

SI Financial Group, Inc.  
Form 10-Q  
November 08, 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 the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-54241

SI FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

\_\_\_\_\_  
Maryland 80-0643149  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

803 Main Street, Willimantic, Connecticut 06226  
(Address of principal executive offices) (Zip Code)

(860) 423-4581  
(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, 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 (Section 232.405 of this chapter) 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.

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.

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

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 November 2, 2018, there were 12,033,611 shares of the registrant's common stock outstanding.

---

SI FINANCIAL GROUP, INC.  
TABLE OF CONTENTS

	Page No.
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements (Unaudited):	
Consolidated Balance Sheets at September 30, 2018 and December 31, 2017	<u>1</u>
Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017	<u>2</u>
Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017	<u>3</u>
Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2018	<u>4</u>
Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017	<u>5</u>
<u>Notes to Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>38</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>49</u>
Item 4. <u>Controls and Procedures</u>	<u>52</u>
<b>PART II. OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	<u>52</u>
Item 1A. <u>Risk Factors</u>	<u>52</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>52</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>53</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>53</u>
Item 5. <u>Other Information</u>	<u>53</u>
Item 6. <u>Exhibits</u>	<u>53</u>
<u>SIGNATURES</u>	<u>54</u>



## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## SI FINANCIAL GROUP, INC.

## CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts / Unaudited)

	September 30, 2018	December 31, 2017
<b>ASSETS:</b>		
Cash and due from banks:		
Noninterest-bearing	\$ 16,915	\$ 16,872
Interest-bearing	59,829	66,614
Total cash and cash equivalents	76,744	83,486
Available for sale securities, at fair value	147,576	154,053
Loans held for sale	1,368	835
Loans receivable (net of allowance for loan losses of \$14,227 at September 30, 2018 and \$12,334 at December 31, 2017)	1,276,373	1,237,174
Federal Home Loan Bank stock, at cost	9,308	9,856
Federal Reserve Bank stock, at cost	3,638	3,636
Bank-owned life insurance	34,397	33,726
Premises and equipment, net	19,099	19,409
Goodwill and other intangibles	16,442	16,893
Accrued interest receivable	5,209	4,784
Deferred tax asset, net	6,943	6,412
Other real estate owned, net	608	1,226
Other assets	9,430	9,466
Total assets	\$ 1,607,135	\$ 1,580,956
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 243,688	\$ 220,877
Interest-bearing	1,006,405	987,170
Total deposits	1,250,093	1,208,047
Mortgagors' and investors' escrow accounts	2,838	4,418
Federal Home Loan Bank advances	152,780	170,094
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	23,164	21,668
Total liabilities	1,437,123	1,412,475
Shareholders' Equity:		
Preferred stock (\$.01 par value; 1,000,000 shares authorized; none issued)	—	—
Common stock (\$.01 par value; 35,000,000 shares authorized; 12,033,734 and 12,242,434 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively)	120	122
Additional paid-in-capital	126,178	126,540
Unallocated common shares held by ESOP	(2,328	) (2,688
Unearned restricted shares	(227	) (235

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

Retained earnings	49,628	46,176
Accumulated other comprehensive loss	(3,359	) (1,434
Total shareholders' equity	170,012	168,481
Total liabilities and shareholders' equity	\$ 1,607,135	\$ 1,580,956

See accompanying notes to unaudited interim consolidated financial statements.

1

---

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
(In Thousands, Except Per Share Amounts / Unaudited)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Interest and dividend income:				
Loans, including fees	\$13,493	\$12,326	\$39,188	\$36,758
Securities:				
Taxable interest	854	891	2,030	2,465
Tax-exempt interest	13	14	41	42
Dividends	199	184	566	538
Other	295	234	847	546
Total interest and dividend income	14,854	13,649	42,672	40,349
Interest expense:				
Deposits	2,528	1,922	6,579	5,555
Federal Home Loan Bank advances	779	802	2,408	2,577
Subordinated debt and other borrowings	82	60	228	173
Total interest expense	3,389	2,784	9,215	8,305
Net interest income	11,465	10,865	33,457	32,044
Provision for loan losses	1,009	171	2,022	501
Net interest income after provision for loan losses	10,456	10,694	31,435	31,543
Noninterest income:				
Service fees	1,736	1,723	5,217	5,165
Wealth management fees	5	20	23	539
Increase in cash surrender value of bank-owned life insurance	230	133	671	395
Mortgage banking	343	519	901	1,140
Net loss on disposal of equipment	(2)	(4)	(2)	(4)
Other	607	124	1,822	1,428
Total noninterest income	2,919	2,515	8,632	8,663
Noninterest expenses:				
Salaries and employee benefits	5,386	5,052	15,898	15,485
Occupancy and equipment	1,668	1,662	5,175	5,138
Computer and electronic banking services	1,350	1,345	3,926	4,015
Outside professional services	268	379	967	1,172
Marketing and advertising	203	173	666	580
Supplies	141	121	436	383
FDIC deposit insurance and regulatory assessments	192	178	530	590
Core deposit intangible amortization	150	150	451	451
Other real estate owned operations	103	117	271	484
Other	491	481	1,536	1,725
Total noninterest expenses	9,952	9,658	29,856	30,023

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

Income before income tax provision	3,423	3,551	10,211	10,183
Income tax provision	719	1,307	2,147	3,378
Net income	\$2,704	\$2,244	\$8,064	\$6,805
Earnings per share:				
Basic	\$0.23	\$0.19	\$0.68	\$0.57
Diluted	\$0.23	\$0.19	\$0.68	\$0.57

See accompanying notes to unaudited interim consolidated financial statements.



SI FINANCIAL GROUP, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (In Thousands / Unaudited)

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income	\$2,704	\$2,244	\$8,064	\$6,805
Other comprehensive income (loss), net of tax:				
Net unrealized holding gains (losses) on available for sale securities				
Other comprehensive income (loss)	(482)	47	(1,925)	202
Comprehensive income	\$2,222	\$2,291	\$6,139	\$7,007

See accompanying notes to unaudited interim consolidated financial statements.

## SI FINANCIAL GROUP, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018

(In Thousands, Except Share Data / Unaudited)

	Common Stock		Unallocated		Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity	
	Shares	Dollars	Additional Paid-in Capital	Common Shares Held by ESOP				
Balance at December 31, 2017	12,242,434	\$ 122	\$ 126,540	\$ (2,688 )	\$ (235 )	\$ 46,176	\$ (1,434 )	\$ 168,481
Comprehensive income	—	—	—	—	—	8,064	(1,925 )	6,139
Cash dividends declared (\$0.18 per share)	—	—	—	—	—	(2,135 )	—	(2,135 )
Equity incentive plans compensation	—	—	148	—	8	—	—	156
Allocation of 36,477 ESOP shares	—	—	166	360	—	—	—	526
Stock options exercised	6,300	—	71	—	—	—	—	71
Common shares repurchased	(215,000 )	(2 )	(747 )	—	—	(2,477 )	—	(3,226 )
Balance at September 30, 2018	12,033,734	\$ 120	\$ 126,178	\$ (2,328 )	\$ (227 )	\$ 49,628	\$ (3,359 )	\$ 170,012

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands / Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$8,064	\$6,805
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,022	501
Employee stock ownership plan expense	526	544
Equity incentive plan expense	156	346
Amortization of investment premiums and discounts, net	1,009	745
Amortization of loan premiums and discounts, net	709	881
Depreciation and amortization of premises and equipment	1,714	1,666
Amortization of core deposit intangible	451	451
Deferred income tax provision (benefit)	(20 )	105
Loans originated for sale	(55,329)	(38,379)
Proceeds from sale of loans held for sale	54,915	38,506
Net gain on sales of loans held for sale	(371 )	(896 )
Net loss on disposal of equipment	2	4
Net loss on sales or write-downs of other real estate owned	82	393
Increase in cash surrender value of bank-owned life insurance	(671 )	(395 )
Change in operating assets and liabilities:		
Accrued interest receivable	(425 )	(300 )
Other assets	288	(630 )
Accrued expenses and other liabilities	1,496	(3,163 )
Net cash provided by operating activities	14,618	7,184
Cash flows from investing activities:		
Purchases of available for sale securities	(30,966)	(32,008)
Proceeds from maturities of and principal repayments on available for sale securities	33,998	22,391
Purchases of Federal Home Loan Bank stock	—	(69 )
Purchases of Federal Reserve Bank stock	(2 )	(7 )
Redemption of Federal Home Loan Bank stock	548	2,214
Loan principal originations, net of principal collections	(6,839 )	12,867
Purchases of loans	(35,201)	(22,280)
Proceeds from sales of other real estate owned	646	288
Purchases of premises and equipment	(1,406 )	(1,410 )
Net cash used in investing activities	(39,222)	(18,014)

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Concluded)  
(In Thousands / Unaudited)

	Nine Months Ended September 30, 2018      2017	
Cash flows from financing activities:		
Net increase in deposits	42,046	83,404
Net decrease in mortgagors' and investors' escrow accounts	(1,580 )	(1,462 )
Proceeds from Federal Home Loan Bank advances	14,817	14,500
Repayments of Federal Home Loan Bank advances	(32,131 )	(65,444 )
Cash dividends on common stock	(2,135 )	(1,778 )
Stock options exercised	71	361
Common shares repurchased	(3,226 )	(205 )
Net cash provided by financing activities	17,862	29,376
Net change in cash and cash equivalents	(6,742 )	18,546
Cash and cash equivalents at beginning of period	83,486	73,186
Cash and cash equivalents at end of period	\$76,744	\$91,732
Supplemental cash flow information:		
Interest paid	\$9,200	\$8,356
Income taxes paid, net	2,731	5,670
Transfer of loans to other real estate owned	110	894
Stock options exercised by net-share settlement	—	163

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

SI Financial Group, Inc. (the “Company”) is the holding company for Savings Institute Bank and Trust Company (the “Bank”). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its 23 offices in eastern Connecticut and Rhode Island. Its primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans, construction loans and consumer loans. The Company does not conduct any material business other than owning all of the stock of the Bank and making payments on the subordinated debentures held by the Company.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, the Bank, and the Bank’s wholly-owned subsidiaries, SI Mortgage Company and SI Realty Company, Inc. All significant intercompany accounts and transactions have been eliminated.

Basis of Financial Statement Presentation

The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, the instructions to Form 10-Q and Rule 10.01 of Regulation S-X of the Securities and Exchange Commission and general practices within the banking industry. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of September 30, 2018 and for the three and nine months ended September 30, 2018 and 2017 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and the accompanying notes for the year ended December 31, 2017 contained in the Company’s Annual Report on Form 10-K.

In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the periods covered herein. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the operating results for the year ending December 31, 2018 or for any other period.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the date of the balance sheets and reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred income taxes and the impairment of long-lived assets such as goodwill and other intangibles.

Reclassifications

Amounts in the Company's prior year consolidated financial statements are reclassified to conform to the current year presentation. Such reclassifications had no effect on net income.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Loans Receivable

Loans receivable are stated at current unpaid principal balances, net of the allowance for loan losses and deferred loan origination fees and costs. Management has the ability and intent to hold its loans receivable for the foreseeable future or until maturity or pay-off.

A loan is impaired when, based on current information and events, it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis for residential and commercial mortgage loans and commercial business loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not typically identify individual consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring ("TDR") agreement.

Troubled Debt Restructurings

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and concessions have been made to the original contractual terms due to the borrower's financial condition that would not otherwise be considered for a borrower with similar risk characteristics, such as reductions of interest rates, deferral of interest or principal payments, or maturity extensions, the modification is considered a TDR. Modified terms are dependent upon the financial position and needs of the individual borrower. If the modification agreement is violated, the loan is handled by the Company's Collections Department for resolution, which may result in foreclosure.

Management considers all nonaccrual loans, with the exception of certain consumer loans, to be impaired. Also, all TDRs are initially classified as impaired and follow the Company's nonaccrual policy. However, if the loan was current prior to modification, nonaccrual status would not be required. If the loan was on nonaccrual prior to modification or if the payment amount significantly increases, the loan will remain on nonaccrual for a period of at least six months. Loans qualify for return to accrual status once the borrower has demonstrated the willingness and the ability to perform in accordance with the restructured terms of the loan agreement for a period of not less than six consecutive months. In most cases, loan payments less than 90 days past due are considered minor collection delays and the related loans are generally not considered impaired.

Impaired classification may be removed after a year following the restructure if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar risk characteristics at the time of restructuring.

Allowance for Loan Losses

The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level management considers adequate to absorb losses in the loan portfolio. Loan losses are charged against the allowance for loan losses when management believes the uncollectibility of the principal loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when

received.

Management's judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic

8

---



Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

and real estate market conditions, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral, historical loan loss experience, the amount and trends of nonperforming loans, delinquencies, classified assets and loan charge-offs and evaluations of loans and other relevant factors.

The allowance for loan losses consists of the following key elements:

Specific allowance for identified impaired loans. For loans identified as impaired, an allowance is established when the present value of expected cash flows, or observable market price of the loan or fair value of the collateral if the loan is collateral dependent, of the impaired loan is lower than the carrying value of that loan. In the determination of the allowance for loan losses, management may obtain independent appraisals for significant properties, when necessary.

