SI Financial Group, Inc.
Form 10-K
March 19, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

o ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2018
o 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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of Exchange on which registered
Common stock, par value $0.01 per share	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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 x No o

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

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

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

Large Accelerated Filer	o	Accelerated Filer	x
Non-Accelerated Filer	o	Smaller Reporting Company	x
Emerging Growth Company	o		

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. o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was $171.8 million, which was computed by reference to the closing price of $14.75, at which the common equity was sold as of June 30, 2018. Solely for the purposes of this calculation, the shares held by the directors and officers of the registrant are deemed to be shares held by affiliates.

As of March 13, 2019, there were 12,054,785 shares of the registrant’s common stock outstanding.

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Forward-Looking Statements

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. 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. Forward-looking statements are generally preceded by terms such as “expects,” “believes,” “anticipates,” “intends,” “estimates,” “projects” and similar expressions. Management’s ability to predict results of the effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of SI Financial Group, Inc. (the "Company" or "SI Financial") and its subsidiaries include, but are not limited to, changes in interest rates, corporate tax 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, deposit flows, competition, demand for financial products and services in the Company’s market area, changes in real estate market values in the Company’s market area and changes in relevant accounting or tax principles and guidelines.

Additional factors that may affect the Company’s results are discussed in Item 1A. “Risk Factors” in this Annual Report on Form 10-K and in other reports filed with the Securities and Exchange Commission ("SEC"). 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.

On December 11, 2018, the Company entered into an Agreement and Plan of Merger ("Merger Agreement") with Berkshire Hills Bancorp, Inc. ("Berkshire"). Under the Merger Agreement, the Company will merge with and into Berkshire, with Berkshire as the surviving corporation, in an all-stock transaction that we refer to as the "merger". Additional factors relating to our proposed merger with Berkshire include the occurrence of any event, change or other circumstances that could give rise to the termination of the Merger Agreement; the risk that the necessary regulatory approvals may not be obtained, may be delayed, or may be obtained subject to conditions that are not anticipated; delays in closing the Merger Agreement or other risks that any of the closing conditions to the Merger Agreement may not be satisfied in a timely manner or at all; the diversion of management’s time from existing business operations due to time spent related to the merger or integration efforts; the risk that our business and the business of Berkshire will not be integrated successfully or such integration may be more difficult, time consuming or costly than expected; expected revenue and other synergies and cost savings from the merger may not be fully realized or realized within the expected time frame; revenues following the merger may be lower than expected; and expenses related to the merger and costs following the merger that are higher than expected.

In connection with the merger, Berkshire has filed with the SEC a Registration Statement on Form S-4 that includes proxy statement/prospectus business and financial information about Berkshire and the Company from documents that Berkshire and the Company have previously filed with the SEC. The Registration Statement was declared effective on February 25, 2019. Shareholders of the Company are urged to read the registration statement and the proxy statement/prospectus regarding the merger and other relevant documents filed with the SEC, as well as any amendments or supplements to those documents.

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PART I.

Item 1. Business.

General

In certain instances where appropriate, the terms “we,” “us” and “our” refer to SI Financial Group, Inc. or Savings Institute Bank and Trust Company, or both.

SI Financial Group, Inc. is the parent holding company for Savings Institute Bank and Trust Company (the "Bank" or "Savings Institute"). The Bank operates as a community-oriented financial institution offering a full range of financial services to consumers and businesses in its market area, including life insurance and annuities. The Bank attracts deposits from the general public and uses those funds to originate one- to four-family residential, multi-family and commercial real estate, commercial business (including time share lending, loans to condominium associations and medical loans) and consumer loans. The Bank also purchases commercial business loans, including loans fully guaranteed by the Small Business Administration (the "SBA") and the United States Department of Agriculture (the "USDA"). The Bank sells certain fixed-rate one- to four-family residential conforming loans the Bank originates in the secondary market, primarily with the servicing retained. Such sales generate mortgage banking fee income. The remainder of the Bank’s loan portfolio is originated for investment.

The Bank is a wholly-owned subsidiary of the Company and management of the Company and the Bank are substantially similar. The Company neither owns nor leases any property, but instead uses the premises, equipment and other property of the Bank with the payment of appropriate rental fees, as required by applicable law and regulations. Thus, the financial information and discussion contained herein primarily relates to the activities of the Bank.

Availability of Information

The Company’s Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to such reports filed or furnished pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge at www.SEC.gov and on the Company’s website, www.mysifi.com, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. The information on the Company’s website shall not be considered as incorporated by reference into this annual report on Form 10-K.

Market Area and Competition

The Company is headquartered in Willimantic, Connecticut, which is located in eastern Connecticut approximately 30 miles east of Hartford. The Bank operates 23 full-service offices throughout Windham, New London, Tolland, Hartford and Middlesex counties in Connecticut and Newport and Washington counties in Rhode Island. Most of the Bank’s deposit customers reside in the areas surrounding the Bank’s branch offices. The Bank’s primary lending area is eastern Connecticut and Rhode Island with additional concentrations in Massachusetts and New Hampshire. The economy in the Company’s Connecticut market area is relatively diverse and primarily oriented to the educational, service, entertainment, insurance, manufacturing and retail industries. The major employers in our Connecticut market area include several hospitals, institutions of higher education, the Mohegan Sun and Foxwoods casinos, Aetna Insurance Company, Inc. and General Dynamics Defense Systems. In addition, there are also many small to mid-sized businesses that support the local economy. The economy in the Company's Rhode Island market area is primarily oriented to the health care, educational, retail and hospitality industries. The major employers in the Rhode Island area include several hospitals, universities and pharmaceutical manufacturers.

Windham, New London, Tolland, Hartford and Middlesex counties in Connecticut have a total population of 1.6 million and 624,201 total households, according to SNL Financial. For 2018, median household income levels ranged from $67,000 to $87,000 in the five counties we maintain branch offices in Connecticut, compared to $79,000 for Connecticut and $63,000 for the United States, according to published statistics. Newport and Washington counties in Rhode Island have a total population and total households of 209,692 and 85,202,

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respectively, according to SNL Financial. Median household income levels in Newport and Washington counties for 2018 ranged from $77,000 to $81,000, compared to $64,000 for Rhode Island, according to published statistics.

The Bank faces significant competition for the attraction of deposits and origination of loans. The most direct competition for deposits has historically come from several financial institutions operating in the Bank's market area and, to a lesser extent, from other financial service companies, such as brokerage firms, credit unions and insurance companies. The Bank also faces competition for investors' funds from money market funds and other corporate and government securities. At June 30, 2018, which is the most recent date for which data is available from the Federal Deposit Insurance Corporation (the "FDIC"), the Bank held 24.01% of the deposits in Windham County, Connecticut, which is the largest market share out of the 10 financial institutions with offices in this county. Also, at June 30, 2018, the Bank held 1.09% of the deposits in New London, Tolland, Hartford and Middlesex counties, Connecticut, which is the 14th largest market share out of the 35 financial institutions with offices in these counties. At June 30, 2018, the Bank held 4.85% of the deposits in Newport and Washington counties in Rhode Island, which is the 5th largest market share out of the 11 financial institutions with offices in these counties. Several large national or regional bank holding companies also operate in the Bank's Connecticut and Rhode Island market areas. These institutions are significantly larger and, therefore, have significantly greater resources and may offer products and services that the Bank does not provide.

The Bank's competition for loans comes primarily from financial institutions in its market area, and, to a lesser extent, from other financial service providers, such as mortgage companies and mortgage brokers. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage market, such as insurance companies, securities companies and specialty finance companies.

The Bank expects competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered barriers to entry, allowed banks to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Changes in federal law permit affiliation among banks, securities firms and insurance companies, which promotes a competitive environment in the financial services industry. Competition for deposits and the origination of loans could limit the Company's growth in the future.

Risk Management

Overview. Managing risk is an essential part of successfully managing a financial institution. Our most prominent risk exposures are credit risk, interest rate risk and market risk. Credit risk is the risk of not collecting the interest and/or the principal balance of a loan or investment when it is due. Interest rate risk is the potential reduction of net interest income as a result of changes in interest rates. Market risk arises from fluctuations in interest rates that may result in changes in the values of financial instruments, such as available for sale securities, that are accounted for on a mark-to-market basis. Other risks the Company faces are operational risks, liquidity risks and reputation risk. Operational risks include risks related to fraud, regulatory compliance, processing errors, cyber security, technology and disaster recovery. Liquidity risk is the possible inability to fund obligations to depositors, lenders or borrowers or for the Company to pay its obligations as they become due as a result of unforeseen circumstances. Reputation risk is the risk negative publicity or press, whether true or not, could cause a decline in the Company's customer base or revenue.

Credit Risk Management. Our strategy for credit risk management focuses on having well-defined credit policies and uniform underwriting criteria and providing prompt attention to potential problem loans. The Company has strengthened its oversight of problem assets by maintaining a Managed Assets Committee. The Committee, which consists of our Chief Executive Officer, Chief Financial Officer and other loan and credit administration officers,

meets quarterly to review classified and watch list credits to ensure the appropriateness of the current classification and to attempt to identify any new problem loans. The Board of Directors reviews the Committee's reports on a quarterly basis.

Lending Activities

General. The Bank's loan portfolio consists primarily of one- to four-family residential mortgage loans, multi-family and commercial real estate loans and commercial business loans. To a much lesser extent, the loan portfolio includes construction and consumer loans. At December 31, 2018, the Bank had loans held for sale totaling $1.9 million.

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The following table summarizes the composition of the Bank's loan portfolio at the dates indicated.

	At December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Perc of T
Real estate loans:	(Dollars in Thousands)									
Residential - 1 to 4 family	$384,353	29.03 %	$397,277	31.86 %	$417,064	33.91 %	$417,458	35.57 %	$430,575	40.9
Multi-family and commercial	568,889	42.96	481,998	38.66	421,668	34.29	385,341	32.84	298,320	28.3
Construction	43,320	3.27	28,765	2.31	36,026	2.93	21,786	1.86	13,579	1.29
Total real estate loans	996,562	75.26	908,040	72.83	874,758	71.13	824,585	70.27	742,474	70.6
Commercial business loans:										
SBA and USDA guaranteed	68,481	5.17	89,514	7.18	116,383	9.46	145,238	12.38	118,466	11.2
Time share	39,391	2.98	50,526	4.05	51,083	4.15	55,192	4.70	45,669	4.3
Condominium association	35,899	2.71	27,096	2.17	23,531	1.91	21,986	1.87	21,386	2.0
Medical loans	37,454	2.83	27,803	2.23	27,180	2.21	23,445	2.00	16,507	1.57
Other	97,220	7.34	88,566	7.10	79,524	6.47	45,588	3.88	49,939	4.7
Total commercial business loans	278,445	21.03	283,505	22.73	297,701	24.20	291,449	24.83	251,967	23.9
Consumer loans:										
Home equity	47,502	3.59	53,480	4.29	55,228	4.49	53,779	4.58	51,093	4.86
Indirect automobile	—	—	57	—	501	0.04	1,741	0.15	3,692	0.3
Other	1,569	0.12	1,835	0.15	1,687	0.14	1,946	0.17	1,864	0.18
Total consumer loans	49,071	3.71	55,372	4.44	57,416	4.67	57,466	4.90	56,649	5.39
Total loans	1,324,078	100.00 %	1,246,917	100.00 %	1,229,875	100.00 %	1,173,500	100.00 %	1,051,090	100
Deferred loan origination costs, net of deferred fees	3,169		2,591		2,268		1,735		1,571	
Allowance for loan losses	(14,682)		(12,334)		(11,820)		(9,863)		(7,797)	
	$1,312,565		$1,237,174		$1,220,323		$1,165,372		$1,044,864	

Loans
receivable,
net

One- to Four-Family Residential Loans. One of the Bank's primary lending activities is the origination of mortgage loans to enable borrowers to purchase or refinance existing homes or to construct new residential dwellings in its market area. The Bank offers fixed-rate loans with terms of 10, 15, 20 or 30 years. The Bank's adjustable-rate mortgage loans are based primarily on 30-year amortization schedules. Interest rates and payments on adjustable-rate mortgage loans adjust annually after a one, three, five, seven or ten-year initial fixed period. Borrower demand for adjustable-rate loans versus fixed-rate loans is a function of the level of current and anticipated future interest rates, the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and the initial period interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate mortgage loans and adjustable-rate mortgage loans that can be originated at any time is largely determined by the demand for each in a competitive environment and the effect each has on the Bank's interest rate risk. The loan fees charged, interest rates and other provisions of mortgage loans are determined on the basis of the Bank's pricing criteria and competitive market conditions.

