00 per share during 2011. The Company makes discretionary contributions to the ESOP and pays dividends on unallocated shares to the ESOP, and the ESOP uses funds it receives to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on relative compensation and expense is recorded. Dividends on allocated shares increase participant accounts.

Participants receive the shares at the end of employment. The Company makes contributions to the ESOP each December, therefore no contributions were made during the three months ended September 30, 2018. Total ESOP compensation expense for the three months ended September 30, 2018 was $115, and for the three months ended September 30, 2017 was $122.

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Shares held by the ESOP at September 30, 2018 and June 30, 2018 were as follows:

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Committed to be released to participants | 15,504 | 10,095 |
| Allocated to participants | 127,985 | 127,985 |
| Unearned | 75,200 | 80,609 |
| Total ESOP shares | 218,689 | 218,689 |
| | | |
| Fair value of unearned shares | $ 1,994 | $ 2,333 |

**(9) STOCK BASED COMPENSATION**

On April 5, 2012, the shareholders of Oconee Federal Financial Corp. approved the Oconee Federal Financial Corp. 2012 Equity Incentive Plan (the “Plan”) for employees and directors of the Company. The Plan authorizes the issuance of up to 435,472 shares of the Company’s common stock, with no more than 124,420 of shares as restricted stock awards and 311,052 as stock options, either incentive stock options or non-qualified stock options. The exercise price of options granted under the Plan may not be less than the fair market value on the date the stock option is granted. The compensation committee of the board of directors has sole discretion to determine the amount and to whom equity incentive awards are granted.

On December 22, 2017, the compensation committee of the board of directors approved the issuance of 22,400 stock options to purchase Company stock to officers. There were no stock options or restricted stock issued in fiscal 2017. Stock options and restricted stock have vesting periods of five years or seven years, a percentage of which vests annually on each anniversary of the grant date. The weighted average vesting period of stock options granted in 2017 was seven years. Apart from the vesting schedule for both stock options and restricted stock, there are no performance-based conditions or any other material conditions applicable to the awards issued.

The following table summarizes stock option activity for the three months ended September 30, 2018:

| | Options | Weighted-Average Exercise Price/Share | Aggregate Intrinsic Value[(1)] |
|---|---|---|---|
| Outstanding - June 30, 2018 | 241,209 | $ 14.18 | |
| Granted | — | — | |
| Exercised | (15,552 ) | — | |
| Forfeited | — | — | |
| Outstanding - September 30, 2018 | 225,657 | $ 14.36 | $ 2,745 |
| Fully vested and exercisable at September 30, 2018 | 174,348 | $ 12.08 | $ 2,518 |
| Expected to vest in future periods | 51,309 | | |
| Fully vested and expected to vest - September 30, 2018 | 225,657 | $ 14.36 | $ 2,745 |

(1) The intrinsic value for stock options is defined as the difference between the current market value and the exercise price. The current market price was based on the closing price of common stock of $26.52 per share on September 30, 2018.

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The fair value for each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model that uses the following assumptions. The Company uses the U.S. Treasury yield curve in effect at the time of the grant to determine the risk-free interest rate. The expected dividend yield is estimated using the projected annual dividend level and recent stock price of the Company's common stock at the date of grant. Expected stock volatility is based on historical volatilities of the SNL Financial Index of Thrift MHCs. The expected life of the options is calculated based on the "simplified" method as provided for under generally accepted accounting principles.

The weighted-average fair value of options granted and assumptions used in the Black-Scholes-Merton option pricing model in the fiscal years granted are listed below:

There have been no stock options granted in fiscal year 2019.

| | Fiscal Years Granted 2018 | |
|---|---|---|
| Risk-free interest rate | 2.43 | % |
| Expected dividend yield | 1.36 | % |
| Expected stock volatility | 15.03 | % |
| Expected life (years) | 8 | |
| Fair value | $ 5.41 | |

Stock options are assumed to be earned ratably over their respective vesting periods and charged to compensation expense based upon their grant date fair value and the number of options assumed to be earned. There were 4,035 and 4,036 options that were earned during the three months ended September 30, 2018 and 2017, respectively. Stock-based compensation expense for stock options for the three months ended September 30, 2018 and 2017 was $11 and $6, respectively. Total unrecognized compensation cost related to stock options was $154 at September 30, 2018 and is expected to be recognized over a weighted-average period of 3.9 years.

The following table summarizes non-vested restricted stock activity for the three months ended September 30, 2018:

| | Septmber 30, 2018 |
|---|---|
| Balance - beginning of year | 15,355 |
| Granted | — |
| Forfeited | — |
| Vested | — |
| Balance - end of period | 15,355 |
| Weighted average grant date fair value | $ 13.09 |

The fair value of the restricted stock awards is amortized to compensation expense over their respective vesting periods and is based on the market price of the Company's common stock at the date of grant multiplied by the number of shares granted that are expected to vest. Stock-based compensation expense for restricted stock included in noninterest expense for the three months ended September 30, 2018 and 2017 was $25 and $25, respectively. Unrecognized compensation expense for non-vested restricted stock awards was $213 at September 30, 2018 and is expected to be recognized over a weighted-average period of 2.7 years.

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**(10) LOAN SERVICING RIGHTS**

Mortgage loans serviced for others are not reported as assets; however, the underlying mortgage servicing rights associated with servicing these mortgage loans serviced for others is recorded as an asset in the consolidated balance sheet.

The principal balances of those loans at September 30, 2018 and June 30, 2018 are as follows:

| | September 30, 2018 | June 30, 2018 |
|---|---|---|
| Mortgage loan portfolio serviced for: | | |
| FHLMC | $ 91,459 | $ 94,779 |

Custodial escrow balances maintained in connection with serviced loans were $1,014 and $799 at September 30, 2018 and June 30, 2018.

Activity for loan servicing rights for the three months ended September 30, 2018 and 2017 is as follows:

| | Three Months Ended September 30, 2018 | September 30, 2017 |
|---|---|---|
| Loan servicing rights: | | |
| Beginning of period: | $ 1,093 | $ 1,141 |
| Additions | — | — |
| Change in fair value | (43 ) | (52 ) |
| End of period: | $ 1,050 | $ 1,089 |

Fair value at September 30, 2018 was determined using a discount rate of 10.38%, prepayment speed assumptions ranging from 4.6% to 13.1% Conditional Prepayment Rate ("CPR") depending on the loans' coupon, term and seasoning, and a weighted average default rate of 0.43%.  Fair value at September 30, 2017 was determined using a discount rate of 9.50%, prepayment speed assumptions ranging from 5.2% to 15.6% CPR depending on the loans' coupon, term and seasoning, and a weighted average default rate of 0.61%.

**(11) SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental cash flow information for the three months ended September 30, 2018 and 2017 is as follows:

September
30,
2018