General valuation allowance. The general component represents a valuation allowance on the remainder of the loan portfolio, after excluding impaired loans. For this portion of the allowance, loans are segregated by category and assigned an allowance percentage based on historical loan loss experience adjusted for qualitative factors stratified by the following loan segments: residential one- to four-family, multi-family and commercial real estate, construction, commercial business and consumer. Management uses a rolling average of historical losses based on the time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: changes in lending policies and procedures, including changes in underwriting standards and collections, charge-off and recovery practices; changes in national, regional and local economic and business conditions and developments that affect the collectibility of the portfolio, including the condition of various market segments; changes in the size and composition of the loan portfolio and in the terms of the loans; changes in the experience, ability and depth of lending and underwriting management and other relevant staff; changes in the volume and severity of past due loans, the volume of nonaccrual loans and the volume and severity of adversely classified or graded loans; changes in the quality of the loan review system; changes in the underlying collateral for collateral-dependent loans; the existence and effect of any concentrations of credit and changes in the level of such concentrations; the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the portfolio.

The qualitative factors are determined based on the following various risk characteristics for each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

**Residential – One to Four Family –** The Bank primarily originates conventional loans with loan-to-value ratios less than 95% and generally originates loans with loan-to-value ratios in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

**Multi-family and Commercial –** Loans in this segment are originated to acquire, develop, improve or refinance multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The underlying cash flows generated by the properties

can be impacted by the economy as evidenced by increased vacancy rates. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. Management continually monitors the cash flows of these loans.

• Construction – This segment includes loans to individuals and, to a lesser extent, builders to finance the construction of residential dwellings. The Bank also originates construction loans for commercial

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

development projects. Upon the completion of construction, the loan generally converts to a permanent mortgage loan. Credit risk is affected by cost overruns, whether estimates of the sale price of the property are correct, the time it takes to sell at an adequate price and market conditions.

Commercial Business – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy and reduced viability of the industry in which the customer operates will have a negative impact on the credit quality in this segment. The Bank provides loans to investors in the time share industry, which are secured by consumer receivables, and provides loans for capital improvements to condominium associations, which are secured by the assigned rights to levy special assessments to condominium owners. Additionally, the Bank purchases loans primarily out of our market area from a company specializing in medical loan originations, which are secured by medical equipment.

Consumer – Loans in this segment primarily include home equity lines of credit (representing both first and second liens) and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles, as well as unsecured loans. Consumer loan collections depend on the borrower's continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

In computing the allowance for loan losses, we do not assign a general valuation allowance to the Small Business Administration ("SBA") and United States Department of Agriculture ("USDA") loans that we purchase as such loans are fully guaranteed. These loans are included in commercial business loans.

The majority of the Company's loans are collateralized by real estate located in eastern Connecticut and Rhode Island. To a lesser extent, certain commercial real estate loans are secured by collateral located outside of our primary market area with concentrations in Massachusetts and New Hampshire. Accordingly, the collateral value of a substantial portion of the Company's loan portfolio and real estate acquired through foreclosure is susceptible to changes in local market conditions.

Although management believes it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and the Company's results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while management believes it has established the allowance for loan losses in conformity with GAAP, our regulators, in reviewing the loan portfolio, may request us to increase our allowance for loan losses based on judgments different from ours. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate or increases may be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations.

Interest and Fees on Loans

Interest on loans is accrued and included in net interest income based on contractual rates applied to principal amounts outstanding. Accrual of interest is discontinued when loan payments are 90 days or more past due, based on contractual terms, or when, in the judgment of management, collectibility of the loan or loan interest becomes uncertain. Subsequent recognition of income occurs only to the extent payment is received subject to management's

assessment of the collectibility of the remaining interest and principal. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt and the borrower has made regular payments in accordance with the terms of the loan over a period of at least six months. Interest collected on nonaccrual loans is recognized only to the extent cash payments are

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

received, and may be recorded as a reduction to principal if the collectibility of the principal balance of the loan is unlikely.

Loan origination fees, direct loan origination costs and loan purchase premiums are deferred, and the net amount is recognized as an adjustment of the related loan's yield utilizing the interest method over the contractual life of the loan. In addition, discounts related to fair value adjustments for loans receivable acquired in a business combination or asset purchase are accreted into earnings over the contractual term as an adjustment of the related loan's yield. The Company periodically evaluates the cash flows expected to be collected for loans acquired with deteriorated credit quality. Changes in the expected cash flows compared to the expected cash flows as of the date of acquisition may impact the accretable yield or result in a charge to the provision for loan losses to the extent of a shortfall.

**Common Share Repurchases**

The Company is chartered in Maryland. Maryland law does not provide for treasury shares, rather shares repurchased by the Company constitute authorized but unissued shares. GAAP states that accounting for treasury stock shall conform to state law. Therefore, the cost of shares repurchased by the Company is allocated to common stock, additional paid-in capital and retained earnings balances.

**Recent Accounting Pronouncements**

**Revenue from Contracts with Customers (Topic 606):** In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance that improves the revenue recognition requirements for contracts with customers. 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 or services. To achieve the core principle, a company should apply a five step approach to revenue recognition. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or entered into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. Accordingly, the guidance does not apply to, among other things, the following: receivables (i.e. loans), debt and equity investments, equity method investments, joint ventures, derivatives and hedging, financial instruments and transfers and servicing. This guidance became effective for fiscal years beginning after December 15, 2017. Significantly all of the Company's revenues are excluded from the scope of the guidance; therefore, adoption of this guidance on January 1, 2018 did not have a material impact on the Company's consolidated financial statements.

**Financial Instruments (Subtopic 825-10):** In January 2016, the FASB issued guidance addressing certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Targeted improvements to GAAP include the requirement for equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income and the elimination of the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost. The amendments in this update became effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of this guidance on January 1, 2018 did not have a material impact on the Company's consolidated financial statements.

Leases (Topic 842): In February 2016, the FASB issued amended guidance to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. An entity that elects

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. It is expected that assets and liabilities will increase based on the present value of remaining lease payments for leases in place at the adoption date; however, based on the current level of long-term leases in place, this is not expected to be material to the Company's consolidated financial statements.

**Financial Instruments - Credit Losses (Topic 326):** In June 2016, the FASB issued guidance that significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The update will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to (1) financial assets subject to credit losses and measured at amortized cost and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments and financial guarantees. The CECL model does not apply to available for sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to current accounting guidance, except that losses will be recognized as allowances rather than reductions in the amortized cost of the securities. The update also simplifies the accounting model for purchased credit-impaired debt securities and loans. Disclosure requirements under the update have been expanded to include the entity's assumptions, models and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by year of origination. The update is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual periods beginning after December 15, 2018. The update requires a modified retrospective transition under which a cumulative effect to equity will be recognized in the period of adoption. Management has developed a focus team that is reviewing and monitoring additional developments and accounting guidance to determine the impact to the Company's consolidated financial statements. Management is evaluating the models and related requirements and is developing an implementation plan.

**Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230):** In August 2016, the FASB issued guidance to reduce the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This update provides guidance on eight specific cash flow issues. The update became effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The amendments in this update should be applied using a retrospective transition method to each period presented. The adoption of this guidance on January 1, 2018 did not have a material impact on the Company's consolidated financial statements.

**Intangibles - Goodwill and Other - Simplifying the Test for Goodwill Impairment (Topic 350):** In January, 2017, the FASB issued guidance aimed at simplifying the subsequent measurement of goodwill. Under these amendments, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from tax deductible

goodwill on the carrying amount of a reporting unit when measuring the goodwill impairment loss, if applicable. The Board also eliminated 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. Therefore, the same impairment assessment applies to all reporting units. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. An entity still has the option to perform the qualitative assessment for a reporting unit to



Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

determine if the quantitative impairment test is necessary. The amendments in this update should be applied on a prospective basis and are effective for annual goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): In March 2017, the FASB issued guidance shortening 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 amendments in this update are effective 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. The amendments in this update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements due to limited holdings with callable features.

Compensation - Stock Compensation (Topic 718): In May 2017, the FASB issued 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. An entity should account for the effects of a modification unless all of the following are met: 1) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; 2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and 3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this update became effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The amendments in this update should be applied prospectively to an award modified on or after the adoption date. The adoption of this guidance on January 1, 2018 did not have a material impact on the Company's consolidated financial statements.

Fair Value Measurement (Topic 820): In August 2018, the FASB issued guidance which removes, modifies and adds disclosure requirements related to fair value measurements. The amendments in this update become effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments are to 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. Early adoption is permitted. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

NOTE 2. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period. Unvested restricted shares are considered outstanding in the computation of basic earnings per share since the shares participate in dividends and the rights to the dividends are non-forfeitable. Diluted earnings per share is computed in a manner similar to basic earnings per

share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. The Company's common stock equivalents relate solely to stock options. Repurchased common shares and unallocated common shares held by the Bank's ESOP are not deemed outstanding for earnings per share calculations.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Anti-dilutive shares are common stock equivalents with weighted average exercise prices in excess of the weighted average market value for the periods presented, and are not considered in diluted earnings per share calculations. The Company had anti-dilutive common shares outstanding of 136,000 and 135,181 for the three and nine months ended September 30, 2018, respectively, and 130,000 for both the three and nine months ended September 30, 2017.

The computation of earnings per share is as follows:

	Three Months Ended September 30, 2018 2017		Nine Months Ended September 30, 2018 2017	
	(Dollars in Thousands, Except Per Share Amounts)			
Net income	\$2,704	\$ 2,244	\$8,064	\$ 6,805
Weighted average common shares outstanding:				
Basic	11,723,926	11,874,142	11,832,723	11,850,229
Effect of dilutive stock options	78,896	88,683	84,303	89,490
Diluted	11,802,822	11,962,825	11,917,026	11,939,719
Earnings per share:				
Basic	\$0.23	\$ 0.19	\$0.68	\$ 0.57
Diluted	\$0.23	\$ 0.19	\$0.68	\$ 0.57

## NOTE 3. SECURITIES

The amortized cost, gross unrealized gains and losses and fair values of available for sale securities at September 30, 2018 and December 31, 2017 are as follows:

September 30, 2018			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In Thousands)			
Debt securities:			
U.S.			
Government			
\$59,689	\$ —	\$(1,774)	\$57,915
agency obligations			
Government-sponsored enterprises			
9,963		(119)	9,844
Mortgage-backed securities: <sup>(1)</sup>			

Agency			
- 78,041	60	(2,444	) 75,657
residential			
Non-agency			
- 54	—	(5	) 49
residential			
Collateralized			
debt	1,059	27	—
obligation			1,086
Obligations			
of			
state			
and	500	—	500
political			
subdivisions			
Tax-exempt			
securities	2,522	7	(4
			) 2,525
Total			
available			
for sale	\$ 151,828	\$ 94	\$ (4,346 ) \$ 147,576
securities			

(1) Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises (“GSEs”). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by any of the GSEs or the U.S. Government.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

December 31, 2017			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In Thousands)			
Debt securities:			
U.S.			
Government and agency obligations	\$ 17	\$ (998 )	\$ 61,768
Government-sponsored enterprises	16	(11 )	9,217
Mortgage-backed securities: <sup>(1)</sup>			
Agency residential	- 79,134	231	(1,135 ) 78,230
Non-agency residential	- 70	—	(5 ) 65
Collateralized debt obligation	1,090	34	— 1,124
Obligations of state and political subdivisions	500	—	— 500
Tax-exempt securities	3,114	37	(2 ) 3,149
Total available for sale securities	\$ 155,869 \$ 335	\$ (2,151 )	\$ 154,053

<sup>(1)</sup> Agency securities refer to debt obligations issued or guaranteed by government corporations or GSEs. Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by any of the GSEs or the U.S. Government.

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

The amortized cost and fair value of debt securities by contractual maturities at September 30, 2018 are presented below. Maturities are based on the final contractual payment dates and do not reflect the impact of potential prepayments or early redemptions. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	AmortizedFair	
	Cost	Value
	(In Thousands)	
Within 1 year	\$6,039	\$6,029
After 1 but within 5 years	24,990	24,577
After 5 but within 10 years	3,110	3,103
After 10 years	39,594	38,161
	73,733	71,870
Mortgage-backed securities	78,095	75,706
Total debt securities	\$ 151,828	\$ 147,576

There were no sales of available for sale securities for the three and nine months ended September 30, 2018 and 2017.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

The following tables present information pertaining to securities with gross unrealized losses at September 30, 2018 and December 31, 2017, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2018	(In Thousands)					
U.S. Government and agency obligations	\$29,310	\$ 383	\$28,605	\$ 1,391	\$57,915	\$ 1,774
Government-sponsored enterprises	8,854	107	990	12	9,844	119
Mortgage-backed securities:						
Agency - residential	28,446	456	44,764	1,988	73,210	2,444
Non-agency - residential	—	—	49	5	49	5
Tax-exempt securities	860	4	—	—	860	4
Total	\$67,470	\$ 950	\$74,408	\$ 3,396	\$141,878	\$ 4,346

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2017	(In Thousands)					
U.S. Government and agency obligations	\$28,871	\$ 156	\$26,461	\$ 842	\$55,332	\$ 998
Government-sponsored enterprises	5,992	7	259	4	6,251	11
Mortgage-backed securities:						
Agency - residential	34,562	239	32,572	896	67,134	1,135
Non-agency - residential	—	—	65	5	65	5
Tax-exempt securities	1,116	2	—	—	1,116	2
Total	\$70,541	\$ 404	\$59,357	\$ 1,747	\$129,898	\$ 2,151

At September 30, 2018, 93 debt securities with gross unrealized losses had an aggregate depreciation of 2.97% of the Company's amortized cost basis. The unrealized losses are primarily related to the Company's agency mortgage-backed securities and U.S. Government and agency obligations. There were no investments deemed other-than-temporarily impaired for the three and nine months ended September 30, 2018 and 2017. The following summarizes, by security type, the basis for management's determination during the preparation of the financial statements of whether the applicable investments within the Company's securities portfolio were not other-than-temporarily impaired at September 30, 2018.