Generally, the Bank does not originate conventional mortgage loans with loan-to-value ratios exceeding 95% and generally originates loans with a loan-to-value ratio in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Mortgage loans with loan-to-value ratios in excess of 80% generally

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require private mortgage insurance or additional collateral. The Bank requires all properties securing mortgage loans to be appraised by a board approved independent licensed appraiser and requires title insurance on all first mortgage loans. Borrowers must obtain hazard insurance and flood insurance for loans on properties located in a flood zone before closing the loan.

In an effort to provide financing for moderate income and first-time buyers, the Bank offers loans insured by the Federal Housing Administration and the Veterans Administration and participates in the Connecticut Housing Finance Authority Program. The Bank also offers Guaranteed Rural Housing Loans through the USDA. The Bank offers fixed-rate residential mortgage loans through these programs to qualified individuals and originates the loans using modified underwriting guidelines.

Multi-Family and Commercial Real Estate Loans. The origination of multi-family and commercial real estate ("CRE") loans is another primary lending activity of the Bank. Such loans are made throughout its market area and in strategic areas in the surrounding region for the purpose of acquiring, developing, improving or refinancing 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 Bank offers fixed-rate and adjustable-rate multi-family and commercial real estate loans. Adjustable-rate multi-family and commercial real estate loans originate for amortization periods up to 25 years. The Bank may originate loans with 30-year amortization periods in investment commercial real estate and commercial bond finance loan categories only. Interest rates and payments on these loans typically adjust every five years after a five-year initial fixed-rate period. The Bank’s multi-family and commercial real estate loans are generally secured by owner-occupied properties, including churches and retail facilities. These loans are secured by first mortgages that generally do not exceed 75% of the property’s appraised value.

The Bank intends to continue to emphasize making these types of loans, as market conditions permit, as such loans produce yields that are generally higher than one- to four-family residential loans and are more sensitive to changes in market interest rates. At December 31, 2018, the largest outstanding multi-family or commercial real estate loan was $17.0 million. This loan is secured by a single tenant retail property and was performing according to its terms at December 31, 2018.

The Bank maintains an Out-of-Market CRE Market Lending Program. The primary focus of this program is to develop greater investment in commercial real estate loans in the metro-Boston area and the surrounding region. The Bank employs a highly seasoned senior commercial real estate loan officer with significant expertise in lending in this region. Loans originated in this lending area comprise income producing properties representing office, flex, industrial, retail, single credit tenant and residential apartments. These properties have strong income support, favorable demographics and are owned and managed by experienced and financially strong property managers. These loans are predominately shorter-term loan facilities (generally 5-year maturities), which are structured to provide the Bank with strong asset growth, coupled with a focus on credit quality and interest rate risk management. At December 31, 2018, the Bank's exposure in out-of-market CRE market lending was $286.9 million.

Construction and Land Loans. The Bank originates loans to individuals, and to a lesser extent, builders, to finance construction of residential dwellings. The Bank also originates construction loans for commercial development projects, including condominiums, apartment buildings, single-family subdivisions as well as owner-occupied properties used for businesses. Residential construction loans generally provide for the payment of interest only during the construction phase, which is usually twelve months. At the end of the construction phase, the loan generally converts to a permanent mortgage loan. Commercial construction loans generally provide for the payment of interest only during the construction phase, which may range from three to twenty-four months. Loans generally can be made with a maximum loan-to-value ratio of 80% on residential construction, 75% on construction for nonresidential properties and 80% of the lesser of the appraised value or cost of the project on multi-family

construction. At December 31, 2018, the largest outstanding commercial construction loan commitment was $13.4 million for the construction of a hotel, of which $3.8 million was outstanding, and the

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largest residential construction loan commitment was $688,000, none of which was outstanding. These loans were performing according to their terms at December 31, 2018. Primarily all commitments to fund construction loans require an appraisal of the property by a board approved independent licensed appraiser. Also, inspections of the property are required before the disbursement of funds during the term of the construction loan.

The Bank also originates development land loans to individuals, local contractors and developers to make improvements on approved building lots, subdivisions and condominium projects within two years of the date of the loan. Such loans to individuals generally are written with a maximum loan-to-value ratio based upon the appraised value or purchase price of the land. Maximum loan-to-value ratio on raw land is 50%, while the maximum loan-to-value ratio for land development loans involving approved projects is 65%. The Bank offers fixed-rate land loans and variable-rate land loans that adjust monthly. Land loans totaled $1.4 million at December 31, 2018.

Commercial Business Loans. The Bank originates commercial business loans to a variety of professionals, sole proprietorships and small businesses primarily in its market area. When originating commercial business loans, the Bank considers the financial statements of the borrower, the borrower's payment history of both corporate and personal debt, the debt service capabilities of the borrower, the projected cash flows of the business, the viability of the industry in which the customer operates and the value of the collateral. At December 31, 2018, the largest outstanding commercial loan was $14.9 million, which is a general obligation bond to a private college and is further secured by a pledge of the unrestricted receipts, revenues, income and other monies of the college. This loan was performing according to its terms at December 31, 2018.

These loans are generally secured by business assets other than real estate, such as business equipment and inventory, in conformance to policy established borrowing base limits. The Bank originates one-year revolving credit facilities to finance short-term working capital needs of businesses to be repaid by business cash flow. In addition, the Bank originates non-revolving credit facilities to provide a period of time during which the business can borrow funds for planned equipment purchases and other improvement expenditures. These loans convert to a term loan at the expiration of a draw period, which is not to exceed twelve months, and will be paid over a predefined amortization period. Additional products such as time notes, letters of credit and equipment lease financing are offered. Additionally, the Bank may purchase the portion of commercial business loans that are fully guaranteed by the SBA or the USDA. At December 31, 2018, purchased SBA and USDA loans totaled $68.5 million.

The Bank utilizes experienced loan officers and staff to offer specialized lending programs to finance capital improvements for residential and commercial condominium associations as well as the time share industry. Condominium association loans are secured with the assigned right to levy and collect special assessments from the individual unit owners. The condominium association loan portfolio consists of 75 loans totaling $35.9 million as of December 31, 2018. The Bank is not involved with the development of time share resorts, but provides financing for investors with loans secured by diverse consumer receivables. The Bank's exposure in time share lending was 16 loans totaling $39.4 million at December 31, 2018.

Consumer Loans. The Bank offers a variety of consumer loans, primarily home equity lines of credit, and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles. Generally, the Bank offers automobile loans with a maximum loan-to-value ratio of 100% of the purchase price for new vehicles.

The procedures for underwriting consumer loans include an assessment of the applicant's payment history on other debts and their ability to meet existing obligations and payments on the proposed loans. Although the applicant's creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount. Home equity lines of credit have adjustable rates of interest that are indexed to the prime rate as reported in The Wall Street Journal. A home equity line of credit may be drawn down by

the borrower for a period of nine years and ten months from the date of the loan agreement. During this period, the borrower is only required to make interest-only payments. The borrower has to pay back

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the amount outstanding under the line of credit over a term not to exceed fifteen years, beginning at the end of the nine-year and ten month period. The Bank will offer home equity loans with a maximum combined loan-to-value ratio of 80%.

Loan Underwriting Risks. While the Bank anticipates that adjustable-rate loans will better offset the adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability and collateral value of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make the Bank's loan portfolio more responsive to changes in interest rates, the extent of this interest sensitivity is limited by annual and lifetime interest rate adjustment limits.

Loans secured by multi-family and commercial real estate generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Additionally, many of our multi-family and commercial real estate borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a residential mortgage loan. Of primary concern in multi-family and commercial real estate lending is the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. As a result, repayment of such loans may be subject, to a greater extent than residential real estate loans, to adverse conditions in the real estate market or the economy. To monitor cash flows on income-producing properties, the Bank generally requires borrowers and loan guarantors to provide annual financial statements and/or tax returns. In reaching a decision on whether to make a multi-family or commercial real estate loan, consideration is given to the net operating income of the property, the borrower's expertise, credit history and the profitability and value of the underlying property. The Bank generally requires that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20. Environmental screens, surveys and inspections are obtained when circumstances suggest the possibility of the presence of hazardous materials. Further, in connection with the ongoing monitoring of the loan, the Bank typically reviews the property, the underlying loan and guarantors annually.

Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction, the estimated cost (including interest) of construction and the ability of the project to be sold upon completion. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the building. If the estimate of value proves to be inaccurate, the Bank may be confronted, at or before the maturity of the loan, with a building having a value that is insufficient to assure full repayment. If the Bank is forced to foreclose on a building before or at completion due to a borrower default, the Bank may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income, and which are secured by real property the value of which tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's underlying business. As a result, the availability of funds for the repayment of commercial business loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Consumer loans entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted

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consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant significant collection efforts against the borrower. In addition, 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. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Loan Originations, Purchases, Sales and Servicing. Loan originations come from a number of sources. The primary source of loan originations are the Bank's in-house loan originators, and, to a lesser extent, advertising and referrals from customers.

The Bank may purchase portions of loans that are fully guaranteed by the SBA or the USDA. The loans are primarily for commercial and agricultural properties located throughout the United States. The Bank did not purchase such loans during the years ended December 31, 2018 or 2017. There were no sales of SBA and USDA loans for the years ended December 31, 2018 and 2017.

The Bank purchased $56.0 million and $36.1 million of multi-family and commercial real estate loans and other commercial business loans in 2018 and 2017, respectively, which included primarily participation loans and medical loans. The Bank performs its own underwriting analysis before purchasing a loan and, therefore, believes there should not be a greater risk of default on these obligations compared to loans the Bank originates itself. However, in a purchased loan, the Bank does not service the loan and thus is subject to the policies and practices of the originating lender with regard to monitoring delinquencies, pursuing collections and instituting foreclosure proceedings. Participation loans are entered into by the Bank with other institutions. Total participation loans entered into by the Bank were $35.0 million for 2018 and $25.0 million for 2017. Medical loans are purchased from a company specializing in medical loan originations. Medical loans are commercial business loans secured by medical equipment and are primarily out of our market area. Total medical loans purchased were $19.4 million and $10.8 million in 2018 and 2017, respectively.

The Bank originates conventional conforming one- to four-family loans which meet Fannie Mae underwriting standards. The Bank sells certain fixed-rate one- to four-family residential conforming loans in the secondary market, primarily on a servicing retained basis. Such loans are sold to Fannie Mae, the Connecticut Housing Finance Authority, the Federal Home Loan Bank of Boston (the "FHLB") under the Mortgage Partnership Finance Program and other third-party correspondents. The decision to sell loans in the secondary market is based on prevailing market interest rate conditions, an analysis of the composition and risk of the loan portfolio, liquidity needs and interest rate risk management. Generally, loans are sold without recourse. The Bank utilizes the proceeds from these sales primarily to meet liquidity needs. Proceeds from the sale of one- to four-family loans totaled $61.1 million and $54.9 million for the years ended December 31, 2018 and 2017, respectively. The Bank intends to continue to originate these types of loans for sale in the secondary market to increase its noninterest income.

At December 31, 2018, the Bank retained the servicing rights on $270.7 million of loans, consisting primarily of fixed-rate mortgage loans sold with or without recourse to third parties. Loan repurchase commitments are agreements to repurchase loans previously sold upon the occurrence of conditions established in the contract, including default by the underlying borrower. At December 31, 2018, there was no exposure amount for loans sold with recourse. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, processing insurance and tax payments on behalf of borrowers, assisting in foreclosures and property dispositions when necessary and general administration of loans.

The following table sets forth the Bank's loan originations, loan purchases, loan sales, principal repayments, net loan charge-offs and other reductions on loans for the years indicated.

	Years Ended December 31,		
	2018	2017	2016
	(In Thousands)		
Total loans at beginning of year	$1,246,917	$1,229,875	$1,173,500
Originations:			
Real estate loans	276,273	175,967	194,198
Commercial business loans	39,997	33,717	36,582
Consumer loans	19,792	24,782	26,008
Total loan originations	336,062	234,466	256,788
Purchases:			
Other commercial loans	55,951	36,123	37,702
Total purchases	55,951	36,123	37,702
Deductions:			
Principal loan repayments, prepayments and other, net	252,925	198,315	198,309
Loan sales	60,910	54,099	38,227
Loan charge-offs	795	239	450
Transfers to other real estate owned	222	894	1,129
Total deductions	314,852	253,547	238,115
Net increase in loans	77,161	17,042	56,375
Total loans at end of year	$1,324,078	$1,246,917	$1,229,875

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Loan Maturity. The following table shows the contractual maturity of the Bank's loan portfolio at December 31, 2018. The table does not reflect any estimate of prepayments, which significantly shortens the average life of all loans and may cause actual repayment experience to differ from that shown below. Demand loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less. The amounts shown below exclude deferred loan fees and costs.

	Amounts Due In			
	One Year or Less	More Than One Year to Five Years	More Than Five Years	Total Amount Due
Real estate loans:	(In Thousands)			
Residential - 1 to 4 family	$139	$12,873	$371,341	$384,353
Multi-family and commercial	13,383	140,998	414,508	568,889
Construction	4,908	3,228	35,184	43,320
Total real estate loans	18,430	157,099	821,033	996,562
Commercial business loans:				
SBA and USDA guaranteed	—	4,435	64,046	68,481
Time share	2,379	24,945	12,067	39,391
Condominium association	123	3,614	32,162	35,899
Medical loans	378	17,166	19,910	37,454
Other	10,615	17,235	69,370	97,220
Total commercial business loans	13,495	67,395	197,555	278,445
Consumer loans:				
Home equity	250	1,498	45,754	47,502
Other	11	194	1,364	1,569
Total consumer loans	261	1,692	47,118	49,071
Total loans	$32,186	$226,186	$1,065,706	$1,324,078

While one- to four-family residential real estate loans are normally originated with terms of up to 30 years, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon the sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase, sale and refinancing activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.

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The following table sets forth the dollar amount of all scheduled maturities of loans at December 31, 2018 that are due after December 31, 2019, and have either fixed interest rates or adjustable interest rates.

	Due After December 31, 2019		
	Fixed Rates	Floating or Adjustable Rates	Total
Real estate loans:	(In Thousands)		
Residential - 1 to 4 family	$294,264	$89,950	$384,214
Multi-family and commercial	265,582	289,924	555,506
Construction	28,874	9,538	38,412
Total real estate loans	588,720	389,412	978,132
Commercial business loans:			
SBA and USDA guaranteed	33,781	34,700	68,481
Time share	8,606	28,406	37,012
Condominium association	24,570	11,206	35,776
Medical loans	37,076	—	37,076
Other	53,714	32,891	86,605
Total commercial business loans	157,747	107,203	264,950
Consumer loans:			
Home equity	11,156	36,096	47,252
Other	304	1,254	1,558
Total consumer loans	11,460	37,350	48,810
Total loans	$757,927	$533,965	$1,291,892

Loan Approval Procedures and Authority. The Bank’s lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by the Company’s Board of Directors and management. All residential mortgages and home equity lines of credit in excess of $10.0 million or other consumer loans in excess of $4.0 million require the approval of the Board of Directors. The Loan Committee of the Board of Directors has the authority to approve: (1) residential mortgage loans and consumer home equity lines of credit up to $10.0 million, (2) commercial loans up to the regulatory legal lending limit, and (3) consumer loans up to $4.0 million. The Credit Committee, which consists of members of management, has authority to approve: (1) residential mortgage loans and consumer home equity lines of credit up to $4.0 million, (2) commercial loans up to $8.0 million, and (3) consumer loans up to $2.0 million. The President and Chief Lending Officer have approval authority for: (1) residential mortgage loans that conform to Fannie Mae and Freddie Mac standards up to $4.0 million or $417,000 for those that are nonconforming, (2) home equity lines of credit up to $4.0 million, and (3) consumer loans up to $250,000 individually or $1.0 million jointly. The President and Chief Lending Officer have approval authority for commercial real estate and other commercial loans up to $1.0 million individually or $2.0 million jointly. Additionally, certain loan and branch administration personnel have the authority to approve residential mortgage loans, home equity lines and consumer loans up to certain limits as specified in the Bank's loan policy.

Loans to One Borrower. The maximum amount that the Bank may lend to one borrower and the borrower’s related entities is limited, by regulation, to 15% of the Bank’s stated capital and reserves. At December 31, 2018, the Bank’s general regulatory limit on loans to one borrower was approximately $25.4 million. At that date, the Bank’s largest lending relationship was $20.5 million, representing commercial real estate loans on office buildings. These loans were performing according to their original terms at December 31, 2018.

Loan Commitments. The Bank issues commitments for fixed- and adjustable-rate mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements

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to lend to customers. Generally, our mortgage loan commitments expire in 60 days or less from the date of the application.

Delinquencies. When a borrower fails to make a required loan payment, the Bank takes a number of steps to have the borrower cure the delinquency and restore the loan to current status. The Bank makes initial contact with the borrower when the loan becomes 15 days past due. If payment is not then received by the 30th day of delinquency, additional letters and phone calls generally are made. When the loan becomes 90 days past due, a letter is sent notifying the borrower foreclosure proceedings will commence if the loan is not brought current within 30 days. Generally, when the loan becomes 120 days past due, the Bank will commence foreclosure proceedings against any real property that secures the loan or attempt to repossess any personal property that secures a consumer or commercial loan. If a foreclosure action is instituted and the loan is not brought current, paid in full or refinanced before the foreclosure sale, the real property securing the loan is typically sold at foreclosure. The Bank may consider loan repayment arrangements with certain borrowers under certain circumstances.

Management reports monthly to the Board of Directors or a committee of the Board regarding the amount of loans delinquent 30 days or more, all loans in foreclosure and all foreclosed and repossessed property that the Bank owns.

The following table provides information about delinquencies in the Bank's loan portfolio at the dates indicated.

	December 31, 2018				December 31, 2017			
	60-89 Days		90 Days or More		60-89 Days		90 Days or More	
	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans
Real estate loans:	(Dollars in Thousands)							
Residential - 1 to 4 family	11	$ 1,233	15	$ 2,331	11	$ 1,582	12	$ 1,280
Multi-family and commercial	2	295	4	1,513	—	—	1	27
Total real estate loans	13	1,528	19	3,844	11	1,582	13	1,307
Commercial business loans:								
Medical loans	—	—	—	—	1	99	—	—
Other	—	—	2	325	2	183	1	26
Total commercial business loans	—	—	2	325	3	282	1	26
Consumer loans:								
Home equity	1	54	1	109	—	—	—	—
Indirect automobile	—	—	—	—	1	3	—	—
Other	1	1	1	1	—	—	—	—
Total consumer loans	2	55	2	110	1	3	—	—
Total delinquent loans	15	$ 1,583	23	$ 4,279	15	$ 1,867	14	$ 1,333

Classified Assets. Management of the Bank, including the Managed Asset Committee, consisting of a number of the Bank's officers, review and classify the assets of the Bank on a monthly basis and the Board of Directors reviews the results of the reports on a quarterly basis. Federal regulations and the Bank's internal policies require that management utilize an internal asset classification system to monitor and evaluate the credit risk inherent in

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its loan portfolio. In addition, the Bank's regulators have the authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets; substandard, doubtful and loss. "Substandard assets" must have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. "Doubtful assets" have all the weaknesses inherent in those classified as "substandard" with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high probability of loss. Assets classified as "loss" are those assets considered uncollectible and of such little value that continuance as assets of the institution are not warranted. The regulations also provide for a "special mention" category, described as assets which do not currently expose the Bank to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weakness deserving close attention. If the Bank classifies an asset as a loss, a loan loss allowance in the amount of 100% of the portion of the asset classified as a loss is established or the loan is fully charged-off.

The following table shows the aggregate amounts of the Bank's criticized and classified assets as of December 31, 2018.

	Loss	Doubtful	Substandard	Special Mention
Real estate loans:	(In Thousands)			
Residential - 1 to 4 family	$—	$ —	$ 7,134	$1,323
Multi-family and commercial	—	—	24,623	12,636
Construction	—	—	—	9,650
Total real estate loans	—	—	31,757	23,609
Commercial business loans:				
Medical Loans	—	—	15	—
Other	—	257	218	3,750
Total commercial business loans	—	257	233	3,750
Consumer loans:				
Home equity	—	—	337	121
Other	—	—	2	—
Total consumer loans	—	—	339	121
Total classified loans	—	257	32,329	27,480
Total criticized and classified assets	$—	$ 257	$ 32,329	$27,480

At December 31, 2018, total criticized and classified assets were comprised of 47 commercial real estate loans totaling $37.3 million, three construction loans totaling $9.7 million, 51 residential mortgage loans totaling $8.5 million, 13 commercial business loans totaling $4.2 million, seven home equity loans totaling $458,000 and two other consumer loans totaling $2,000. Of the $32.3 million in substandard loans, $9.0 million were nonperforming at December 31, 2018. Substandard loans included residential real estate loans totaling $2.3 million, multi-family and commercial real estate loans totaling $991,000 and other commercial business loans totaling $68,000 that were 90 days or more past due. Doubtful loans included one commercial business loan totaling $257,000 that was 90 days or more past due.

Other than disclosed in the above tables, there were no loans at December 31, 2018 that management has serious doubts about the ability of the borrowers to comply with the present loan repayment terms.

Nonperforming Assets and Restructured Loans. The Bank considers repossessed assets and loans that are 90 days or more past due to be nonperforming assets. Loans are generally placed on nonaccrual status when they become 90

days delinquent at which time the accrual of interest ceases and any previously recorded interest is reversed

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and recorded as a reduction of loan interest and fee income. Typically, payments received on a nonaccrual loan are applied to the outstanding principal and interest balance as determined at the time of collection of the loan.