U.S. Government and Agency Obligations and Mortgage-backed Securities - Agency - Residential. The unrealized losses on the Company's U.S. Government and agency obligations and mortgage-backed agency-residential securities related primarily to a widening of the rate spread to comparable treasury securities. The Company does not expect these securities to settle at a price less than the par value of the securities.

Government Sponsored Enterprises. The unrealized losses on the Company's government-sponsored enterprises were also caused by interest rate movement. The contractual cash flows of these investments are guaranteed by a government-sponsored agency. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of our investment.



Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Mortgage-backed Securities - Non-Agency - Residential. The unrealized losses on the Company's non-agency-residential mortgage-backed securities relate to one investment which has been evaluated by management and no potential credit loss was identified.

NOTE 4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loan Portfolio

The composition of the Company's loan portfolio at September 30, 2018 and December 31, 2017 is as follows:

	September 30, 2018	December 31, 2017
	(In Thousands)	

Real estate loans:		
Residential		
-		
1 to 4 family	\$380,571	\$397,277
Multi-family	57,008	481,998
commercial		
Construction	34,642	28,765
Total real estate loans	972,228	908,040

Commercial business loans:		
SBA and USDA guaranteed		
Time share	72,779	89,514
Condominium association	41,583	50,526
Medical loans	33,051	27,096
	28,605	27,803

Other	88,566	
Total commercial business loans	265,753	283,505
Consumer loans:		
Home equity	48,307	53,480
Indirect automobile	57	
Other	1,344	1,835
Total consumer loans	49,652	55,372
Total loans	1,287,633	1,246,917
Deferred loan origination costs	2,967	2,591
net of fees		
Allowance for loan losses	(14,227)	(12,334)
Loans receivable, net	\$1,276,373	\$1,237,174

The Company purchased commercial loans totaling \$35.2 million during the nine months ended September 30, 2018. For the twelve months ended December 31, 2017, the Company purchased commercial loans totaling \$36.1 million.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

## Allowance for Loan Losses

Changes in the allowance for loan losses for the three and nine months ended September 30, 2018 and 2017 are as follows:

Three Months Ended September 30, 2018	Residential - 1 to 4 Family Commercial	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	\$1,194	\$ 7,642	\$ 721	\$ 3,051	\$ 627	\$13,235
Provision for loan losses	72	377	139	419	2	1,009
Loans charged-off	(30 )	—	—	—	(1 )	(31 )
Recoveries of loans previously charged-off	—	—	—	13	1	14
Balance at end of period	\$1,236	\$ 8,019	\$ 860	\$ 3,483	\$ 629	\$14,227

Nine Months Ended September 30, 2018	Residential - 1 to 4 Family Commercial	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	\$1,093	\$ 6,627	\$ 633	\$ 3,308	\$ 673	\$12,334
Provision (credit) for loan losses	173	1,392	227	274	(44 )	2,022
Loans charged-off	(30 )	—	—	(132 )	(2 )	(164 )
Recoveries of loans previously charged-off	—	—	—	33	2	35
Balance at end of period	\$1,236	\$ 8,019	\$ 860	\$ 3,483	\$ 629	\$14,227

Three Months Ended September 30, 2017	Residential - 1 to 4 Family Commercial	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	\$1,181	\$ 6,230	\$ 562	\$ 3,439	\$ 735	\$12,147
Provision (credit) for loan losses	(48 )	241	37	(56 )	(3 )	171
Loans charged-off	(21 )	—	—	(32 )	(57 )	(110 )
Recoveries of loans previously charged-off	—	—	—	7	2	9
Balance at end of period	\$1,112	\$ 6,471	\$ 599	\$ 3,358	\$ 677	\$12,217

Nine Months Ended September 30, 2017	Residential - 1 to 4 Family Commercial	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	\$1,149	\$ 5,724	\$ 952	\$ 3,266	\$ 729	\$11,820
Provision (credit) for loan losses	3	747	(353 )	106	(2 )	501

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

Loans charged-off	(43 )	—	—	(46 )	(58 )	(147 )
Recoveries of loans previously charged-off	3	—	—	32	8	43
Balance at end of period	\$1,112	\$ 6,471	\$ 599	\$ 3,358	\$ 677	\$12,217

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Further information pertaining to the allowance for loan losses at September 30, 2018 and December 31, 2017 is as follows:

	Residential - 1 to 4 Family (In Thousands)	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
September 30, 2018						
Allowance for loans individually evaluated and deemed to be impaired	\$344	\$ 1,384	\$ —	\$ 638	\$ 28	\$2,395
Allowance for loans individually or collectively evaluated and not deemed to be impaired	892	6,635	860	2,844	601	11,832
Allowance for loans acquired with deteriorated credit quality	—	—	—	—	—	—
Total loan loss allowance	\$1,236	\$ 8,019	\$ 860	\$ 3,483	\$ 629	\$14,227
Loans individually evaluated and deemed to be impaired	\$6,086	\$ 10,281	\$ —	\$ 1,201	\$ 368	\$17,936
Loans individually or collectively evaluated and not deemed to be impaired	374,485	545,412	34,649	264,552	49,284	1,268,382
Amount of loans acquired with deteriorated credit quality	—	1,315	—	—	—	1,315
Total loans	\$380,571	\$ 557,008	\$ 34,649	\$ 265,753	\$ 49,652	\$1,287,633
December 31, 2017						
Allowance for loans individually evaluated and deemed to be impaired	\$231	\$ 251	\$ —	\$ —	\$ —	\$482
Allowance for loans individually or collectively evaluated and not deemed to be impaired	862	6,376	633	3,308	673	11,852
Allowance for loans acquired with deteriorated credit quality	—	—	—	—	—	—
Total loan loss allowance	\$1,093	\$ 6,627	\$ 633	\$ 3,308	\$ 673	\$12,334
Loans individually evaluated and deemed to be impaired	\$5,113	\$ 9,646	\$ —	\$ 334	\$ 292	\$15,385
Loans individually or collectively evaluated and not deemed to be impaired	392,164	470,433	28,765	283,171	55,080	1,229,613
	—	1,919	—	—	—	1,919

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

Amount of loans acquired with deteriorated  
credit quality

Total loans	\$397,277	\$ 481,998	\$ 28,765	\$ 283,505	\$ 55,372	\$1,246,917
-------------	-----------	------------	-----------	------------	-----------	-------------

19

---

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

## Past Due Loans

The following represents an aging of loans at September 30, 2018 and December 31, 2017:

30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total 30 Days or More Past Due	Current	Total Loans
(In Thousands)					
Real Estate: Residential					
-					
1 \$—	\$2,329	\$2,263	\$4,592	\$375,979	\$380,571
4					
family					
16,897	2,435	962	19,794	537,214	557,008
commercial					
Construction	—	—	—	34,649	34,649
Commercial Business:					
SBA and USDA					
guaranteed	—	—	—	72,779	72,779
Time share	—	—	—	41,583	41,583
Condominium association	—	—	289	32,762	33,051
Medical loans	—	38	87	28,518	28,605
Other	—	957	1,419	88,316	89,735
Consumer:					
Home equity	767	157	1,045	47,262	48,307
Indirect automobile	—	—	—	1	1
Other	2	—	21	1,323	1,344
\$17,983	\$4,923	\$4,341	\$27,247	\$1,260,386	\$1,287,633

30-59	60-89	Total 30	Current	Total
-------	-------	----------	---------	-------

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

December 31, 2017	Days Past Due	90 Days or More Past Due	Days or More Past Due	Loans	
(In Thousands)					
Real Estate: Residential					
1	\$6,243	\$1,582	\$1,280	\$9,105	\$388,172
to					\$397,277
4	family				
Multi-family	3	—	27	3,660	478,338
and commercial	3	—	—	—	481,998
Construction	—	—	—	28,765	28,765
Commercial Business:					
SBA and USDA	—	—	—	483	89,031
guaranteed	483	—	—	—	89,514
Time share	—	—	—	50,526	50,526
Condominium association	—	—	—	27,096	27,096
Medical loans	139	99	—	238	27,565
Other	183	26	286	88,280	27,803
Consumer:					
Home equity	475	—	—	475	53,005
Indirect automobile	2	3	—	5	53,480
Other	—	—	8	1,827	57
Total	1,060	\$1,867	\$1,333	\$14,260	\$1,232,657
					\$1,246,917



Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Impaired and Nonaccrual Loans

The following is a summary of impaired loans and nonaccrual loans at September 30, 2018 and December 31, 2017:

	September 30, 2018	Unpaid Principal Investment Balance	Related Allowance	Nonaccrual Loans
--	--------------------	-------------------------------------	-------------------	------------------

(In Thousands)

Impaired loans without valuation allowance:				
Real Estate:				
Residential				
-				
1 to 4 family	\$3,728	\$3,728	\$ —	\$ 3,231
Multi-family	672	6,869	—	1,092
Commercial				
Business:				
Medical loans	24	70	—	24
Other	80	80	—	72
Consumer:				
Home equity	230	230	—	230
Total impaired loans without valuation allowance:	10,734	10,977	—	4,649

Impaired loans with valuation allowance:

Real Estate: Residential				
-				
1 to 4 family	2,358	2,369	344	668
Multi-family and commercial	1,924	4,924	1,384	2,137
Business:				
Medical loans	38	38	1	38
Other	1,059	1,059	638	885
Consumer:				
Home equity	138	138	28	38
Total impaired loans with valuation allowance	8,517	8,528	2,395	3,766
Total impaired loans	\$19,261	\$19,505	\$ 2,395	\$ 8,415

(1) Includes loans acquired with deteriorated credit quality from the Newport Federal Savings Bank ("Newport") merger and performing troubled debt restructurings.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Impaired Loans<sup>(1)</sup>  
 December 31, 2017  
 Unpaid Principal Balance  
 Related Allowance  
 Nonaccrual Loans

(In Thousands)

Impaired loans without valuation allowance:				
Real Estate: Residential				
-				
1 to 4 family	\$3,097	\$3,156	\$ —	\$ 2,024
Multi-family	7120	7,317	—	3,169
commercial				
Commercial business	308	308	—	298
-				
Other Consumer				
-	292	292	—	192
Home equity				
Consumer				
-	—	—	—	1
Indirect automobile				
Total impaired loans without valuation allowance	10,817	11,073	—	5,684
Impaired loans with				

valuation allowance:				
Real Estate:				
Residential				
-				
1 to 4 family	2,016	2,027	231	381
Multi-family and commercial	4,029	4,029	251	313
Commercial business	26	26	—	26
-				
Other				
Total impaired loans with valuation allowance	6,071	6,082	482	720
Total impaired loans	\$6,888	\$17,155	\$ 482	\$ 6,404

(1) Includes loans acquired with deteriorated credit quality from the Newport merger and performing troubled debt restructurings.

The Company reviews and establishes, if necessary, an allowance for certain impaired loans for the amount by which the present value of expected cash flows, or observable market price of loan or fair value of the collateral if the loan is collateral dependent, are lower than the carrying value of the loan. At September 30, 2018 and December 31, 2017, the Company concluded that certain impaired loans required no valuation allowance as a result of management's measurement of impairment. No additional funds are advanced to those borrowers whose loans are deemed impaired without prior approval of the Loan Committee or the Board of Directors.

Additional information related to impaired loans is as follows:

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	Average Interest Recorded Investment Recognized	Interest Income Recognized on Cash Basis		Average Interest Recorded Investment Recognized	Interest Income Recognized on Cash Basis	
(In Thousands)						
Real Estate:						
Residential - 1 to 4 family	\$5,991	\$ 41	\$ 11	\$5,727	\$ 97	\$ 12
Multi-family and commercial	10,873	133	—	10,560	381	38
Commercial business:						
Medical loans	47	—	4	46	—	4

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

Other	1,785	12	—	1,593	42	14
Consumer:						
Home equity	341	1	—	340	3	—
Total	\$19,037	\$ 187	\$ 15	\$18,266	\$ 523	\$ 68

22

---

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
	Average Interest Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Interest Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Real Estate:						
Residential - 1 to 4 family	\$5,328	\$ 32	\$ 1	\$5,834	\$ 102	\$ 10
Multi-family and commercial	8,010	98	—	8,401	324	11
Commercial business:						
Medical loans	23	—	—	12	—	—
Other	1,449	8	—	1,218	52	27
Consumer:						
Home equity	284	1	—	354	4	1
Other	4	—	—	3	—	—
Total	\$15,098	\$ 139	\$ 1	\$15,822	\$ 482	\$ 49

**Credit Quality Information**

The Company utilizes an eight-grade internal loan rating system for all loans in the portfolio, with the exception of its purchased SBA and USDA commercial business loans that are fully guaranteed by the U.S. government, as follows:

o Pass (Ratings 1-4): Loans in these categories are considered low to average risk.

o Special Mention (Rating 5): Loans in this category are starting to show signs of potential weakness and are being closely monitored by management.

o Substandard (Rating 6): Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

o Doubtful (Rating 7): Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

o Loss (Rating 8): Loans in this category are considered uncollectible and of such little value that their continuance as assets is not warranted.