The Bank 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, such as reductions of interest rates or deferral of interest or principal payments, due to the borrower's financial condition, the modification is considered a troubled debt restructuring ("TDR"). All TDRs are initially classified as impaired. The Bank adheres to its nonaccrual policy for all TDR loans. Loans that were current prior to modification would not require nonaccrual status subsequent to the modification. If the accrual of interest was suspended on the loan prior to the modification or if the payment amount significantly increased subsequent to the modification, the loan would remain on nonaccrual status until the borrower demonstrates the willingness and the ability to make the restructured loan payments for a period of six consecutive months.

Real estate acquired as a result of foreclosure or by deed-in-lieu of foreclosure is classified as a foreclosed asset until it is sold. When property is acquired, it is recorded at fair value, net of estimated selling expenses. Holding costs and declines in fair value after acquisition of the property result in charges to earnings.

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

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands)				
Nonaccrual loans:					
Real estate loans:					
Residential - 1 to 4 family	$3,657	$2,405	$3,425	$3,894	$3,167
Multi-family and commercial	5,104	3,482	1,056	2,167	907
Total real estate loans	8,761	5,887	4,481	6,061	4,074
Commercial business loans	325	324	593	339	446
Consumer loans:					
Home equity	208	192	353	183	23
Other	2	1	6	—	—
Total consumer loans	210	193	359	183	23

Total nonaccrual loans	9,296	6,404	5,433	6,583	4,543
Accruing loans past due 90 days or more:					
Commercial business loans	522	—	—	—	459
Total accruing loans past due 90 days or more	522	—	—	—	459
Total nonperforming loans	9,818	6,404	5,433	6,583	5,002
Other real estate owned, net (1)	720	1,226	1,466	1,088	1,271
Total nonperforming assets	10,538	7,630	6,899	7,671	6,273
Accruing troubled debt restructurings	9,731	9,438	9,982	4,659	3,387
Total nonperforming assets and troubled debt restructurings	$20,269	$17,068	$16,881	$12,330	$9,660
Total nonperforming	0.74 %	0.51 %	0.44 %	0.56 %	0.48 %

loans to total loans					
Total nonperforming loans to total assets	0.60	0.41	0.35	0.44	0.37
Total nonperforming assets and troubled debt restructurings to total assets	1.23	1.08	1.09	0.83	0.72

(1) Other real estate owned balances are shown net of related write-downs or valuation allowance.

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The increase in nonperforming assets was primarily due to increases of $1.6 million in nonperforming multi-family and commercial real estate loans and $1.3 million in residential real estate loans. Nonaccrual loans consisted of 26 residential one- to four-family loans, six commercial real estate loans, three home equity loans, two commercial business loans and three consumer loans.

Other real estate owned decreased $506,000 from December 31, 2017 to $720,000 at December 31, 2018. During 2018, the Bank acquired two residential properties with a net carrying value of $222,000 and sold four residential properties with a net carrying value of $515,000 and one commercial property with a net carrying value of $131,000.

At December 31, 2018 and 2017, TDRs totaled $12.6 million and $13.1 million, respectively, as a result of interest rate concessions, deferral of principal payments, extension of maturity or a combination of these items. Of the TDRs at December 31, 2018, $9.7 million continued to accrue interest under the restructured terms of their agreements while the accrual of interest was suspended on loans totaling $2.9 million. As of December 31, 2018, there were no TDRs that were in payment default. All TDRs were performing in accordance with the terms of their restructured loan agreements.

Interest income that would have been recorded for the year ended December 31, 2018 had nonaccruing loans and TDRs been current in accordance with their original terms and had been outstanding throughout the period amounted to $445,000. The amount of interest recognized on impaired loans was $692,000 for the year ended December 31, 2018.

Loans Acquired with Deteriorated Credit Quality. Loans acquired in a transfer, including business combinations, where there is evidence of credit deterioration since origination and it is probable at the date of acquisition the Company will not collect all contractually required principal and interest payments, are accounted for under accounting guidance for purchased credit-impaired loans. This guidance provides that the excess of the cash flows initially expected to be collected over the fair value of the loans at the acquisition date (i.e., the accretable yield) is accreted into interest income over the estimated remaining life of the loans, provided the timing and amount of future cash flows is reasonably estimable. Such loans are considered to be accruing because their interest income relates to the accretable yield and not to contractual interest payments. The difference between the contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. Subsequent to acquisition, probable decreases in expected cash flows are recognized through a provision for loan losses, resulting in an increase to the allowance for loan losses. If the Company has probable and significant increases in cash flows expected to be collected, the Company will first reverse any previously established allowance for loan losses and then increase interest income as a prospective yield adjustment.

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 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. In the determination of the allowance for loan losses, management obtains independent appraisals for significant properties, when necessary.

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 and real estate market conditions, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying

collateral, historical loan loss experience, level 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.

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.

In computing the allowance for loan losses, we do not assign a general valuation allowance to the SBA and USDA loans we purchase as such loans are fully guaranteed. Such loans accounted for $68.5 million, or 5.2% of the loan portfolio, at December 31, 2018.

The majority of the Company's loans are collateralized by real estate located in eastern Connecticut, Rhode Island and the Boston metro area. Certain commercial real estate loans are secured by collateral located outside of our primary market area. 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 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 generally accepted accounting principles ("GAAP") in the United States of America, our regulators, in reviewing the loan portfolio, may require the Company to increase its allowance for loan losses based on judgments different from those of the Company. 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.

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The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated.

	December 31,								
	2018			2017			2016		
	Amount	% of Allowance in each Category to Total Allowance	% of Loans in each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	% of Loans in each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	% of Loans in each Category to Total Loans
Real estate loans:	(Dollars in Thousands)								
Residential - 1 to 4 family	$1,196	8.15 %	29.03 %	$1,093	8.86 %	31.86 %	$1,149	9.72 %	33.91 %
Multi-family and commercial	8,140	55.44	42.96	6,627	53.73	38.66	5,724	48.43	34.29
Construction	1,120	7.63	3.27	633	5.13	2.31	952	8.05	2.93
Commercial business:									
SBA & USDA guaranteed	—	—	5.17	—	—	7.18	—	—	9.46
Time share	197	1.34	2.98	581	4.71	4.05	639	5.41	4.15
Condominium association	179	1.22	2.71	312	2.53	2.17	294	2.49	1.91
Medical loans	1,107	7.53	2.83	820	6.65	2.23	815	6.89	2.21
Other	2,116	14.42	7.34	1,595	12.93	7.10	1,518	12.84	6.47
Consumer loans:									
Home equity	598	4.07	3.59	630	5.11	4.29	685	5.80	4.49
Indirect automobile	—	—	—	—	—	—	4	0.03	0.04
Other	29	0.20	0.12	43	0.35	0.15	40	0.34	0.14
Total allowance for loan losses	$14,682	100.00 %	100.00%	$12,334	100.00 %	100.00%	$11,820	100.00 %	100.00%

	December 31,					
	2015			2014		
	Amount	% of Allowance in each Category to Total Allowance	% of Loans in each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	% of Loans in each Category to Total Loans
Real estate loans:	(Dollars in Thousands)					
Residential - 1 to 4 family	$1,036	10.50 %	35.57 %	$955	12.25 %	40.97 %
Multi-family and commercial	5,033	51.03	32.84	3,607	46.26	28.38
Construction	516	5.23	1.86	254	3.26	1.29
Commercial business:						
SBA & USDA guaranteed	—	—	12.38	—	—	11.27
Time share	690	7.00	4.70	685	8.78	4.35
Condominium association	330	3.35	1.87	321	4.12	2.03
Medical loans	703	7.13	2.00	495	6.35	1.57
Other	902	9.14	3.88	881	11.30	4.75
Consumer loans:						
Home equity	595	6.03	4.58	530	6.80	4.86

Indirect automobile	12	0.12	0.15	26	0.33	0.35
Other	46	0.47	0.17	43	0.55	0.18
Total allowance for loan losses	$9,863	100.00 %	100.00%	$7,797	100.00 %	100.00%

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The following table sets forth an analysis of the allowance for loan losses for the years indicated.

	Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands)				
Allowance at beginning of year	$12,334	$11,820	$9,863	$7,797	$6,916
Provision for loan losses	3,143	661	2,190	2,509	1,539
Charge-offs:					
Real estate loans:					
Residential - 1 to 4 family	(88)	(102)	(208)	(102)	(335)
Multi-family and commercial	—	—	(50)	(289)	(144)
Commercial business loans	(780)	(79)	(68)	(165)	(164)
Consumer loans:					
Home equity	—	(53)	(115)	—	(40)
Indirect automobile	—	(3)	(3)	—	(32)
Other	(2)	(2)	(6)	(1)	(8)
Total charge-offs	(870)	(239)	(450)	(557)	(723)
Recoveries:					
Real estate loans:					
Residential - 1 to 4 family	14	3	28	74	38
Multi-family and commercial	—	—	110	24	1
Commercial business loans	43	81	77	15	5
Consumer loans:					
Home equity	15	—	—	—	—
Indirect automobile	—	1	—	—	17
Other	3	7	2	1	4
Total recoveries	75	92	217	114	65
Net charge-offs	(795)	(147)	(233)	(443)	(658)
Allowance at end of year	$14,682	$12,334	$11,820	$9,863	$7,797
Ratios:					
Allowance to total loans outstanding at year end	1.11 %	0.99 %	0.96 %	0.84 %	0.74 %
Allowance to nonperforming loans	149.54	192.60	217.56	149.83	155.88
Net charge-offs to average loans outstanding during the year	0.06	0.01	0.02	0.04	0.06

The allowance as a percentage of total loans increased to 1.11% at December 31, 2018 compared to 0.99% at December 31, 2017. The higher provision for loan losses for 2018 was primarily due to increases in nonperforming loans, charge-offs, reserves for impaired loans and an increase in commercial loans, which carry a higher degree of risk than other loans held in the loan portfolio. At December 31, 2018, nonperforming loans totaled $9.8 million compared to $6.4 million at December 31, 2017. An increase of $1.6 million in nonperforming multi-family and commercial real estate loans and an increase of $1.3 million in nonperforming residential real estate loans , contributed to the higher balance of nonperforming loans at December 31, 2018. Specific loan loss allowances relating to impaired loans increased to $1.9 million at December 31, 2018 compared to $482,000 at December 31, 2017.

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Investment Activities

The Company has legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies, government-sponsored enterprises, state and municipal governments, mortgage-backed securities and certificates of deposit of federally-insured institutions. Within certain regulatory limits, the Company also may invest a portion of its assets in corporate securities and mutual funds. The Company is also required to maintain an investment in FHLB stock and Federal Reserve Bank ("FRB") stock. While the Company has the authority under applicable law and its investment policies to invest in derivative securities, the Company had no such investments at December 31, 2018.

The Company’s primary source of income continues to be derived from its loan portfolio. The investment portfolio is mainly used to meet the cash flow needs of the Company, provide adequate liquidity for the protection of customer deposits and yield a favorable return on excess funds. The type of securities and the maturity periods are dependent on the composition of the loan portfolio, interest rate risk, liquidity position and tax strategies of the Company. The Company’s investment objectives are to provide and maintain liquidity, to maintain a balance of high quality, diversified investments to minimize risk, to provide collateral for pledging requirements, to establish an acceptable level of interest rate and credit risk, to provide an alternate source of low-risk investments when demand for loans is weak, to generate a favorable return and to assist in the financing needs of various local public entities, subject to credit quality review and liquidity concerns.

The Company’s Board of Directors has the overall responsibility for the investment portfolio, including approval of the Company’s Investment Policy and appointment of the Investment Committee. The Investment Committee is responsible for the approval of investment strategies and monitoring investment performance. The execution of specific investment initiatives and the day-to-day oversight of the Company’s investment portfolio is the responsibility of the Chief Executive Officer and the Chief Financial Officer. These officers, and others designated by the Board, are authorized to execute investment transactions up to specified limits based on the type of security without prior approval of the Investment Committee. Transactions exceeding these limitations require the approval of two of these officers designated by the Board, one of whom must be either the Chief Executive Officer or the Chief Financial Officer. Individual investment transactions are reviewed by the Board of Directors on a monthly basis, while portfolio composition and performance are reviewed at least quarterly by the Investment Committee. Management determines the appropriate classification of securities at the date individual securities are acquired, and the appropriateness of such classification is reassessed at each balance sheet date.

Debt securities management has the intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities purchased and held principally for trading in the near term are classified as “trading securities.” These securities are carried at fair value, with unrealized gains and losses recognized in earnings. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss), net of taxes.

At December 31, 2018, the Company’s investment portfolio consisted solely of available for sale securities, totaling $143.8 million, representing 8.7% of assets. The Company’s available for sale securities consisted primarily of “agency” mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae with stated final maturities of 30 years or less, U.S. government and agency obligations, government-sponsored enterprise securities with maturities of 20 years or less, and, to a lesser extent, tax-exempt securities, collateralized debt obligations and obligations of state and political subdivisions with maturities of 30 years or less.

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The following table sets forth the amortized costs and fair values of the Company's securities portfolio at the dates indicated.

	December 31,					
	2018		2017		2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)					
U.S. Government and agency obligations	$58,296	$57,038	$62,749	$61,768	$64,894	$64,296
Government-sponsored enterprises	9,969	9,945	9,212	9,217	11,267	11,364
Mortgage-backed securities: [(1)]						
Agency - residential	74,412	72,939	79,134	78,230	78,843	78,302
Non-agency - residential	51	47	70	65	93	87
Collateralized debt obligations	786	826	1,090	1,124	1,157	1,157
Obligations of state and political subdivisions	500	500	500	500	1,000	1,000
Tax-exempt securities	2,516	2,527	3,114	3,149	3,145	3,161
Total available for sale securities	$146,530	$143,822	$155,869	$154,053	$160,399	$159,367

[(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 one of the GSEs or the U.S. Government.

The Company had no investment in a single entity that had an aggregate book value in excess of 10% of the Company's shareholders' equity at December 31, 2018.

The following table sets forth the amortized cost, weighted average yields and contractual final maturities of available for sale securities at December 31, 2018. Weighted average yields on tax-exempt securities are not presented on a tax

equivalent basis because the impact would be insignificant. Certain mortgage-backed securities and collateralized debt obligations have adjustable interest rates and will reprice periodically within the various maturity ranges. These repricing schedules are not reflected in the following table below. At December 31, 2018, the amortized cost of mortgage-backed securities with adjustable rates totaled $8.4 million.

	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
	(Dollars in Thousands)									
U.S. Government and agency obligations	$3,478	2.27 %	$17,402	2.48 %	$116	4.87 %	$37,300	3.55 %	$58,296	3.16 %
Government-sponsored enterprises	1,001	1.62	5,973	2.27	2,995	3.48	—	—	9,969	2.57
Mortgage-backed securities:										
Agency - residential	31	4.76	322	2.68	10,701	2.75	63,358	2.61	74,412	2.63
Non-agency -residential	—	—	—	—	51	6.25	—	—	51	6.25
Collateralized debt obligations	—	—	—	—	—	—	786	3.33	786	3.33
Obligations of state and political subdivisions	—	—	500	5.57	—	—	—	—	500	5.57
Tax-exempt securities	542	1.37	1,630	2.15	—	—	344	2.35	2,516	2.01
Total available for sale securities	$5,052	2.06 %	$25,827	2.47 %	$13,863	2.94 %	$101,788	2.96 %	$146,530	2.84 %

Each reporting period, the Company evaluates securities with a decline in fair value below the amortized cost of the investment to determine whether the impairment is deemed to have other-than-temporary impairment

("OTTI"). The evaluation is based upon factors such as the creditworthiness of the issuers/guarantors, the underlying collateral, if applicable, and the continuing performance of the securities. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition, such as the type of security, length of time and extent to which the fair value has been less than cost and the near-term prospects of the issuers. OTTI is required to be recognized if (1) the Company intends to sell the security; (2) it is “more likely than not” that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis.

For impaired debt securities the Company intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. For all other impaired debt securities, credit-related OTTI is recognized through earnings and noncredit-related OTTI is recognized in other comprehensive income (loss), net of applicable taxes. During 2018, the Company did not recognize any OTTI for credit losses on debt securities. See Notes 3 and 15 in Item 8. Financial Statements and Supplementary Data, for more details.

Deposit Activities and Other Sources of Funds

General. Deposits, other borrowings, repayments and sale of loans and investment securities are the major sources of the Company’s funds for lending and other investment purposes. Loan and investment security repayments are a relatively stable source of funds, while deposit inflows and loan prepayments are significantly influenced by general interest rates and money market conditions.

Deposit Accounts. Substantially all of the Bank’s depositors are residents of Connecticut or Rhode Island. The Bank attracts deposits in its market areas through advertising and through the offering of a broad selection of deposit instruments, including noninterest-bearing demand accounts (such as checking accounts) and interest-bearing accounts (such as NOW and money market accounts, regular savings accounts and certificates of deposit). Certificate of Deposit Account Registry Service ("CDARS") and Insured Cash Sweeps ("ICS") deposits, which are generally offered to in-market retail and commercial customers, offer our customers the ability to receive FDIC insurance on deposits up to $50.0 million. At December 31, 2018, CDARS deposits totaled $1.6 million and ICS deposits totaled $957,000. The Bank also utilizes brokered deposits, which were $21.4 million at December 31, 2018. Brokered deposits, which are deposits sold by brokers to banks, are generally out-of-market, thus, they are less likely to remain with the institution after their maturity, which may require us to replace these deposits with higher cost alternative funds. Also, because they generally have larger balances, they often are accompanied by a higher interest rate. Generally, the Bank does not utilize brokered deposits as a primary funding source, but rather maintains such deposits to ensure access to another liquidity source should the need arise. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rates, among other factors. In determining the terms of the Bank’s deposit accounts, the Bank considers the rates offered by its competition, liquidity needs, profitability, matching deposit and loan products and customer preferences and concerns. The Bank generally reviews its deposit mix and pricing weekly. The Bank’s current strategy is to offer competitive rates, but not be the market leader in every account type and maturity.

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The following table sets forth the average balance of deposits by type and weighted average rates paid thereon at the dates indicated.

	December 31,					
	2018		2017		2016	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
	(Dollars in Thousands)					
Noninterest-bearing demand deposits	$227,905	— %	$208,898	— %	$174,536	— %
Interest-bearing demand deposits	588	0.14	1,028	0.15	838	0.15
NOW and money market accounts	507,806	0.30	490,766	0.21	468,654	0.11
Savings accounts (1) (2)	31,546	0.29	35,818	0.26	36,565	0.30
Certificates of deposit (3)	468,885	2.14	454,380	1.47	431,732	1.39
Total deposits	$1,236,730	0.98 %	$1,190,890	0.64 %	$1,112,325	0.59 %

(1) Includes mortgagors' and investors' escrow accounts of $3.2 million, $3.1 million and $2.6 million for the years ended December 31, 2018, 2017 and 2016, respectively.
(2) Includes brokered deposits of $625,000 and $333,000 for the years ended December 31, 2017 and 2016, respectively.
(3) Includes brokered deposits of $23.2 million, $25.3 million and $24.9 million at December 31, 2018, 2017 and 2016, respectively.

The Bank had $274.1 million of certificates of deposit of $100,000 or more outstanding as of December 31, 2018, maturing as follows:

Maturity Period:	Amount	Weighted Average Rate
	(Dollars in Thousands)	
Three months or less	$22,907	1.55%
Over three through six months	14,087	1.50
Over six through twelve months	92,194	1.95
Over twelve months	144,865	2.59
Total	$274,053	2.23%

The following table sets forth certificates of deposit accounts classified by the rates at December 31, 2018.

	Less Than One Year	One to Two Years	Two to Three Years	Three to Four Years	More than Four Years	Total	Percent of Total Certificate Accounts
	(Dollars in Thousands)						
0.00 - 1.00%	$29,886	$7,039	$3,841	$—	$—	$40,766	7.88 %
1.01 - 2.00%	168,445	38,529	3,008	1,870	1,263	213,115	41.22
2.01 - 3.00%	46,363	169,316	36,906	396	—	252,981	48.93
3.01 - 3.20%	(4)	5,571	2,813	1,828	—	10,208	1.97
Total	$244,690	$220,455	$46,568	$4,094	$1,263	$517,070	100.00 %

Cash Management Services. The Bank offers a variety of deposit accounts designed for the businesses operating in its market area. The Bank's business banking deposit products include a commercial checking account and checking accounts specifically designed for small businesses and non-profit organizations. In an effort to increase its commercial deposits, the Bank also offers remote capture products and money market accounts for its business customers.

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FHLB Borrowings. The Bank utilizes advances from the FHLB to supplement its supply of lendable funds and to meet deposit withdrawal requirements. As of December 31, 2018, the Bank had outstanding borrowings with the FHLB of $151.8 million.

The FHLB functions as a central reserve bank providing credit for member financial institutions. As a member, the Bank is required to own capital stock in the FHLB and is authorized to apply for advances on the security of such stock and certain mortgage loans and other assets (principally mortgage related securities which are obligations of, or guaranteed by, the United States), provided certain standards related to creditworthiness have been met. Advances are made under several different programs, each having its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution's net worth or on the FHLB's assessment of the institution's creditworthiness.

Junior Subordinated Debt Owed to Unconsolidated Trust. In 2006, SI Capital Trust II (the "Trust"), a business trust, issued $8.0 million of trust preferred securities in a private placement and issued 248 shares of common stock at $1,000 par value to the Company. The Trust has no independent assets or operations and was formed to issue trust preferred securities and invest the proceeds in an equivalent amount of junior subordinated debentures issued by the Company. The trust preferred securities mature in 30 years and bear interest at a rate equal to the three-month LIBOR plus 1.70%. The interest rate on these securities at December 31, 2018 was 4.49%. After receipt of regulatory approval, the Company may redeem the trust preferred securities, in whole or in part.

The debentures are the sole assets of the Trust and are subordinate to all of the Company's existing and future obligations for borrowed money, its obligations under letters of credit and certain derivative contracts and any guarantees by the Company of any such obligations. The trust preferred securities generally rank equal to the trust common securities in priority of payment, but rank before the trust common securities if and so long as the Company fails to make principal or interest payments on the debentures. Concurrently with the issuance of the debentures and the trust preferred and common securities, the Company issued a guarantee related to the trust securities for the benefit of the holders. The Company's obligations under the guarantee and the Company's obligations under the debentures, the related indentures and the trust agreement relating to the trust securities, constitute a full and unconditional guarantee by the Company of the obligations of the Trust under the trust preferred securities. If the Company defers interest payments on the junior subordinated debt, or otherwise is in default of the obligations, the Company would be prohibited from making dividend payments to its shareholders.