Management periodically reviews the ratings described above and the Company's internal audit function reviews components of the credit files, including the assigned risk ratings, of certain commercial loans as part of its loan review.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

The following tables present the Company's loans by risk rating at September 30, 2018 and December 31, 2017:

September 30, 2018	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In Thousands)						
<b>Real Estate:</b>							
Residential - 1 to 4 family	\$—	\$372,078	\$ 1,482	\$ 7,011	\$	—\$	—\$380,571
Multi-family and commercial	—	517,754	30,826	8,428	—	—	557,008
Construction	—	25,101	9,548	—	—	—	34,649
Total real estate loans	—	914,933	41,856	15,439	—	—	972,228
<b>Commercial Business:</b>							
SBA and USDA guaranteed	72,779	—	—	—	—	—	72,779
Time share	—	41,583	—	—	—	—	41,583
Condominium association	—	33,051	—	—	—	—	33,051
Medical loans	—	28,543	—	62	—	—	28,605
Other	—	85,525	3,097	1,113	—	—	89,735
Total commercial business loans	72,779	188,702	3,097	1,175	—	—	265,753
<b>Consumer:</b>							
Home equity	—	47,769	140	398	—	—	48,307
Indirect automobile	—	1	—	—	—	—	1
Other	—	1,344	—	—	—	—	1,344
Total consumer loans	—	49,114	140	398	—	—	49,652
Total loans	\$72,779	\$1,152,749	\$ 45,093	\$ 17,012	\$	—\$	—\$1,287,633

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

December 31, 2017	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In Thousands)						
Real Estate:							
Residential - 1 to 4 family	\$—	\$389,276	\$1,592	\$6,409	\$—	—\$	—\$397,277
Multi-family and commercial	—	457,395	13,362	11,241	—	—	481,998
Construction	—	28,765	—	—	—	—	28,765
Total real estate loans	—	875,436	14,954	17,650	—	—	908,040
Commercial Business:							
SBA and USDA guaranteed	89,514	—	—	—	—	—	89,514
Time share	—	50,526	—	—	—	—	50,526
Condominium association	—	27,096	—	—	—	—	27,096
Medical loans	—	27,803	—	—	—	—	27,803
Other	—	83,742	3,559	1,265	—	—	88,566
Total commercial business loans	89,514	189,167	3,559	1,265	—	—	283,505
Consumer:							
Home equity	—	53,086	137	257	—	—	53,480
Indirect automobile	—	57	—	—	—	—	57
Other	—	1,834	—	1	—	—	1,835
Total consumer loans	—	54,977	137	258	—	—	55,372
Total loans	\$89,514	\$1,119,580	\$18,650	\$19,173	\$—	—\$	—\$1,246,917



Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

The following tables provide information on loans modified as TDRs during the three and nine months ended September 30, 2018 and 2017. During the modification process, there were no loan charge-offs or principal reductions for the loans included in the table below.

	Three Months Ended September 30, 2018			2017		
	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)
	(Dollars in Thousands)					
Residential - 1 to 4 family	1	\$ 126	\$ 72	1	\$ 214	\$ 4
Multi-family and commercial	1	2,137	1,217	—	—	53
Consumer - Home equity	—	—	9	—	—	—
Total	2	\$ 2,263	\$ 1,298	1	\$ 214	\$ 57

	Nine Months Ended September 30, 2018			2017		
	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)
	(Dollars in Thousands)					
Residential - 1 to 4 family	4	\$ 585	\$ 72	2	\$ 505	\$ 4
Multi-family and commercial	1	2,137	1,217	2	234	53
Consumer - home equity	1	100	9	—	—	—
Total	6	\$ 2,822	\$ 1,298	4	\$ 739	\$ 57

The following table provides the recorded investment, by type of modification, during the three and nine months ended September 30, 2018 and 2017 for modified loans identified as TDRs.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
Interest rate adjustments	\$—	\$—	\$77	\$—
Principal deferrals	2,137	—	2,240	—

Combination of rate and payment (1)	214	379	214
Combination of rate and maturity (2)	126	—	126
Maturity only	—	—	291
Total	\$214	\$214	\$2,822
	\$214	\$214	\$739

(1) Terms include combination of rate adjustments and interest-only payment with deferral of principal.

There were no TDRs in payment default (defined as 90 days or more past due) within twelve months of restructure for the three and nine months ended September 30, 2018 and September 30, 2017.

As of September 30, 2018, the Company held \$1.2 million in consumer mortgage loans collateralized by residential real estate properties that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

## Loans Acquired with Deteriorated Credit Quality

The following is a summary of loans acquired from Newport with evidence of credit deterioration as of September 30, 2018 and December 31, 2017.

	Contractual Required Payments Receivable (In Thousands)	Cash Expected To Be Collected (In Thousands)	Non-Accrutable Discount	Accrutable Yield	Loans Receivable
Balance at December 31, 2017	\$2,141	\$ 1,919	\$ 222	\$ 143	\$ 1,776
Collections	(13 )	(13 )	—	(74 )	61
Dispositions	(591 )	(591 )	—	(42 )	(549 )
Balance at September 30, 2018	\$1,537	\$ 1,315	\$ 222	\$ 27	\$ 1,288

## NOTE 5. PREMISES AND EQUIPMENT

Premises and equipment at September 30, 2018 and December 31, 2017 are summarized as follows:

	September 30, 2018	December 31, 2017
	(In Thousands)	
Land	\$4,746	\$ 4,746
Buildings	13,707	13,675
Leasehold improvements	11,787	11,746
Furniture and equipment	13,170	12,561
Construction in process	353	7
	43,763	42,735
Accumulated depreciation and amortization	(24,664 )	(23,326 )
Premises and equipment, net	\$19,099	\$ 19,409

At September 30, 2018, construction in process related to construction costs of remodeling an existing branch. At September 30, 2018, the Company had outstanding commitments related to the remodeling of an existing branch totaling \$597,000. Construction in process related to construction, design and site costs associated with a new off-site ATM at December 31, 2017.

## NOTE 6. OTHER COMPREHENSIVE LOSS

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of shareholders' equity on the balance sheet, such items along with net income are components of comprehensive income.

Components of other comprehensive loss and related tax effects are as follows:

Nine Months Ended  
September 30, 2018  
Tax

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

	Before Tax Amount	Effects	Net of Tax Amount
Securities:			
Unrealized holding losses on available for sale securities	\$(2,436)	\$ 511	\$(1,925)
Other comprehensive loss	\$(2,436)	\$ 511	\$(1,925)

27

---

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

The components of accumulated other comprehensive loss included in shareholders' equity are as follows:

	September 30, 2018		
	Before Tax Amount	Tax Effects	Net of Tax Amount
	(In Thousands)		
Net unrealized losses on available for sale securities	\$ (4,252)	\$ 893	\$ (3,359)
Accumulated other comprehensive loss	\$ (4,252)	\$ 893	\$ (3,359)

	December 31, 2017		
	Before Tax Amount	Tax Effects	Net of Tax Amount
	(In Thousands)		
Net unrealized losses on available for sale securities	\$ (1,816)	\$ 618	\$ (1,198)
Reclassification of stranded tax effect from change in tax law <sup>(1)</sup>		(236 )	(236 )
Accumulated other comprehensive loss	\$ (1,816)	\$ 382	\$ (1,434)

<sup>(1)</sup> Reclassification was due to the one-time revaluation of the net deferred tax assets as a result of the Tax Cuts and Jobs Act.

NOTE 7. REGULATORY CAPITAL

The Bank is subject to regulatory capital requirements promulgated by federal bank regulatory agencies. Failure by the Bank to meet minimum capital requirements could result in certain mandatory and discretionary actions by regulators that could have a material adverse effect on our consolidated financial statements. Under Basel III capital requirements, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation require the Bank to maintain certain minimum capital amounts and ratios. Federal bank regulators require the Bank to maintain minimum ratios of core capital to adjusted average assets, common equity tier 1 capital to risk-weighted assets, tier 1 capital to risk-weighted assets and total risk-based capital to risk-weighted assets. At September 30, 2018, the Bank met all the capital adequacy requirements to which they were subject and were "well capitalized" under the regulatory requirements. Management believes no conditions or events have occurred since September 30, 2018 that would materially adversely change the Bank's capital classifications.

Effective January 1, 2016, Basel III implemented a requirement for all banking organizations to maintain a capital conservation buffer exclusively composed of common equity Tier 1 capital in an amount greater than 2.5% of total risk-weighted assets to avoid being subject to limitations on capital distributions, stock repurchases and discretionary bonus payments to executive officers. The capital conservation buffer increases the three risk-based capital ratios and will be phased in over a multi-year schedule with full compliance in 2019. Management believes the Bank's capital level will remain characterized as "well-capitalized" under the new rules.

As a result of the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act, the Federal Reserve Board amended its Small Bank Holding Company Policy Statement to provide that bank holding companies and savings and loan companies with consolidated assets of less than \$3 billion that (i) are not engaged in significant nonbanking activities, (ii) do not conduct significant off-balance sheet activities, and (iii) do not have a material amount of SEC-registered debt or equity securities, other than trust preferred securities, that contribute

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

to an organization's complexity, will no longer be subject to regulatory capital requirements, effective no later than November 2018.

In addition, as a result of the legislation, the federal banking agencies are required to develop a "Community Bank Leverage Ratio" (the ratio of a bank's tangible equity capital to average total consolidated assets) for financial institutions with assets of less than \$10 billion. A "qualifying community bank" that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered "well capitalized" under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution's risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement. The federal banking agencies must set the minimum capital for the new Community Bank Leverage Ratio at not less than 8% and not more than 10%. A financial institution can elect to be subject to this new definition. The Bank's regulatory capital amounts and ratios at September 30, 2018 and December 31, 2017, compared to the FDIC's requirements for classification as a well capitalized institution and for minimum capital adequacy, were as follows:

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2018	(Dollars in Thousands)					
Common Equity Tier 1 Capital	\$151,354	13.02 %	\$52,307	4.50 %	\$75,555	6.50 %
Tier 1 Capital to Risk Weighted Assets	151,354	13.02	69,743	6.00	92,991	8.00
Total Capital to Risk Weighted Assets	165,887	14.27	92,991	8.00	116,238	10.00
Tier 1 Capital to Average Assets	151,354	9.61	63,004	4.00	78,756	5.00
December 31, 2017	(Dollars in Thousands)					
Common Equity Tier 1 Capital	\$146,509	13.81 %	\$47,740	4.50 %	\$68,958	6.50 %
Tier 1 Capital to Risk Weighted Assets	146,509	13.81	63,653	6.00	84,871	8.00
Total Capital to Risk Weighted Assets	159,303	15.02	84,871	8.00	106,089	10.00
Tier 1 Capital to Average Assets	146,509	9.40	62,348	4.00	77,934	5.00

## NOTE 8. FAIR VALUE OF ASSETS AND LIABILITIES

## Fair Value Hierarchy

The Company groups its assets and liabilities in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Transfers between levels are recognized at the end of a reporting period, if applicable.

Level Valuation is based on quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or

liabilities.

Level 2: Valuation is based on 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 for substantially the full term of the assets or liabilities.

29

---



Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include assets or liabilities whose value is determined using unobservable inputs to pricing models, discounted cash flow methodologies, or similar techniques, as well as assets or liabilities for which the determination of fair value requires significant management judgment or estimation.

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of assets and liabilities is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various assets and liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the assets and liabilities.

The following methods and assumptions were used by the Company in estimating fair value disclosures of its financial instruments:

• Cash and cash equivalents. The carrying amounts of cash and cash equivalents approximate the fair values based on the short-term nature of the assets.

Securities available for sale. Included in the available for sale category are debt securities. The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market. Securities measured at fair value in Level 2 are based on pricing models that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. The Company utilizes a nationally-recognized third-party pricing service to estimate fair value measurements for the majority of its portfolio. The pricing service evaluates each asset class based on relevant market information considering observable data, but these prices do not represent binding quotes. The fair value prices on all investments are reviewed for reasonableness by management. Securities measured at fair value in Level 3 include one collateralized debt obligation that was backed by a trust preferred security issued by banks and insurance companies. Management determined that an orderly and active market for this security and similar securities did not exist based on a significant reduction in trading volume and widening spreads relative to historical levels. The Company estimates future cash flows discounted using a rate management believes is representative of current market conditions. Factors in determining the discount rate include the current level of deferrals and/or defaults, changes in credit rating and the financial condition of the debtors within the underlying securities, broker quotes for securities with similar structure and credit risk, interest rate movements and pricing for new issuances.

• Federal Home Loan Bank stock. The carrying value of Federal Home Loan Bank ("FHLB") stock approximates fair value based on the redemption provisions of the FHLB.

•

Federal Reserve Bank stock. The carrying value of Federal Reserve Bank ("FRB") stock approximates fair value based on the redemption provisions of the FRB.

Loans held for sale. The fair value of loans held for sale is estimated using quoted market prices.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

Loans receivable. For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of fixed-rate loans are estimated by discounting the future cash flows using the rates at the end of the period in which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Accrued interest receivable. The carrying amount of accrued interest approximates fair value.

Deposits. The fair value of demand deposits, negotiable orders of withdrawal, regular savings, certain money market deposits and mortgagors' and investors' escrow accounts is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities to a schedule of aggregated expected maturities on such deposits.

Federal Home Loan Bank advances. The fair value of the advances is estimated using a discounted cash flow calculation that applies current FHLB interest rates for advances of similar maturity to a schedule of maturities of such advances.