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The following table sets forth information regarding the Company's borrowings at and for the years indicated.

	At or For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in Thousands)		
Maximum amount of advances outstanding at any month-end during the year:			
FHLB advances	$173,954	$217,650	$227,477
Subordinated debt	8,248	8,248	8,248
Average balance outstanding during the year:			
FHLB advances	$162,801	$190,519	$211,429
Subordinated debt	8,248	8,248	8,248
Weighted average interest rate during the year:			
FHLB advances	1.96 %	1.76 %	1.57 %
Subordinated debt	3.78	2.86	2.34
Balance outstanding at end of year:			
FHLB advances	$151,836	$170,094	$217,759
Subordinated debt	8,248	8,248	8,248
Weighted average interest rate at end of year:			
FHLB advances	2.04 %	1.86 %	1.58 %
Subordinated debt	4.49	3.29	2.66

Trust Services

In May 2017, the Company sold its trust and asset management business, resulting in a pre-tax gain of $795,000. The Bank's trust department provided fiduciary services, investment management and retirement services to individuals, partnerships, corporations and institutions. Total trust services revenue was $431,000 and $1.0 million for the years ended December 31, 2017 and 2016, respectively.

Subsidiary Activities

The Company's subsidiaries include Savings Institute Bank and Trust Company and SI Capital Trust II. The following are descriptions of the Bank's wholly-owned subsidiaries.

SI Realty Company, Inc. SI Realty Company, Inc., established in 1999 as a Connecticut corporation, holds real estate managed by the Bank, including foreclosure properties. At December 31, 2018, SI Realty Company, Inc. had $6.0 million in assets.

SI Mortgage Company. In January 1999, the Bank formed SI Mortgage Company to manage and hold loans secured by real property. SI Mortgage Company qualifies as a "passive investment company," which exempts it from Connecticut income tax under current law. Income tax savings to the Bank from the use of a passive investment company was $764,000 and $748,000 for the years ended December 31, 2018 and 2017, respectively.

Personnel

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At December 31, 2018, the Company had 274 full-time employees and 21 part-time employees. None of the Company's employees are represented by a collective bargaining unit. The Company believes its relationship with its employees is good.

REGULATION AND SUPERVISION

General. The Bank, a Connecticut-chartered stock savings bank, is subject to extensive regulation, supervision and examination by the Connecticut Department of Banking (the "CDB") and, as a member of the FRB. The Bank is a member of the FHLB and its deposit accounts are insured up to applicable limits by the Deposit Insurance Fund managed by the FDIC. The Bank must file reports with the CDB concerning its activities and financial condition in addition to obtaining regulatory approvals before entering into certain transactions such as mergers with, or acquisitions of, other financial institutions and opening or closing branch offices. There are periodic examinations by the FRB and the CDB to evaluate the Bank's safety and soundness and compliance with various regulatory requirements. This regulatory structure is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan losses. Any change in such policies, whether by the CDB, the FRB or Congress, could have a material adverse impact on the Company and the Bank and their operations.

The Company, as a bank holding company that has elected to be treated as a financial holding company, is required to file certain reports with, is subject to examination by, and otherwise must comply with the rules and regulations of the FRB. The Company is also subject to the rules and regulations of the SEC under the federal securities laws.

Certain of the regulatory requirements that are applicable to the Bank and the Company are described below. This description of statutes and regulations is not intended to be a complete explanation of such statutes and regulations and their effects on the Bank and the Company and is qualified in its entirety by reference to the actual statutes and regulations.

State Regulation and Supervision

Connecticut Banking Commissioner. The Connecticut Banking Commissioner regulates the deposit, lending and investment activities of state-chartered banks, including the Bank. The approval of the Connecticut Banking Commissioner is required for, among other things, the establishment of branch offices and business combination transactions. The Commissioner conducts periodic examinations of Connecticut-chartered banks, as does the FRB. The FRB also regulates many of the areas regulated by the Connecticut Banking Commissioner, and federal law may limit some of the authority provided to Connecticut-chartered banks by Connecticut law.

Lending Activities. Connecticut banking laws grant banks broad lending authority. With certain limited exceptions, unsecured loans of any one obligor under this statutory authority may not exceed 15.0% of a bank's equity capital and allowance for loan losses. An additional 10.0% may be lent if fully secured.

Consumer Protection. The Bank is also subject to a variety of Connecticut statutes and regulations that are intended to protect consumers and prohibit discrimination in the granting of credit. These statutes and regulations provide for a range of sanctions for non-compliance with their terms, including imposition of administrative fines and remedial orders, and referral to the Attorney General for prosecution of a civil action for actual and punitive damages and injunctive relief. Certain of these statutes authorize private individual and class action lawsuits and the award of actual, statutory and punitive damages and attorneys' fees for certain types of violations.

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Dividends. The Bank may pay cash dividends out of its net profits. For purposes of this restriction, “net profits” represents the remainder of all earnings from current operations. Further, the total amount of all dividends declared by a bank in any year may not exceed the sum of a bank’s net profits for the year in question combined with its retained net profits from the preceding two years, without the specific approval of the Connecticut Banking Commissioner. FRB regulations establish limits on dividends, including requiring FRB approval for aggregate dividends exceeding net income for the current year and the two prior calendar years. In addition, as a subsidiary of a bank holding company, the Bank must provide prior notice to the FRB of any dividend. The FRB has the authority to object to the dividend if deemed unsafe or unsound. Federal law also prevents an institution from paying dividends or making other capital distributions that, if by doing so, would cause it to become “undercapitalized.” The FRB may limit a bank’s ability to pay dividends. No dividends may be paid to the Bank’s sole stockholder, the Company, if such dividends would reduce stockholders’ equity below the amount of the liquidation account required by federal regulations.

Powers. Connecticut law permits Connecticut banks to sell insurance and fixed and variable rate annuities if licensed to do so by the Connecticut Insurance Commissioner. With the prior approval of the Connecticut Banking Commissioner, Connecticut banks are also authorized to engage in a broad range of activities related to the business of banking, or that are financial in nature or that are permitted under the Bank Holding Company Act or the Home Owners’ Loan Act, both federal statutes, or the regulations promulgated as a result of these statutes. Connecticut banks are also authorized to engage in any activity permitted for a national bank or a federal savings association upon filing notice with the Connecticut Banking Commissioner unless the Connecticut Banking Commissioner disapproves the activity.

Assessments. Connecticut banks are required to pay annual assessments to the CDB to fund the CDB’s operations. The general assessments are paid pro-rata based upon a bank’s asset size.

Enforcement. Under Connecticut law, the Connecticut Banking Commissioner has extensive enforcement authority over Connecticut banks and, under certain circumstances, affiliated parties, insiders, and agents. The Connecticut Banking Commissioner’s enforcement authority includes cease and desist orders, fines, receivership, conservatorship, removal of officers and directors, emergency closures, dissolution and liquidation.

Federal Banking Regulation

Activities and Investments of Insured State-Chartered Banks. The Federal Deposit Insurance Act (“FDIA”) generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (1) acquiring or retaining a majority interest in a subsidiary, (2) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank’s total assets, (3) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors’, trustees’ and officers’ liability insurance coverage or bankers’ blanket bond group insurance coverage for insured depository institutions, or (4) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

Subject to certain regulatory exceptions, FDIC regulations provide that an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as “principal” in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the insurance fund of which it is a member and the bank is in compliance with applicable regulatory capital requirements.

Capital Requirements. Federal regulations require federally insured depository institutions to meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio of 4.5%, a Tier 1 capital to

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risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8%, and a 4% Tier 1 capital to total assets leverage ratio. These capital standards were effective January 1, 2015 as a result of a final rule issued by the federal banking agencies to implement certain recommendations of the Basel Committee on Bank Supervision and certain requirements of the Dodd-Frank Act.

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, all assets, including certain off-balance sheet assets (recourse obligations, direct credit substitutes, residual interests) are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of accumulated other comprehensive income, up to 45% of net unrealized gains on available for sale equity securities with readily determinable fair market values. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations. In assessing an institution's capital adequacy, the FRB takes into consideration, not only these numeric factors, but qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions where deemed necessary.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted asset above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement began to be phased in on January 1, 2016 at 0.625% of risk-weighted assets and increased each year until fully implemented at 2.5% on January 1, 2019.

The FRB has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution's capital level is or may become inadequate in light of the particular risks or circumstances. At December 31, 2018, the Bank met each of its capital requirements.

Federal legislation enacted in 2018 requires that the federal banking agencies, including the FRB, establish a "community bank leverage ratio" of between 8-10% of average total consolidated assets for qualifying banking organizations with less than $10 billion of assets. Institutions and holding companies with tangible equity (subject to certain adjustments) meeting the specified level and electing to follow the alternative framework would be deemed to comply with the applicable regulatory capital requirements, including the risk-based requirements, and be considered to be "well-capitalized" for purposes of the Prompt Consecutive Action, regulations, discussed in the following section. The agencies have issued a proposed rule that would set the "community bank leverage ratio" at 9%.

Prompt Corrective Regulatory Action. Federal law requires, among other things, that federal bank regulators take "prompt corrective action" with respect to institutions that do not meet minimum capital requirements. For this purpose, the law establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

The applicable FRB regulations were amended to incorporate the previously mentioned increased regulatory capital standards that were effective January 1, 2015. Under the amended regulations, an institution is deemed to be "well

capitalized” if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of

8.0% or greater, a leverage ratio of 5.0% or greater and a common equity Tier 1 ratio of 6.5% or greater. An institution is "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a leverage ratio of 4.0% or greater and a common equity Tier 1 ratio of 4.5% or greater. An institution is "undercapitalized" if it has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 6.0%, a leverage ratio of less than 4.0% or a common equity Tier 1 ratio of less than 4.5%. An institution is deemed to be "significantly undercapitalized" if it has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 4.0%, a leverage ratio of less than 3.0% or a common equity Tier 1 ratio of less than 3.0%. An institution is considered to be "critically undercapitalized" if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%.

The Bank's capital ratios were all above the minimum levels required for it to be considered a "well capitalized" financial institution at December 31, 2018 under the "prompt corrective action" regulations in effect as of such date.

Insurance of Deposit Accounts. Deposit accounts in the Bank are insured up to a maximum of $250,000 for each separately insured depositor. The FDIC imposes an assessment for deposit insurance on all depository institutions. Under the FDIC's risk-based assessment system, insured institutions are assessed based on perceived risk to the Deposit Insurance Fund. Originally, each institution was assigned to a risk category based on supervisory evaluations, regulatory capital levels and certain other factors. An institution's assessment rate depended upon the category to which it is assigned and certain adjustments specified by FDIC regulations, with less risky institutions paying lower rates. Assessment rates (inclusive of possible adjustments) ranged from 2.5 to 45 basis points of each institution's total assets less tangible capital. In conjunction with the Deposit Insurance Fund's reserve ratio reaching 1.15%, the range of assessments for banks of less than $10 billion in assets was reduced by 1.5 basis points to 30 basis points of total assets less tangible capital, effective July 1, 2016. In addition, the risk categories were eliminated in favor of a combination of examination ratings and financial modeling designed to estimate the probability of such institution's failure over a three-year period.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on our operating expenses and results of operations. Management cannot predict what insurance assessment rates will be in the future.

Community Reinvestment Act. Savings banks have a responsibility under the federal Community Reinvestment Act ("CRA") and related regulations to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. An institution's failure to comply with the provisions of the CRA could result in restrictions on activities and/or denials of applications for transactions such as mergers, acquisitions and branches. The Bank received a "satisfactory" CRA rating in its most recently completed federal examination.

Connecticut has its own statutory counterpart to the CRA that is also applicable to the Bank. The Connecticut version is generally similar to the CRA but utilizes a four-tiered descriptive rating system. Connecticut law requires the Connecticut Banking Commissioner to consider, but not be limited to, a bank's record of performance under Connecticut law in considering any application by a bank to establish a branch or other deposit-taking facility, to relocate an office or to merge or consolidate with or acquire the assets and assume the liabilities of any other banking institution. The Bank received a "satisfactory" CRA rating in its most recently completed examination under Connecticut law.

Transactions with Related Parties. Federal law limits the Bank's authority to engage in transactions with "affiliates" (e.g., any entity that controls or is under common control with the Bank, including the Company and their non-savings institution subsidiaries). The aggregate amount of "covered transactions" with any individual affiliate is limited to 10% of the capital and surplus of the Bank. The aggregate amount of covered transactions with all affiliates is limited to 20% of the Bank's capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an

amount and of a type specified by federal law. The purchase of low quality assets from affiliates is generally prohibited. Transactions with affiliates must generally be on terms and under

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circumstances that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the law contains a specific exception for loans by a depository institution to its executive officers and directors in compliance with federal banking laws. Under such laws, the Bank's authority to extend credit to executive officers, directors and 10% shareholders ("insiders"), as well as entities such persons control, is limited. The laws limit both the individual and aggregate amount of loans the Bank may make to insiders based, in part, on the Bank's capital level and requires that certain board approval procedures be followed. Such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Loans to executive officers are subject to additional limitations based on the type of loan involved.

Enforcement. The FRB has extensive enforcement authority over the Bank and has authority to bring actions against the Bank and all Bank-affiliated parties, including shareholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful actions likely to have an adverse effect on the Bank. Formal enforcement action may range from the issuance of a capital directive or cease and desist order for removal of officers and/or directors to institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to $25,000 per day, or even $1.0 million per day in especially egregious cases. Federal law also establishes criminal penalties for certain violations.

Federal Home Loan Bank System. The Bank is a member of the FHLB, which consists of eleven regional Federal Home Loan Banks. The Federal Home Loan Banks provide a central credit facility primarily for member institutions. The Bank, as a member of the FHLB, is required to acquire and hold shares of capital stock in the FHLB of Boston. The Bank was in compliance with this requirement with an investment in FHLB stock at December 31, 2018 of $9.0 million.

Federal Reserve System. Under FRB regulations, the Bank is required to maintain reserves against its transaction accounts (primarily NOW and regular checking accounts). The Bank is required to maintain average daily reserves equal to 3% on aggregate transaction accounts of up to $115.1 million, plus 10% on the remainder, and the first $15.5 million of otherwise reservable balances will both be exempt. These reserve requirements are subject to adjustment by the FRB. The Bank is in compliance with the foregoing requirements.

Other Regulations

The Bank's operations are also subject to federal laws applicable to credit transactions, such as, but not limited to, the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies; and
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies.

The operations of the Bank also are subject to the:

- The Truth in Savings Act and Regulation DD, which requires disclosure of deposit terms to consumers;
- Regulation CC, which relates to the availability of deposit funds to consumers;

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- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumers' financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check.

Holding Company Regulation

General. In August 2017, the Company changed status from that of a savings and loan holding company to that of a bank holding company. As a result, the previously applicable requirement that the Bank comply with the Qualified Thrift Lender Test, which required that a specified percentage of assets be in primarily residential mortgage-related investments, was eliminated.
The Company is subject to examination, regulation, and periodic reporting as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company is required to obtain the prior approval of the FRB to acquire all, or substantially all, of the assets of any other bank or bank holding company. Prior FRB approval would be required for the Company to acquire direct or indirect ownership or control of any voting securities of any bank or bank holding company if, after such acquisition, it would, directly or indirectly, own or control more than 5% of any class of voting shares of the bank or bank holding company.
A bank holding company is generally prohibited from engaging in non-banking activities, or acquiring direct or indirect control of more than 5% of the voting securities of any company engaged in non-banking activities. One of the principal exceptions to this prohibition is for activities found by the FRB to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the principal activities that the FRB has determined by regulation to be so closely related to banking are: (1) making or servicing loans; (2) performing certain data processing services; (3) providing discount brokerage services; (4) acting as fiduciary, investment or financial advisor; and (5) acquiring a savings and loan association whose direct and indirect activities are limited to those permitted for bank holding companies.
The Gramm-Leach-Bliley Act of 1999 authorized a bank holding company that meets specified conditions, including being "well capitalized" and "well managed" as defined in the regulations, to opt to become a "financial holding company" and thereby engage in a broader array of financial activities. Such activities can include insurance and investment banking. The Company has elected to become a financial holding company.
The status of the Company as a registered bank holding company under the Bank Holding Company Act does not exempt it from certain federal and state laws and regulations applicable to corporations generally, including, without limitation, certain provisions of the federal securities laws.

Dividends and Repurchases. Federal regulations require a bank holding company to give the FRB prior written notice of any repurchase or redemption of outstanding equity securities if the gross consideration for the repurchase or redemption, when combined with the net consideration paid for all such repurchases or redemptions during the preceding 12 months, is equal to 10% or more of the company's consolidated net worth. The FRB may disapprove such a purchase or redemption under certain circumstances. There is an exception to this approval requirement for well-capitalized bank holding companies that meet certain other conditions. Federal Reserve policy provides for regulatory consultation prior to a holding company redeeming or repurchasing regulatory capital instruments under specified circumstances regardless of the applicability of the previously referenced notification requirement. The FRB has issued a policy statement regarding the payment of dividends and the repurchase of shares of common stock by bank holding companies. In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial

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condition. This policy statement also provides for regulatory consultation before a holding company pays dividends or redeems or repurchases shares of common stock under certain circumstances. These regulatory policies may affect the ability of the Company to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

Source of Strength. Under FRB policy, a bank holding company must serve as a source of strength for its subsidiary bank. Under this policy, the FRB may require, and has required in the past, a holding company to provide capital, liquidity and other support in times of financial stress.

Capital Requirements. The FRB has adopted regulatory capital requirements that are generally applicable to holding companies with $1.0 billion or more in consolidated assets. The Dodd-Frank Act required the FRB to revise its holding company capital requirements so that they are no less stringent, quantitatively and in terms of components of capital, than those applicable to the subsidiary depository institutions themselves. The previously discussed final rule which revised regulatory capital requirements for depository institutions also implemented the Dodd-Frank requirements for holding companies. Holding companies of $1.0 billion or more in consolidated assets are now subject to regulatory capital requirements that are identical to those applicable to the institutions themselves. As is the case with the institution-level requirements, the capital conservation buffer was phased in from 2016 to 2019.

Acquisition of Control. Under the Change in Bank Control Act, no person may acquire control of a bank holding company unless the FRB has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the institution's directors, or a determination by the regulator that the acquirer has the power, directly or indirectly, to exercise a controlling influence over the management or policies of the institution. Acquisition of more than 10% of any class of a bank holding company's voting stock constitutes a rebuttable determination of control under the regulations under certain circumstances.

Federal Income Taxation

General. The Company reports its income on a calendar year basis using the accrual method of accounting. The federal income tax laws apply to the Company in the same manner as to other corporations with some exceptions, particularly the Bank's reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Company and its subsidiaries. With limited exception, the Company is no longer subject to United States federal, state and local income tax examinations by the tax authorities for the years prior to 2015. The Company's maximum federal income tax rate was 21.0% for 2018.

On December 22, 2017, the President signed into law the Tax Cuts and Jobs Act (the "Act"). The Act included a number of changes in existing law impacting, among other things, a permanent reduction in the corporate tax rate from 35% to 21%, effective January 1, 2018.

Bad Debt Reserves. For fiscal years beginning before June 30, 1996, thrift institutions that qualified under certain definitional tests and other conditions of the Internal Revenue Code were permitted to use certain favorable provisions to calculate their deductions from taxable income for annual additions to their bad debt reserve. A reserve could be established for bad debts on qualifying real property loans, generally secured by interests in real property improved or to be improved, under the percentage of taxable income method or the experience method. The reserve for non-qualifying loans was computed using the experience method. Federal legislation enacted in 1996 repealed the reserve method of accounting for bad debts for institutions with assets in excess of $500.0 million and the percentage

of taxable income method for all institutions for tax years beginning after 1995 and required savings institutions to recapture or take into income certain portions of their accumulated bad debt reserves. However, those tax-based bad debt reserves accumulated prior to 1988 ("Base Year Reserves") were not required to be recaptured unless the institution failed certain tests. Approximately $4.7 million of the Bank's accumulated tax-based bad debt reserves would not be recaptured into taxable income unless it makes a "non-dividend distribution" to the Company as described below.

Distributions. If the Bank makes "non-dividend distributions" to the Company, the distributions will be considered to have been made from the Bank's unrecaptured tax-based bad debt reserves, including the balance of its Base Year Reserves as of December 31, 1987, to the extent of the "non-dividend distributions," and then from the Bank's supplemental reserve for losses on loans, to the extent of those reserves, and an amount based on the

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amount distributed, but not more than the amount of those reserves, will be included in the Bank's taxable income. Non-dividend distributions include distributions in excess of the Bank's current and accumulated earnings and profits as calculated for federal income tax purposes, distributions in redemption of stock and distributions in partial or complete liquidation. Dividends paid out of the Bank's current or accumulated earnings and profits will not be included in the Bank's taxable income.

The amount of additional taxable income triggered by a non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Therefore, if the Bank makes a non-dividend distribution to the Company, approximately one and one-third times the amount of the distribution not in excess of the amount of the reserves would be includable in income for federal income tax purposes, assuming a 21% federal corporate income tax rate. The Bank does not intend to pay non-dividend distributions that would result in a recapture of any portion of its bad debt reserves.

State Income Taxation

The Company and its subsidiaries are subject to the Connecticut corporation business tax. The Company and its subsidiaries are required to file a combined Connecticut income tax return and pay the regular corporation business tax. The Connecticut corporation business tax is based on the federal taxable income before net operating loss and special deductions of the Company and its subsidiaries and makes certain modifications to federal taxable income to arrive at Connecticut taxable income. Connecticut taxable income is multiplied by the state tax rate (8.25% for fiscal year 2018) to arrive at Connecticut income tax.

In May 1998, the State of Connecticut enacted legislation permitting the formation of passive investment company subsidiaries by financial institutions. This legislation exempts qualifying passive investment companies from the Connecticut corporation business tax and excludes dividends paid from a passive investment company from the taxable income of the parent financial institution. The Bank's formation of a passive investment company in January 1999 substantially eliminates the state income tax expense of the Company and its subsidiaries under current law. See Item 1. Business. "Subsidiary Activities – SI Mortgage Company" for a discussion of the Bank's passive investment company.

In addition to Connecticut, the Company also files income tax returns in Rhode Island, New Hampshire and Massachusetts.

As a Maryland corporation, the Company is required to file annual returns and pay annual fees to the State of Maryland.