Junior subordinated debt owed to unconsolidated trust. Rates currently available for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

Forward loan sale commitments and derivative loan commitments. Forward loan sale commitments and derivative loan commitments are based on the fair values of the underlying mortgage loans, including the servicing rights for derivative loan commitments, and the probability of such commitments being exercised. Significant management judgment and estimation is required in determining these fair value measurements.

Interest rate swap agreements. The fair value of interest rate swap agreements are obtained from a third-party pricing service and are determined using a discounted cash flow approach and utilize observable inputs such as the LIBOR swap curve, effective date, maturity date, notional amount and stated interest rate. Such derivatives do not have embedded interest rate caps or floors.

Off-balance sheet instruments. Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

## Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present assets and liabilities measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017. The Company had no significant transfers into or out of Levels 1, 2 or 3 during the three and nine months ended September 30, 2018.

	September 30, 2018			Total
	Level 1	Level 2	Level 3	
	(In Thousands)			
Assets:				
U.S. Government and agency obligations	\$18,307	\$39,608	\$—	\$57,915
Government-sponsored enterprises	—	9,844	—	9,844
Mortgage-backed securities	—	75,706	—	75,706
Collateralized debt obligation	—	—	1,086	1,086
Obligations of state and political subdivisions	—	500	—	500
Tax-exempt securities	—	2,525	—	2,525
Forward loan sale commitments and derivative loan commitments	—	—	103	103
Interest rate swap agreements	—	353	—	353
Total assets	\$18,307	\$128,536	\$1,189	\$148,032
Liabilities:				
Interest rate swap agreements	\$—	\$353	\$—	\$353
Total liabilities	\$—	\$353	\$—	\$353

	December 31, 2017			Total
	Level 1	Level 2	Level 3	
	(In Thousands)			
Assets:				
U.S. Government and agency obligations	\$19,435	\$42,333	\$—	\$61,768
Government-sponsored enterprises	—	9,217	—	9,217
Mortgage-backed securities	—	78,295	—	78,295
Collateralized debt obligation	—	—	1,124	1,124
Obligations of state and political subdivisions	—	500	—	500
Tax-exempt securities	—	3,149	—	3,149
Forward loan sale commitments and derivative loan commitments	—	—	43	43
Total assets	\$19,435	\$133,494	\$1,167	\$154,096

The following table shows a reconciliation of the beginning and ending balances for Level 3 assets:

Collateralized Debt Obligations	Derivative Loan and Forward Loan Sale
---------------------------------	---------------------------------------

	Commitments, Net	
	(In Thousands)	
Balance at December 31, 2017	\$1,124	\$ 43
Total realized gains included in net income	—	60
Total unrealized losses included in other comprehensive loss	(38 )	—
Balance at September 30, 2018	\$1,086	\$ 103

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

## Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may also be required from time to time to measure certain other financial assets on a nonrecurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets at September 30, 2018 and December 31, 2017. There were no liabilities measured at fair value on a nonrecurring basis at September 30, 2018 and December 31, 2017.

	At September 30, 2018			At December 31, 2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(In Thousands)					
Impaired loans	\$—	\$—	—\$1,402	\$—	\$—	—\$337
Other real estate owned	—	—	608	—	—	1,226
Total assets	\$—	\$—	—\$2,010	\$—	\$—	—\$1,563

The following table summarizes losses resulting from fair value adjustments for assets measured at fair value on a nonrecurring basis.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	(In Thousands)			
Impaired loans	\$613	\$34	\$1,989	\$88
Other real estate owned	—	—	—	197
Total losses	\$613	\$34	\$1,989	\$285

The Company measures the impairment of loans that are collateral dependent based on the fair value of the collateral (Level 3). The fair value of collateral used by the Company represents the amount expected to be received from the sale of the property, net of selling costs, as determined by an independent, licensed or certified appraiser using observable market data. This data includes information such as selling price of similar properties, expected future cash flows or earnings of the subject property based on current market expectations, and relevant legal, physical and economic factors. The appraised values of collateral are adjusted as necessary by management based on observable inputs for specific properties. Losses applicable to write-downs of impaired loans are based on the appraised market value of the underlying collateral, assuming foreclosure of these loans is imminent, and are recorded through the provision for loan losses.

The amount of other real estate owned represents the carrying value of the collateral based on the appraised value of the underlying collateral less estimated selling costs. The loss on foreclosed assets represents adjustments in the valuation recorded during the time period indicated and not for losses incurred on sales.

#### Summary of Fair Values of Financial Instruments

The estimated fair values and related carrying or notional amounts of the Company's financial instruments are presented in the following table. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

realized in a sales transaction at September 30, 2018 and December 31, 2017. The estimated fair value amounts at September 30, 2018 and December 31, 2017 have been measured as of each respective date, and have not been re-evaluated or updated for purposes of the consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period-end. The information presented should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only required for a limited portion of the Company's assets. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimate, comparisons between the Company's disclosures and those of other banks may not be meaningful.

As of September 30, 2018 and December 31, 2017, the recorded carrying amounts and estimated fair values of the Company's financial instruments are as follows:

	September 30, 2018				
	Carrying Fair Value				
	Amount	Level 1	Level 2	Level 3	Total
	(In Thousands)				
<b>Financial Assets:</b>					
Cash and cash equivalents	\$76,744	\$76,744	\$	—\$	—\$76,744
Available for sale securities	147,576	18,307	128,183	1,086	147,576
Loans held for sale	1,368	—	—	1,386	1,386
Loans receivable, net	1,276,373	—	—	1,232,510	1,232,510
Federal Home Loan Bank stock	9,308	—	—	9,308	9,308
Federal Reserve Bank stock	3,638	—	—	3,638	3,638
Accrued interest receivable	5,209	—	—	5,209	5,209
<b>Financial Liabilities:</b>					
Deposits	1,250,093	—	—	1,250,044	1,250,044
Mortgagors' and investors' escrow accounts	2,838	—	—	2,838	2,838
Federal Home Loan Bank advances	152,780	—	149,732	—	149,732
Junior subordinated debt owed to unconsolidated trust	8,248	—	6,821	—	6,821
<b>On-balance Sheet Derivative Financial Instruments:</b>					
<b>Assets:</b>					
Derivative loan commitments	28	—	—	28	28
Forward loan sale commitments	75	—	—	75	75
Interest rate swap agreements	353	—	353	—	353
<b>Liabilities:</b>					
Interest rate swap agreements	353	—	353	—	353



Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

	December 31, 2017				
	Carrying Fair Value				
	Amount	Level 1	Level 2	Level 3	Total
	(In Thousands)				
<b>Financial Assets:</b>					
Cash and cash equivalents	\$83,486	\$83,486	\$ —	—	—\$ 83,486
Available for sale securities	154,053	19,435	133,494	1,124	154,053
Loans held for sale	835	—	—	847	847
Loans receivable, net	1,237,174	—	—	1,229,696	1,229,696
Federal Home Loan Bank stock	9,856	—	—	9,856	9,856
Federal Reserve Bank stock	3,636	—	—	3,636	3,636
Accrued interest receivable	4,784	—	—	4,784	4,784
<b>Financial Liabilities:</b>					
Deposits	1,208,047	—	—	1,209,458	1,209,458
Mortgagors' and investors' escrow accounts	4,418	—	—	4,418	4,418
Federal Home Loan Bank advances	170,094	—	163,568	—	163,568
Junior subordinated debt owed to unconsolidated trust	8,248	—	6,231	—	6,231
<b>On-balance Sheet Derivative Financial Instruments:</b>					
<b>Assets:</b>					
Derivative loan commitments	27	—	—	27	27
Forward loan sale commitments	16	—	—	16	16

## NOTE 9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

## Derivative Instruments Not Designated As Hedging Instruments

Certain derivative instruments do not meet the requirements to be accounted for as hedging instruments. These undesignated derivative instruments are recognized on the consolidated balance sheets at fair value, with changes in fair value recorded in noninterest income.

**Derivative Loan Commitments - Mortgage loan commitments** are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Company to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the values of these loan commitments decrease. Conversely, if interest rates decrease, the value of these loan commitments increase.

Forward Loan Sale Commitments - To protect against the price risk inherent in the exercise of derivative loan commitments resulting from potential decreases in the value of loans, the Company utilizes both “mandatory delivery” and “best efforts” forward loan sale commitments.

With a “mandatory delivery” contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay a “pair-off” fee, based on then-current market prices, to the investor to compensate the investor for the shortfall.

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

With a "best efforts" contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g., on the same day the lender commits to lend funds to a potential borrower).

The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments.

**Interest Rate Swap Agreements** - The Company does not use derivatives for trading or speculative purposes. Interest rate swap derivatives not designated as hedges are offered to certain qualifying commercial customers and to manage the Company's exposure to interest rate movements but do not meet the strict hedge accounting definition under FASB ASC 815, "Derivatives and Hedging." The interest rate swap agreement enables the customer to synthetically fix the interest rate on a variable rate loan. The customer pays a variable rate and enters into a fixed rate swap agreement with the Company. The credit risk associated with the interest rate swap derivatives executed with these customers is essentially the same as that involved in extending loans and is subject to the Company's normal credit policies. The Company obtains collateral, if needed, based upon its assessment of the customers' credit quality. Generally, interest rate swap agreements are offered to "pass" rated customers requesting long-term commercial loans or commercial mortgages in amounts generally of at least \$1.0 million. The interest rate swap agreements with our customers are cross-collateralized by the loan collateral and do not have any embedded interest rate caps or floors.

For every variable rate loan and fixed rate swap agreement entered into with a commercial customer, the Company simultaneously enters into an offsetting fixed rate swap agreement with a correspondent bank, agreeing to pay a fixed payment and receive a variable interest rate swap. The Company is party to master netting agreements with its correspondent bank; however, the Company does not offset assets and liabilities for financial statement presentation purposes. The master netting agreements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral generally in the form of cash is received or posted by the counterparty with the net liability position, in accordance with contract thresholds. As of September 30, 2018, based on its current position, the Company has paid \$850,000 into a collateral account to collateralize its position. The Company and correspondent bank have an agreement to secure any outstanding payable in excess of \$100,000.

The Company's agreements with its derivative counterparties contain the following provisions related to contingent credit risk:

- if the Company defaults on any of its indebtedness, including a default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations;
- if the Company fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative position, and the Company would be required to settle its obligations under the agreements;
- if the Company fails to maintain a specified minimum leverage ratio, then the Company could be declared in default on its derivative obligations; and
- if a specified event or condition occurs that materially changes the Company's creditworthiness in an adverse manner, it may be required to fully collateralize its obligations under the derivative instrument.

The Company is in compliance with the above provisions as of September 30, 2018.

The Company has established a derivative policy which sets forth the parameters for such transactions (including underwriting guidelines, rate setting process, maximum maturity, approval and documentation requirements), as

36

---

Table of Contents

SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018 AND 2017 AND DECEMBER 31, 2017

well as identifies internal controls for the management of risks related to these hedging activities (such as approval of counterparties, limits on counterparty credit risk, maximum loan amounts and limits to single dealer counterparties).

The interest rate swap derivatives executed with our customers and our counterparties are marked to market and are included with other assets and other liabilities on the consolidated balance sheets at fair value.

## Interest Rate Risk Management - Derivative Instruments

The following table presents the fair values of derivative instruments as well as their classification on the consolidated balance sheets at September 30, 2018 and December 31, 2017.

Balance Sheet Location	September 30, 2018		December 31, 2017	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
(In Thousands)				
Derivatives not designated as hedging instruments:				
Derivative loan commitments	Other Assets	\$3,857 \$ 28	\$ 3,133	\$ 27
Forward loan sale commitments	Other Assets	4,722 75	2,752	16
Commercial loan customer interest rate swap position	Other Assets	34,059 353	—	—
Counterparty interest rate swap position	Other Liabilities	34,059 353	—	—

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

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding changes in the Company's financial condition as of September 30, 2018 and December 31, 2017 and the results of operations for the three and nine months ended September 30, 2018 and 2017. The information contained in this section should be read in conjunction with the consolidated financial statements and notes thereto appearing in Part I, Item 1 of this document as well as with management's discussion and analysis of financial condition and results of operations and the consolidated financial statements included in the Company's 2017 Annual Report on Form 10-K.

This report may contain certain "forward-looking statements" within the meaning of the federal securities laws, which are made in good faith pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally preceded by terms such as "expects," "believes," "anticipates," "intends," "estimates," "projects" and similar expressions. These statements are not historical facts; rather, they are statements based on management's current expectations regarding our business strategies, intended results and future performance.

Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to: changes in interest rates; national and regional economic conditions; legislative and regulatory changes; monetary and fiscal policies of the United States government, including policies of the United States Treasury and the Federal Reserve Board; the quality and composition of the loan and investment portfolios; demand for loan products; deposit flows; competition; demand for financial services in the Company's market area; changes in real estate market values in the Company's market area; and changes in relevant accounting and tax principles and guidelines. Additional factors that may affect the Company's results are discussed in the Company's Annual Report on Form 10-K and in other reports filed with the Securities and Exchange Commission. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims, any obligation to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

### Critical Accounting Policies

The Company considers accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. The Company considers the determination of allowance for loan losses, deferred income taxes and the impairment of long-lived assets, such as goodwill and other intangibles, to be its critical accounting policies. Additional information about the Company's accounting policies is included in the notes to the Company's consolidated financial statements contained in Part I, Item 1 of this document and in the Company's 2017 Annual Report on Form 10-K.

### Impact of New Accounting Standards

Refer to Note 1 of the consolidated financial statements in this report for a discussion of recent accounting pronouncements.

### Comparison of Financial Condition at September 30, 2018 and December 31, 2017

#### Assets:

Summary. Assets increased \$26.2 million, or 1.7%, to \$1.61 billion at September 30, 2018, compared to \$1.58 billion at December 31, 2017, principally due to increases of \$39.2 million in net loans receivable, \$671,000 in the cash

surrender value of life insurance due to the purchase of \$11.8 million in new policies in October 2017 and

38

---

\$533,000 in loans held for sale, offset by decreases of \$6.7 million in cash and cash equivalents, \$6.5 million in available for sale securities and \$618,000 in other real estate owned.

Loans Receivable, Net. Net loans increased \$39.2 million primarily due to increases of \$75.0 million, \$6.0 million and \$5.9 million in multi-family and commercial real estate loans, condominium association loans and construction loans, respectively, offset by decreases of \$16.7 million in both residential mortgage loans and SBA and USDA guaranteed loans, \$8.9 million in timeshare loans and \$5.7 million in consumer loans. Changes in the loan portfolio consisted of the following:

**Residential Real Estate.** Residential mortgage loans comprised 29.6% of the total loan portfolio at September 30, 2018 and decreased \$16.7 million to \$380.6 million as compared to \$397.3 million at December 31, 2017. The reduction in residential mortgage loans reflects the sale of \$54.8 million of long-term fixed-rate loans in the secondary market during 2018. The Company sold \$37.9 million of such loans in the nine months ended September 30, 2017. Residential mortgage loan originations decreased \$5.5 million during the nine months ended September 30, 2018 over the comparable period in 2017 as a result of decreased activity in the housing market. Proceeds from loans sold for the nine months ended September 30, 2018 were \$54.9 million compared to \$38.5 million for the nine months ended September 30, 2017.

**Multi-family and Commercial Real Estate.** Multi-family and commercial real estate loans represented 43.3% of total loans at September 30, 2018 and increased \$75.0 million, or 15.6%, during the nine months ended September 30, 2018 to \$557.0 million. Originations for multi-family and commercial real estate loans were \$132.9 million during the nine months ended September 30, 2018, representing an increase of \$84.0 million compared to the same period in 2017.

**Construction.** Construction loans, which include both residential and commercial construction loans, increased \$5.9 million to \$34.6 million for the nine months ended September 30, 2018, primarily due to increased commercial real estate activity.

**Commercial Business.** Commercial business loans represented 20.6% of total loans at September 30, 2018. Commercial business loans decreased \$17.8 million, or 6.3%, for the nine months ended September 30, 2018, primarily due to decreases of \$16.7 million in SBA and USDA guaranteed loans and \$8.9 million in time share loans, offset by increases of \$6.0 million in condominium association loans and \$1.2 million in other commercial business loans. Commercial business loan originations decreased \$8.1 million during the nine months ended September 30, 2018 as compared to the same period in 2017. At September 30, 2018, unfunded lines of credit related to time share lending totaled \$27.1 million.

**Consumer.** Consumer loans represented 3.9% of the Company's total loan portfolio at September 30, 2018. Consumer loans decreased \$5.7 million during the nine months ended September 30, 2018, primarily as a result of a decrease of \$5.2 million in home equity loans due to decreased activity in the housing market and \$491,000 in other consumer loans. Loan originations for consumer loans totaled \$14.6 million, representing a decrease of \$3.1 million for the nine months ended September 30, 2018 over the comparable period in 2017.

The allowance for loan losses totaled \$14.2 million at September 30, 2018 compared to \$12.3 million at December 31, 2017. The ratio of the allowance for loan losses to total loans increased to 1.10% at September 30, 2018 from 0.99% at December 31, 2017, primarily due to increases in nonperforming loans and reserves for impaired loans, a higher provision incurred from the increase in the commercial real estate loan portfolio, which carries a higher degree of risk (excluding guaranteed SBA and USDA loans) than other loans held in the portfolio, a decrease in SBA and USDA loans, which because of the government guarantee on these loans does not require a corresponding allowance for loan losses, and \$129,000 of net loan charge-offs for the period.





The following table provides information with respect to nonperforming assets and TDRs as of the dates indicated.

September 30, 2018  
December 31, 2017

Nonaccrual  
(Dollars in Thousands)  
loans:

Real estate loans:		
Residential		
-		
1 to 4 family	\$3,899	\$2,405
Multi-family		
and commercial	229	3,482
Total real estate loans	7,128	5,887
Commercial business loans:		
Medical Loans		—
Other	324	324
Total commercial business loans	1,019	324
Consumer loans:		
Home equity	268	192
Other	—	1
Total consumer loans	268	193
Total nonaccrual loans	8,415	6,404
Accruing loans past due 90 days or		

more  
 Total  
 nonperforming  
 loans <sup>(1)</sup>

Other  
 real  
 estate  
 owned,  
 net  
<sup>(2)</sup>

Total  
 nonperforming  
 assets

Accruing  
 troubled  
 debt  
 restructurings

Total  
 nonperforming  
 assets  
 and  
 troubled  
 debt  
 restructurings

Allowance  
 for  
 loan  
 losses  
 as  
 a  
 percent  
 of

nonperforming  
 loans  
 Total  
 nonperforming  
 loans  
 to  
 total  
 loans

Total  
 nonperforming  
 loans  
 to  
 total  
 assets  
 Total  
 nonperforming  
 assets  
 and

1,226

9,438

\$ 17,068

169.07 % 192.60 %

0.65 % 0.51 %

0.52 % 0.41 %

1.08 %

troubled  
debt  
restructurings  
to  
total  
assets

(1) Includes nonperforming TDRs totaling \$3.1 million and \$3.6 million at September 30, 2018 and December 31, 2017, respectively.

(2) Other real estate owned balances are shown net of related write-downs.

The increase in nonperforming loans was primarily due to increases in nonperforming residential real estate loans of \$1.5 million and commercial business loans of \$695,000, offset by a decrease in nonperforming multi-family and commercial real estate loans of \$253,000.

Other real estate owned decreased \$618,000 to \$608,000 at September 30, 2018, primarily due to the sale of one consumer, one commercial and three residential properties totaling \$646,000. At September 30, 2018, other real estate owned consisted of one residential property and one commercial property.

Over the past few years, the Company has sought to restructure nonperforming loans rather than pursue foreclosure or liquidation, believing this approach achieves the best economic outcome for the Company in view of the current economic environment. Modified payment terms for TDRs generally involve deferred principal payments, interest rate concessions, maturity extensions, or a combination of these items. TDRs decreased \$199,000 to \$12.9 million at September 30, 2018, compared to \$13.1 million at December 31, 2017. Of the TDRs, \$9.8 million and \$9.4 million were performing in accordance with their restructured terms at September 30, 2018 and December 31, 2017, respectively. The Company anticipates these borrowers will repay all contractual principal and interest in accordance with the terms of their restructured loan agreements.

**Liabilities:**

Summary. Liabilities increased \$24.6 million, or 1.7%, to \$1.44 billion at September 30, 2018 compared to \$1.41 billion at December 31, 2017. Deposits increased \$42.0 million, or 3.5%, which included increases in certificates of deposit of \$36.1 million and noninterest-bearing deposits of \$22.8 million, offset by decreases in NOW and money market accounts of \$9.8 million and savings accounts of \$6.7 million. Although market competition has intensified, deposit growth remained strong due to competitively-priced deposit products and marketing initiatives. Borrowings decreased \$17.3 million from \$178.3 million at December 31, 2017 to \$161.0 million at September 30, 2018, resulting from repayments of FHLB advances with funds from excess deposits.

**Equity:**

Summary. Shareholders' equity increased \$1.5 million from \$168.5 million at December 31, 2017 to \$170.0 million at September 30, 2018. The increase in shareholders' equity was attributable to net income of \$8.1 million, partially offset by the repurchase of common shares totaling \$3.2 million, dividends paid of \$2.1 million and unrealized losses on securities included in other comprehensive loss of \$1.9 million.

Accumulated Other Comprehensive Loss. Accumulated other comprehensive loss is comprised of the unrealized gains and losses on available for sale securities. In addition, accumulated other comprehensive loss includes \$236,000 of the tax effect from the change in tax law that was reclassified to retained earnings in 2017. The net unrealized losses on available for sale securities, net of taxes, totaled \$3.4 million at September 30, 2018 and \$1.2 million at December 31, 2017.

**Results of Operations for the Three and Nine Months Ended September 30, 2018 and 2017**

General. The Company's results of operations depend primarily on net interest income, which is the difference between the interest income earned on the Company's interest-earning assets, such as loans and investments, and the interest expense on its interest-bearing liabilities, such as deposits and borrowings. The Company also generates noninterest income such as fees earned from mortgage banking activities, fees from deposits and other fees. The Company's noninterest expenses primarily consist of employee compensation and benefits, occupancy, computer services, furniture and equipment, outside professional services, electronic banking fees, FDIC deposit insurance and regulatory assessments, marketing and other general and administrative expenses. The Company's results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, governmental policies and actions of regulatory agencies.

Summary. The Company reported net income of \$2.7 million for the three months ended September 30, 2018 compared to \$2.2 million for the three months ended September 30, 2017. The Company reported net income of \$8.1 million for the nine months ended September 30, 2018 compared to \$6.8 million for the nine months ended September 30, 2017.

Interest and Dividend Income. Total interest and dividend income increased \$1.2 million, or 8.8%, to \$14.9 million for the quarter ended September 30, 2018, compared to \$13.6 million for the same period in 2017. The increase in interest and dividend income was primarily a result of increases in the average balance of loans and the average yield earned on loans, securities and other interest-earning assets, partially offset by a decrease in the average balance on investment securities and other interest-earning assets. Interest income on loans and securities reflects net accretion of \$60,000 and \$31,000 for the quarters ended September 30, 2018 and 2017, respectively, related to fair value adjustments of loans and securities resulting from the Newport acquisition. The average yield earned on interest-earning assets for the quarter ended September 30, 2018 increased 30 basis points to 3.93% compared to 3.63% for the quarter ended September 30, 2017, primarily due to increases of 72 basis points in the average yield earned on other interest-earning assets, 29 basis points in the average yield earned on securities and 22 basis points in the average yield earned on loans. The increase in yields reflects the rising interest rate environment. The average

balance of interest-earning assets increased \$1.4 million to \$1.51 billion for the three months ended September 30, 2018 due to increases of \$41.9 million in the average balance of loans, partially offset by decreases of \$25.0 million in the average balance of securities and \$15.5 million in the average balance of other interest-earning assets compared to the same period in 2017.

Total interest and dividend income increased \$2.3 million or 5.8%, to \$42.7 million for the nine months ended September 30, 2018 compared to \$40.3 million for the same period in 2017. The increase in interest and dividend income was primarily due to increases in the average balance of loans and the average yield earned on loans and other interest-earning assets, partially offset by decreases in the average balance and yield on investment securities versus the same period in 2017. Interest income on loans and securities reflects net accretion of \$553,000 and \$30,000 for the nine months ended September 30, 2018 and 2017, respectively, related to fair value adjustments of loans and securities resulting from the Newport acquisition. The average yield earned on interest-earning assets for the nine months ended September 30, 2018 increased 20 basis points to 3.82% compared to 3.62% for the nine months ended September 30, 2017, primarily due to a 74 basis point increase in the average yield on other interest-earning assets and a 15 basis point increase in the yield on loans, offset by a four basis point decrease in the average yield on securities. The average balance of interest-earning assets decreased \$304,000 to \$1.50 billion during the nine months of 2018, due to decreases of \$22.6 million in the average balance of securities and \$7.5 million in the average balance of other interest-earning assets, offset by an increase of \$29.8 million in the average balance of loans, as compared to the same period in 2017.

**Interest Expense.** For the quarter ended September 30, 2018, interest expense increased \$605,000, or 21.7%, primarily resulting from higher average rates paid on deposits and borrowings, partially offset by a reduction in the average balance of FHLB advances compared to the same quarter in 2017. Higher interest expense on interest-bearing liabilities reflects net amortization of \$14,000 and \$66,000 for the three months ended September 30, 2018 and 2017, respectively, related to fair value adjustments of deposits and borrowings resulting from the Newport acquisition. The average balance of interest-bearing deposits increased \$10.8 million to \$1.00 billion for the quarter ended September 30, 2018 compared to the same period in 2017, primarily due to increases in the average balance of NOW and money market accounts of \$9.5 million and \$7.7 million in the average balance of certificates of deposit, offset by a decrease of \$5.7 million in the average balance of savings deposits. The average rate paid on interest-bearing deposits increased 23 basis points to 1.00%. The average balance of FHLB advances decreased \$20.1 million for the quarter ended September 30, 2018, and the average rate paid increased 17 basis points to 1.96%. The average rate paid on subordinated debt increased 105 basis points to 3.94%, compared to the same period in 2017, due to increases in the three-month LIBOR rate.

Interest expense increased \$910,000, or 11.0%, for the nine months ended September 30, 2018, resulting from higher average rates paid on deposits and borrowings, partially offset by a decrease in the average balance of borrowings compared to the same period in 2017. Higher interest expense on interest-bearing liabilities reflects net amortization of \$40,000 and net accretion of \$289,000 for the nine months ended September 30, 2018 and 2017, respectively, related to fair value adjustments of deposits and borrowings resulting from the Newport acquisition. The average balance of interest-bearing deposits increased \$25.6 million to \$1.00 billion for the nine months ended September 30, 2018 and the average rate paid increased 12 basis points to 0.88%, compared to the same period in 2017. Increases in the average balance of NOW and money market deposits and certificates of deposit totaled \$26.7 million and \$2.6 million, respectively, while the average balance of savings accounts decreased \$3.2 million compared to the first nine months of 2017. The average balance of FHLB advances decreased \$32.1 million for the nine months ended September 30, 2018, while the average rate paid increased 20 basis points to 1.94%. The average rate paid on subordinated debt increased 90 basis points to 3.70%, compared to the same period in 2017, due to increases in the three-month LIBOR rate.

**Average Balance Sheet.** The following sets forth information regarding average balances of assets and liabilities as well as the total dollar amounts of interest income from average interest-earning assets and interest expense on average interest-bearing liabilities, resulting yields and rates paid, interest rate spread, net interest margin and the ratio of average interest-earning assets to average interest-bearing liabilities for the periods indicated.





Edgar Filing: SI Financial Group, Inc. - Form 10-Q

	At or For the Three Months Ended September 30,					
	2018			2017		
	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate
	(Dollars in Thousands)					
Interest-earning assets:						
Loans <sup>(1) (2) (3)</sup>	\$1,279,803	\$13,558	4.20 %	\$1,237,878	\$12,430	3.98 %
Securities <sup>(3)</sup>	165,085	1,069	2.57	190,045	1,094	2.28
Other interest-earning assets	60,372	295	1.94	75,921	234	1.22
Total interest-earning assets	1,505,260	14,922	3.93	1,503,844	13,758	3.63
Noninterest-earning assets	92,881			82,364		
Total assets	\$1,598,141			\$1,586,208		
Interest-bearing liabilities:						
Deposits:						
Business checking	\$375	—	—	\$1,094	—	—
NOW and money market	506,591	328	0.26	497,059	229	0.18
Savings <sup>(4)</sup>	29,886	28	0.37	35,539	39	0.44
Certificates of deposit <sup>(5)</sup>	465,867	2,172	1.85	458,190	1,654	1.43
Total interest-bearing deposits	1,002,719	2,528	1.00	991,882	1,922	0.77
Federal Home Loan Bank advances	157,359	779	1.96	177,439	802	1.79
Subordinated debt	8,248	82	3.94	8,248	60	2.89
Total interest-bearing liabilities	1,168,326	3,389	1.15	1,177,569	2,784	0.94
Noninterest-bearing liabilities	259,435			237,475		
Total liabilities	1,427,761			1,415,044		
Total shareholders' equity	170,380			171,164		
Total liabilities and shareholders' equity	\$1,598,141			\$1,586,208		
Net interest-earning assets	\$336,934			\$326,275		
Tax equivalent net interest income <sup>(3)</sup>		11,533			10,974	
Tax equivalent interest rate spread <sup>(6)</sup>			2.78 %			2.69 %
Tax equivalent net interest margin as a percentage of interest-earning assets <sup>(7)</sup>			3.04 %			2.90 %
Average of interest-earning assets to average interest-bearing liabilities			128.84 %			127.71 %
Less tax equivalent adjustment <sup>(3)</sup>		(68 )			(109 )	
Net interest income		\$11,465			\$10,865	

(1) Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale and excludes the allowance for loan losses.

(2) Loan fees are included in interest income and are immaterial.

(3) Municipal securities income, tax-exempt loan income and net interest income are presented on a tax equivalent basis using a tax rate of 21% and 34% for the periods ended September 30, 2018 and 2017, respectively. The tax equivalent adjustment is deducted from tax equivalent net interest income to agree to the amounts reported in the statements of income.

(4) Includes mortgagors' and investors' escrow accounts.

(5) Includes brokered deposits.

(6) Tax equivalent net interest rate spread represents the difference between the

weighted average  
yield on  
interest-earning  
assets and the  
weighted average  
cost of  
interest-bearing  
liabilities.

<sup>(7)</sup> Tax equivalent  
net interest  
margin represents  
tax equivalent net  
interest income  
divided by  
average  
interest-earning  
assets.

Edgar Filing: SI Financial Group, Inc. - Form 10-Q

	At or For the Nine Months Ended September 30,					
	2018			2017		
	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate
	(Dollars in Thousands)					
Interest-earning assets:						
Loans <sup>(1) (2) (3)</sup>	\$1,270,754	\$39,385	4.14 %	\$1,240,956	\$37,039	3.99 %
Securities <sup>(3)</sup>	164,223	2,646	2.15	186,776	3,060	2.19
Other interest-earning assets	64,117	846	1.76	71,666	546	1.02
Total interest-earning assets	1,499,094	42,877	3.82	1,499,398	40,645	3.62
Noninterest-earning assets	91,848			82,427		
Total assets	\$1,590,942			\$1,581,825		
Interest-bearing liabilities:						
Deposits:						
Business checking	\$557	—	—	\$1,050	—	—
NOW and money market	513,157	899	0.23	486,478	597	0.16
Savings <sup>(4)</sup>	32,696	81	0.33	35,899	102	0.38
Certificates of deposit <sup>(5)</sup>	456,792	5,599	1.64	454,150	4,856	1.43
Total interest-bearing deposits	1,003,202	6,579	0.88	977,577	5,555	0.76
Federal Home Loan Bank advances	166,282	2,408	1.94	198,428	2,577	1.74
Subordinated debt	8,248	228	3.70	8,248	173	2.80
Total interest-bearing liabilities	1,177,732	9,215	1.05	1,184,253	8,305	0.94
Noninterest-bearing liabilities	243,207			228,683		
Total liabilities	1,420,939			1,412,936		
Total shareholders' equity	170,003			168,889		
Total liabilities and shareholders' equity	\$1,590,942			\$1,581,825		
Net interest-earning assets	\$321,362			\$315,145		
Tax equivalent net interest income <sup>(3)</sup>		33,662			32,340	
Tax equivalent interest rate spread <sup>(6)</sup>			2.77 %			2.68 %
Tax equivalent net interest margin as a percentage of interest-earning assets <sup>(7)</sup>			3.00 %			2.88 %
Average of interest-earning assets to average interest-bearing liabilities			127.29%			126.61%
Less tax equivalent adjustment <sup>(3)</sup>		(205 )			(296 )	
Net interest income		\$33,457			\$32,044	

(1) Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale and excludes the allowance for loan losses.

(2) Loan fees are included in interest income and are immaterial.

(3) Municipal securities income, tax-exempt loan income and net interest income are presented on a tax equivalent basis using a tax rate of 21% and 34% for the periods ended September 30, 2018 and 2017, respectively. The tax equivalent adjustment is deducted from tax equivalent net interest income to agree to the amounts reported in the statements of income.

(4) Includes mortgagors' and investors' escrow accounts.

(5) Includes brokered deposits.

(6) Tax equivalent net interest rate spread represents the difference between the

weighted average  
yield on  
interest-earning  
assets and the  
weighted average  
cost of  
interest-bearing  
liabilities.

<sup>(7)</sup> Tax equivalent  
net interest  
margin represents  
tax equivalent net  
interest income  
divided by  
average  
interest-earning  
assets.

44

---

The following table sets forth the extent to which changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities have on the Company's interest income and interest expense for the periods presented. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the rate and volume columns. For purposes of this table, changes attributable to both changes in rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Three Months Ended September 30, 2018 and 2017			Nine Months Ended September 30, 2018 and 2017		
	Increase (Decrease) Due To			Increase (Decrease) Due To		
	Rate	Volume	Net	Rate	Volume	Net
	(In Thousands)					
Interest-earning assets:						
Interest and dividend income:						
Loans <sup>(1)(2)(3)</sup>	\$716	\$ 412	\$1,128	\$1,470	\$ 876	\$2,346
Securities <sup>(3)</sup>	110	(135 )	(25 )	(50 )	(364 )	(414 )
Other interest-earning assets	102	(41 )	61	353	(53 )	300
Total interest-earning assets	928	236	1,164	1,773	459	2,232
Interest-bearing liabilities:						
Interest expense:						
Deposits <sup>(4)</sup>	579	27	606	974	50	1,024
Federal Home Loan Bank advances	64	(87 )	(23 )	219	(388 )	(169 )
Subordinated debt	22	22	44	55	—	55
Total interest-bearing liabilities	665	(38 )	627	1,248	(338 )	910
Change in net interest income	\$263	\$ 274	\$537	\$525	\$ 797	\$1,322

<sup>(1)</sup> Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale.

<sup>(2)</sup> Loan fees are included in interest income and are immaterial.

<sup>(3)</sup> Municipal securities income, tax-exempt loan income and net interest income

are presented on a tax equivalent basis using a tax rate of 21% and 34% for the periods ended September 30, 2018 and 2017, respectively. The tax equivalent adjustment is deducted from tax equivalent net interest income to agree to the amount reported in the statements of income.

<sup>(4)</sup> Includes mortgagors' and investors' escrow accounts and brokered deposits.

Provision for Loan Losses. The provision for loan losses increased \$838,000 and \$1.5 million for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017, primarily due to increases in nonperforming loans, reserves for impaired loans and an increase in commercial real estate loans, which carry a higher degree of risk than other loans held in the loan portfolio. For the quarter ended September 30, 2018, the increase in the provision for loan losses was partially offset by a decrease in net loan charge-offs. At September 30, 2018, nonperforming loans increased to \$8.4 million compared to \$3.6 million at September 30, 2017, primarily resulting from increases in nonperforming multi-family and commercial real estate loans of \$2.5 million and residential real estate loans of \$1.9 million. Net loan charge-offs, consisting primarily of commercial business loans, were \$17,000 and \$129,000 for the three and nine months ended September 30, 2018, respectively, compared to \$101,000 and \$104,000 for the three and nine months ended September 30, 2017, respectively.



Noninterest Income. The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

	Three Months				Nine Months			
	Ended		Change		Ended		Change	
	September 30,		Dollars	Percent	September 30,		Dollars	Percent
	2018	2017			2018	2017		
	(Dollars in Thousands)							
Service fees	\$1,736	\$1,723	\$13	0.8 %	\$5,217	\$5,165	\$52	1.0 %
Wealth management fees	5	20	(15 )	(75.0 )	23	539	(516 )	(95.7 )
Increase in cash surrender value of bank-owned life insurance	230	133	97	72.9	671	395	276	69.9
Mortgage banking	343	519	(176 )	(33.9 )	901	1,140	(239 )	(21.0 )
Net loss on disposal of equipment	(2 )	(4 )	2	(50.0 )	(2 )	(4 )	2	(50.0 )
Other	607	124	483	389.5	1,822	1,428	394	27.6
Total noninterest income	\$2,919	\$2,515	\$404	16.1 %	\$8,632	\$8,663	\$(31)	(0.4 )%

Noninterest income increased \$404,000 to \$2.9 million for the three months ended September 30, 2018 and decreased \$31,000 to \$8.6 million for the nine months ended September 30, 2018, respectively, compared to the same periods in the prior year. The increase in noninterest income for the three months ended September 30, 2018 compared to the same period in 2017 was primarily due to income of \$488,000, reported as other income from interest rate swap agreements entered into during the third quarter of 2018. The decrease in noninterest income for the nine months ended September 30, 2018 as compared to the same period in 2017 was primarily due to a pre-tax gain in May 2017 of \$795,000 on the sale of the Company's trust and asset management business, partially offset by income of \$684,000 in June 2018 resulting from the release of funds held in escrow related to the December 2016 sale of the Company's ownership interest in Vantis Life Insurance Company. Wealth management fees decreased \$15,000 and \$516,000 for the three and nine months ended September 30, 2018, respectively, versus the comparable periods in the prior year as a result of the sale of the Company's trust and asset management business in 2017. Fees earned from mortgage banking activities decreased \$176,000 and \$239,000 for the three and nine months ended September 30, 2018, respectively, primarily due to lower volume and lower gains on residential fixed-rate loan sales versus the comparable periods in 2017 due to rising interest rates. The cash surrender value of bank owned life insurance increased \$97,000 and \$276,000 for the three and nine months ended September 30, 2018, respectively, compared to the same periods in the prior year resulting from the purchase of \$11.8 million in new policies in October 2017.

Noninterest Expenses. The following table shows the components of noninterest expenses and the dollar and percentage changes for the periods presented.

	Three Months				Nine Months			
	Ended		Change		Ended		Change	
	September 30,	September 30,	Dollars	Percent	September 30,	September 30,	Dollars	Percent
	2018	2017			2018	2017		
	(Dollars in Thousands)							
Salaries and employee benefits	\$5,386	\$5,052	\$334	6.6 %	\$15,898	\$15,485	\$413	2.7 %
Occupancy and equipment	1,668	1,662	6	0.4	5,175	5,138	37	0.7
Computer and electronic banking services	1,350	1,345	5	0.4	3,926	4,015	(89 )	(2.2 )
Outside professional services	268	379	(111 )	(29.3)	967	1,172	(205 )	(17.5)
Marketing and advertising	203	173	30	17.3	666	580	86	14.8
Supplies	141	121	20	16.5	436	383	53	13.8
FDIC deposit insurance and regulatory assessments	192	178	14	7.9	530	590	(60 )	(10.2)
Core deposit intangible amortization	150	150	—	—	451	451	—	—
Other real estate operations	103	117	(14 )	(12.0)	271	484	(213 )	(44.0)
Other	491	481	10	2.1	1,536	1,725	(189 )	(11.0)
Total noninterest expenses	\$9,952	\$9,658	\$294	3.0 %	\$29,856	\$30,023	\$(167)	(0.6 )%

Noninterest expenses increased \$294,000 and decreased \$167,000 for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. Salaries and benefits increased \$334,000 and \$413,000 for the three and nine months ended September 30, 2018, respectively, due to an increase in employee compensation, benefits and related taxes. Outside professional services decreased \$111,000 and \$205,000 for the three and nine months ended September 30, 2018, respectively, versus the same periods in 2017 due to a decrease in legal expenses. Compared to the same periods in 2017, other real estate operations decreased \$14,000 and \$213,000 for the three and nine months ended September 30, 2018, respectively, due to the sale of one commercial property, one consumer property and three residential properties held by the Bank. Other noninterest expenses decreased \$189,000 for the nine months ended September 30, 2018 versus the comparable period in 2017 in large part due to \$373,000 of fraudulent debit card transactions which occurred in early 2017. Regulatory assessments increased \$14,000 and decreased \$60,000 for the three and nine months ended September 30, 2018, respectively. The decrease for the nine months ended September 30, 2018 was a result of a lower FDIC assessment rate. Computer and electronic banking expenses decreased \$89,000 for the nine months ended September 30, 2018 versus the comparable period in 2017 as a result of contract renegotiations with a third party provider for electronic banking services.

Income Tax Provision. The provision for income taxes decreased \$588,000 and \$1.2 million for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. The decrease in the income tax provision was due to the passage of the Tax Cuts and Jobs Act on December 22, 2017, which reduced the statutory corporate income tax rate from 35% to 21% effective for January 1, 2018. The effective tax rate for the three months ended September 30, 2018 and 2017 was 21.0% and 36.8%, respectively. The effective tax rate for the first nine months of 2018 and 2017 was 21.0% and 33.2%, respectively.

#### Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short- and long-term nature. The Bank's primary sources of funds consist of deposit inflows, loan sales and repayments, maturities and sales of securities and FHLB borrowings. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows, mortgage prepayments and loan and security sales are greatly influenced by general interest rates, economic conditions and competition.



The Bank's most liquid assets are cash and cash equivalents. The levels of these assets depend on the Bank's operating, financing, lending and investing activities during any given period. At September 30, 2018, cash and cash equivalents totaled \$76.7 million. Securities classified as available for sale, which provide additional sources of liquidity, totaled \$147.6 million at September 30, 2018. In addition, at September 30, 2018, the Bank had the ability to borrow an additional \$146.2 million from the FHLB, which included overnight lines of credit of \$10.0 million. On that date, the Bank had FHLB advances outstanding of \$152.8 million and no overnight advances outstanding. Additionally, the Bank has the ability to access the Federal Reserve Bank's Discount Window on a collateralized basis and maintains a \$25.0 million unsecured line of credit with a financial institution to access federal funds. The Bank believes that its liquid assets combined with the available lines of credit provide adequate liquidity to meet its current financial obligations.

The Bank's primary investing activities are the origination, purchase and sale of loans and the purchase of securities. For the nine months ended September 30, 2018, the Bank originated \$245.9 million of loans, and purchased \$35.2 million of loans and \$31.0 million of securities. For the year ended December 31, 2017, the Bank originated \$234.5 million of loans and purchased \$36.1 million of loans and \$32.0 million of securities.

Financing activities consist primarily of activity in deposit accounts and in borrowed funds. The net increase in total deposits, including mortgagors' and investors' escrow accounts, was \$40.5 million for the nine months ended September 30, 2018. FHLB advances decreased \$17.3 million for the nine months ended September 30, 2018 and decreased \$47.7 million for the year ended December 31, 2017. The decrease in borrowings for the nine months of 2018 resulted from the net repayments of FHLB advances with excess deposits and proceeds from maturing securities. Certificates of deposit due within one year of September 30, 2018 totaled \$234.5 million, or 18.8% of total deposits. Management believes the amount of deposits in shorter-term certificates of deposit reflects customers' hesitancy to invest their funds in longer-term certificates of deposit due to the uncertain interest rate environment. To compensate, the Bank has increased the duration of its borrowings with the FHLB. The Bank will be required to seek other sources of funds, including other certificates of deposit and lines of credit, if maturing certificates of deposit are not retained. Depending on market conditions, the Bank may be required to pay higher rates on such deposits or other borrowings than are currently paid on certificates of deposit. Additionally, a shorter duration in the securities portfolio may be necessary to provide liquidity to compensate for any deposit outflows. The Bank believes, however, based on past experience, a significant portion of its certificates of deposit will be retained. The Bank has the ability, if necessary, to adjust the interest rates offered to its customers in an effort to attract and retain deposits.

Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by the Bank and its local competitors and other factors. The Bank generally manages the pricing of its deposits to be competitive and to increase core deposits and commercial banking relationships. Occasionally, the Bank offers promotional rates on certain deposit products to attract deposits.

The Company repurchased 215,000 shares of the Company's common stock at a cost of \$3.2 million during the first nine months of 2018 and repurchased 24,832 shares of the Company's common stock at a cost of \$371,000 during the year ended December 31, 2017. Additional discussion about the Company's liquidity and capital resources is contained in Item 7 in the Company's 2017 Annual Report on Form 10-K.

SI Financial Group, Inc. is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders and making payments on its subordinated debentures. The Company may continue to repurchase shares of its common stock in the future. The Company's primary sources of funds are interest and dividends on securities and dividends received from the Bank. The amount of dividends the Bank may declare and pay to the Company in any calendar year, without prior regulatory approval, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. The Company believes such restriction will not have an impact on the Company's

ability to meet its ongoing cash obligations. At September 30, 2018, on an unconsolidated basis, the Company had cash and cash equivalents of \$2.3 million and available for sale securities of \$7.9 million.

### Payments Due Under Contractual Obligations

Information relating to payments due under contractual obligations is presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. There were no material changes in the Company's payments due under contractual obligations between December 31, 2017 and September 30, 2018.

### Off-Balance Sheet Arrangements

As a financial services provider, we routinely are a party to various financial instruments with off-balance sheet risks, such as commitments to extend credit, standby letters of credit and unused lines of credit. While these contractual obligations represent our future cash requirements, a significant portion of the commitments to extend credit may expire without being drawn upon. The contractual amounts of commitments to extend credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments whose contract amounts represent credit risk at September 30, 2018 and December 31, 2017 are as follows:

	September 30, 2018	December 31, 2017
	(In Thousands)	
Commitments to extend credit:		
Commitments to originate loans	\$20,128	\$60,360
Undisbursed construction loans	47,336	9,027
Undisbursed home equity lines of credit	57,338	56,044
Undisbursed commercial lines of credit	65,220	50,054
Overdraft protection lines	1,246	1,306
Standby letters of credit	237	134
Total commitments	\$191,505	\$176,925

Future loan commitments at September 30, 2018 and December 31, 2017 included fixed-rate loan commitments of \$13.3 million and \$34.1 million, respectively, at interest rates ranging from 3.00% to 5.88% and 2.88% to 6.00%, respectively.

The Bank is a limited partner in three small business investment corporations ("SBICs"). At September 30, 2018, the Bank's remaining off-balance sheet commitment for the capital investment in the SBICs was \$787,000.

For the nine months ended September 30, 2018, with the exception of the aforementioned commitments, the Company did not engage in any additional off-balance sheet transactions reasonably likely to have a material effect on the Company's financial condition, results of operations or cash flows. See Notes 6 and 12 to the consolidated financial statements contained in the Company's 2017 Annual Report on Form 10-K.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

#### Qualitative Aspects of Market Risk

The primary market risk affecting the financial condition and operating results of the Company is interest rate risk. Interest rate risk is the exposure of current and future earnings and capital arising from movements in interest rates.

The Company manages the interest rate sensitivity of its interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. To reduce the volatility of its earnings, the Company has sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. The Company's strategy for managing interest rate risk

generally is to emphasize the origination of adjustable-rate mortgage loans for retention in its loan portfolio. However, the ability to originate adjustable-rate loans depends to a great extent on market interest rates and borrowers' preferences. As an alternative to adjustable-rate mortgage loans, the Company may occasionally purchase variable-rate SBA and USDA loans in the secondary market that are fully guaranteed by the U.S. government. These loans have a significantly shorter duration than fixed-rate mortgage loans. Fixed-rate mortgage loans typically have an adverse effect on interest rate sensitivity compared to adjustable-rate loans. Accordingly, the Company has sold more longer-term fixed-rate mortgage loans in the secondary market in recent periods to manage interest rate risk. The Company offers 10-year fixed-rate mortgage loans that it retains in its portfolio. In addition, the Company utilizes interest rate swap derivatives with certain commercial customers as a fixed rate loan alternative to manage exposure to interest rate risk. The Company may offer attractive rates for existing certificates of deposit accounts to extend their maturities. The Company also uses shorter-term investment securities and longer-term borrowings from the FHLB to help manage interest rate risk.

The Company has an Asset/Liability Committee to communicate, coordinate and control all aspects involving asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

#### Quantitative Aspects of Market Risk

The Company analyzes its interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The Company's goal is to manage asset and liability positions to moderate the effect of interest rate fluctuations on net interest income.

#### Net Interest Income Simulation Analysis

The interest income simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions and are completed quarterly. Interest income simulations and the numerous assumptions used in the simulation process are presented and reviewed by the Asset/Liability Committee on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates. The simulation analysis incorporates management's current assessment of the risk that pricing margins will change adversely over time due to competition or other factors. Simulation analysis is only an estimate of the Company's interest rate risk exposure at a particular point in time. The Company continually reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The table below sets forth an approximation of the Company's exposure as a percentage of estimated net interest income for the next 12- and 24-month periods using interest income simulation. The simulation uses projected repricing of assets and liabilities at September 30, 2018 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the large percentage of loans and mortgage-backed securities the Company holds, rising or falling interest rates have a significant impact on the prepayment speeds of the Company's earning assets that in turn affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. The Company's asset sensitivity would be reduced if prepayments slow and vice versa. While the Company believes such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.





The following table reflects changes in estimated net interest income for the Company at September 30, 2018.

	Percentage Change in Estimated Net Interest Income Over	
	12	24
	Months	Months
100 basis point decrease in rates	(3.72)%	(3.32)%
200 basis point increase in rates	4.38	3.08
300 basis point increase in rates	5.33	2.35

As indicated by the results of the above scenarios, net interest income would be adversely affected (within our internal guidelines) if rates decreased 100 basis points in the 12- and 24-month periods. Conversely, net interest income would be positively impacted in the 12- and 24-month periods if rates increased 200 or 300 basis points as a result of the Company's initiative to position the balance sheet for the anticipated increase in market interest rates. The Company's strategy for mitigating interest rate risk includes the purchase of adjustable-rate investment securities that will reprice in a rising rate environment, selling longer-term and lower fixed-rate residential mortgage loans in the secondary market, extending the duration of FHLB advances and utilizing certain derivative instruments such as forward loan sale commitments to manage the risk of loss associated with its mortgage banking activities and interest rate swap agreements for certain longer-term commercial loans to manage exposure to interest rate movements.

Item 4. Controls and Procedures.

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (2) is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. No changes in the Company's internal control over financial reporting occurred during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. Periodically, there have been various claims and lawsuits against the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds a security interest, claims involving the making and servicing of real property loans and other issues incident to the Bank's business. Management believes that any potential liability that may result from these legal proceedings would not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

Item 1A. Risk Factors.

There are no material changes from the risk factors set forth under Part I, Item 1A. "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. However, the risks described in the Company's Annual Report on Form 10-K are not the only risks that the Company faces. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect the Company's business, financial condition and/or operating results.

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

On May 9, 2018, the Company announced that the Board of Directors had approved a stock repurchase program authorizing the Company to repurchase up to 5%, or 612,122 shares, of its common stock from time to time, depending on market conditions. The repurchase program will continue until it is completed or terminated by the Company's Board of Directors. The Company did not repurchase any shares of its equity securities for the three months ended September 30, 2018. As of September 30, 2018, 397,122 shares remain available for purchase under the program.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

3.1 Articles of Incorporation of SI Financial Group, Inc. <sup>(1)</sup>

3.2 Amended and Restated Bylaws of SI Financial Group, Inc. <sup>(2)</sup>

4 Specimen Stock Certificate of SI Financial Group, Inc. <sup>(1)</sup>

10.1 Supplemental Executive Retirement Plan, dated December 20, 2006, between Savings Institute Bank and Rheo A. Brouillard

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.0 18 U.S.C. Section 1350 Certifications

The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in eXtensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) 101 the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Statement of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) related Notes to Consolidated Financial Statements.

<sup>(1)</sup> Incorporated herein by reference into this document from the Exhibits on the Registration Statement on Form S-1 (File No. 333-169302), and any amendments thereto, filed with the Securities and Exchange Commission on September 10, 2010.

(2) Incorporated herein by reference into this document from the Exhibits to the Company's Current Report on Form 8-K (File No. 000-54241) filed with the Securities and Exchange Commission on August 23, 2017.

SIGNATURES

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

SI FINANCIAL GROUP, INC.

Date: November 8, 2018 /s/ Rheo A. Brouillard  
Rheo A. Brouillard  
President and Chief Executive Officer  
(principal executive officer)

Date: November 8, 2018 /s/ Lauren L. Murphy  
Lauren L. Murphy  
Executive Vice President and Chief Financial Officer  
(principal accounting and financial officer)