Executive Officers of the Registrant

Our executive officers are elected by the Board of Directors and serve at the Board's discretion. Certain executive officers of the Bank also serve as executive officers of the Company. The day-to-day management duties of the executive officers of the Company and the Bank relate primarily to their duties as to the Bank. The executive officers of the Company currently are as follows:

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Name	Age [1]	Position
Rheo A. Brouillard	64	President and Chief Executive Officer of Savings Institute Bank and Trust Company and SI Financial Group
Lauren L. Murphy	47	Executive Vice President, Chief Financial Officer of Savings Institute Bank and Trust Company and SI Financial Group
Laurie L. Gervais	54	Executive Vice President, Director of Human Resources and Chief Operating Officer of Savings Institute Bank and Trust Company and SI Financial Group
Paul R. Little	58	Senior Vice President and Chief Credit Officer of Savings Institute Bank and Trust Company
Jonathan S. Wood	63	Executive Vice President and Director of Retail Banking of Savings Institute Bank and Trust Company
Kenneth B. Martin	60	Senior Vice President and Chief Lending Officer of Savings Institute Bank and Trust Company

[1] Ages presented are as of December 31, 2018.

Biographical Information:

Rheo A. Brouillard has been the President and Chief Executive Officer of Savings Institute Bank and Trust Company and SI Financial Group since 1995 and 2004, respectively. Mr. Brouillard has been a director of the Company since 1995.

Lauren L. Murphy was named Executive Vice President in 2017 after having served as Senior Vice President and Chief Financial Officer of Savings Institute Bank and Trust Company and SI Financial Group since 2015, Senior Vice President and Principal Accounting Officer since 2013 and Vice President and Corporate Controller since 2007.

Laurie L. Gervais was named Chief Operating Officer in 2017 after having served as Executive Vice President and Chief Administrative Officer of Savings Institute Bank and Trust Company and SI Financial Group since 2015, Senior Vice President and Director of Human Resources since 2009 and Vice President and Director of Human Resources since 2003. Ms. Gervais serves as Corporate Secretary for SI Financial Group. Ms. Gervais joined Savings Institute Bank and Trust Company in 1983.

Paul R. Little was named Chief Credit Officer in 2017 after having served as Senior Vice President and Chief Lending Officer since 2013 and Senior Vice President and Senior Commercial Loan Officer since he joined Savings Institute Bank and Trust Company in 2011. Prior to joining Savings Institute Bank and Trust Company, Mr. Little was Chief Lending Officer at Simsbury Bank and Trust.

Jonathan S. Wood was named Executive Vice President and Director of Retail Banking in 2015 after having served as Senior Vice President and Retail Banking Officer since he joined Savings Institute Bank and Trust Company in 2012. Prior to joining Savings Institute Bank and Trust Company, Mr. Wood was a Senior Vice President and Consumer Market Executive at Bank of America.

Kenneth B. Martin was named Chief Lending Officer in 2017 after having served as Senior Vice President and Marketing Executive since he joined Savings Institute Bank and Trust Company in May 2017. Prior to joining Savings Institute Bank and Trust Company, Mr. Martin was Director of Business Banking at Santander Bank, N.A.

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Item 1A. Risk Factors.

Prospective investors in, and current holders of, the Company's common stock should carefully consider the following risk factors.

If the pending merger with Berkshire Hills does not occur, our business, results of operations and our stock price could be materially adversely affected. Consummation of the merger is subject to the satisfaction of a number of conditions, including the approval of the Company's stockholders and the receipt of all required regulatory approvals. Assuming the satisfaction of all closing conditions, the merger is expected to be consummated in the second quarter of 2019. However, the failure to obtain stockholder or regulatory approvals could cause a delay or inability of the Company to consummate the merger.

If the merger does not occur, our business, results of operations and our stock price could be materially adversely affected as: (1) the attention of management and employees could be diverted from day-to-day operations as they focus on merger integration; (2) the restrictions and limitations on the conduct of the Company's business pending the merger could disrupt or otherwise adversely affect our business and relationships with our customers; (3) the Company's ability to retain its existing employees could be adversely affected due to the uncertainties created by the merger; and (4) the Company's ability to maintain existing customer relationships, or to establish new ones, could be adversely affected. Any delay or inability to consummate the merger could exacerbate these issues.

There can be no assurance that all of the conditions to closing will be satisfied, or where possible, waived, or that the merger will become effective. If the merger is not consummated; (1) the Company's stock price could decline; (2) the Company's business could be adversely affected; (3) the Company will have incurred significant transaction costs related to negotiating and working towards the merger; and (4) under certain circumstances, the Company could be obligated to pay Berkshire a termination fee of $7.4 million. For further information regarding the merger and the Merger Agreement, see the proxy statement/prospectus filed on February 26, 2019.

A worsening of economic conditions in our market area could reduce demand for our products and services and/or result in increases in our level of nonperforming loans, which could adversely affect our results of operations and financial condition. Our performance is significantly influenced by the general economic conditions in our primary markets in Connecticut and Rhode Island. Local economic conditions have a significant impact on the ability of our borrowers to repay loans and the value of the collateral securing loans. A deterioration in economic conditions could result in the following consequences, any of which could have a material adverse affect on our business, financial condition, liquidity and results of operations:

- demand for our products and services may decline;
- loan delinquencies, charge-offs, problem assets and foreclosures may increase;
- collateral for loans, especially real estate, may decline in value, in turn reducing customers' future borrowing power, and reducing the value of assets and collateral associated with existing loans; and
- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us.

In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

Our business may be adversely affected by an increasing prevalence of fraud and other financial crimes. Our loans to businesses and individuals and our deposit relationships and related transactions are subject to exposure to the risk of loss due to fraud and other financial crimes. Nationally, reported incidents of

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fraud and other financial crimes have increased. We have also experienced losses due to apparent fraud and other financial crimes. While we have policies and procedures designed to prevent such losses, losses may still occur.

The Company's cost of operations is high relative to its assets. The Company's failure to maintain or reduce its operating expenses could hurt its profits. Our noninterest expenses totaled $41.1 million and $39.8 million for the years ended December 31, 2018 and 2017, respectively. We continue to analyze our expenses and achieve efficiencies where available. Although we strive to generate increases in both net interest income and noninterest income and have had some improvement, our efficiency ratio remains high as a result of operating expenses. Our efficiency ratio was 72.86% and 73.60% for the years ended December 31, 2018 and 2017, respectively.

The Bank's level of nonperforming loans and classified assets may require the Bank to increase the provision for loan losses or to charge-off additional losses in the future. Further, the allowance for loan losses may prove to be insufficient to absorb losses in the Bank's loan portfolio. For 2018, we recorded a provision for loan losses of $3.1 million compared to a provision for loan losses of $661,000 in 2017. We also recorded net loan charge-offs of $795,000 in 2018 compared to net loan charge-offs of $147,000 in 2017. Our nonperforming assets and troubled debt restructurings increased to $20.3 million, or 1.23% of total assets, at December 31, 2018 from $17.1 million, or 1.08% of total assets, at December 31, 2017. Additionally, at December 31, 2018, loans classified as either special mention, substandard, doubtful or loss totaled $60.1 million, representing 4.54% of total loans, including nonperforming loans of $9.8 million, representing 0.74% of total loans. If these loans do not perform according to their terms and the value of the collateral is insufficient to pay the remaining loan balance or if the economy and/or the real estate market weakens, more of our classified loans may become nonperforming and we could experience loan losses or be required to add further reserves to our allowance for loan losses, either of which could have a material adverse effect on our operating results. We maintain an allowance for loan losses at a level representing management's best estimate of known losses in the portfolio based upon management's evaluation of the portfolio's collectibility as of the corresponding balance sheet date. However, our allowance for loan losses may be insufficient to cover actual loan losses, and future provisions for loan losses could materially and adversely affect our operating results.

At December 31, 2018, our allowance for loan losses totaled $14.7 million, which represented 1.11% of total loans and 149.54% of nonperforming loans. Our regulators, as an integral part of their examination process, periodically review the allowance for loan losses and may require us to increase the allowance for loan losses by recognizing additional provisions for loan losses charged to income, or to charge-off loans, which, net of any recoveries, would decrease the allowance for loan losses. Any such additional provisions for loan losses or charge-offs, as required by our regulators, could have a material adverse effect on our operating results.

Changes or inaccuracies in management's estimates and assumptions regarding the allowance for loan losses may have a material impact on our financial condition or results of operations. In evaluating the adequacy of our allowance for loan losses, we consider numerous quantitative factors, including our historical charge-off experience, growth of our loan portfolio, changes in the composition of our loan portfolio and the volume of and trends in our nonperforming, delinquent and classified loans. In addition, we use information about specific borrower situations, including their financial position and estimated collateral values, to estimate the risk and amount of loss for those borrowers. Finally, we also consider many qualitative factors, including general and economic business conditions, anticipated duration of the current business cycle, current general market collateral valuations, trends apparent in any of the factors we take into account and other matters, which are, by nature, more subjective and fluid. Our estimates of the risk of loss and amount of loss on any loan are complicated by the significant uncertainties surrounding our borrowers' abilities to successfully execute their business models through changing economic environments, competitive challenges, the effect of the current and future economic conditions on

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collateral values and other factors. Because of the degree of uncertainty and susceptibility of these factors to change, our actual losses may vary from our current estimates.

Fluctuations in interest rates could reduce the Company's profitability and affect the value of its assets. We are subject to interest rate risk. Our primary source of income is net interest income, which is the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. Changes in the general level of interest rates can affect our net interest income by affecting the difference between the weighted average yield earned on our interest-earning assets and the weighted average rate paid on our interest-bearing liabilities, or interest rate spread and the average life of our interest-earning assets and interest-bearing liabilities. Although the yield we earn on our assets and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, causing our net interest margin to expand or contract. Our liabilities tend to be shorter in duration than our assets, so they may adjust faster in response to changes in interest rates. As a result, when interest rates rise, our funding costs may rise faster than the yield we earn on our assets, causing our net interest margin to contract until the yield catches up. This contraction could be more severe following a prolonged period of lower interest rates, as a larger proportion of our fixed-rate residential loan portfolio and fixed-rate residential related mortgage-backed securities will have been originated at those lower rates and borrowers may be more reluctant to refinance or unable to sell their homes in a higher interest rate environment. Changes in the slope of the "yield curve," or the spread between short-term and long-term interest rates, could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or even inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets.

Changes in interest rates also can affect: (1) the ability to originate loans; (2) the value of our interest-earning assets and our ability to realize gains from the sale of such assets; (3) the ability to obtain and retain deposits in competition with other available investment alternatives; and (4) the ability of our borrowers to repay adjustable rate loans. Interest rates are highly sensitive to many factors, including government monetary policies, domestic and international economic and political conditions and other factors beyond our control. Although we believe that the estimated maturities of our interest-earning assets currently are well balanced in relation to the estimated maturities of our interest-bearing liabilities, our profitability could be adversely affected during any period of changes in interest rates.

The Bank's commercial lending exposes us to greater lending risks. At December 31, 2018, $847.3 million, or 63.99%, of our loan portfolio consisted of commercial real estate and commercial business loans. We intend to continue to emphasize these types of lending. Commercial loans generally expose a lender to greater risk of non-payment and loss and require a commensurately higher loan loss allowance than one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the business and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Also, many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. Further, unlike one- to four-family real estate loans or multi-family and commercial real estate loans, commercial business loans may be secured by collateral other than real estate, the value of which may be more difficult to appraise and may be more susceptible to fluctuation in value.

The Bank's residential mortgage loans and home equity loans exposes it to lending risks. At December 31, 2018, $384.4 million, or 29.03%, of our loan portfolio consisted of one- to four-family residential mortgage loans and $47.5 million, or 3.59%, of our loan portfolio consisted of home equity lines of credit. One- to four-family residential mortgage lending is generally sensitive to regional and local

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economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. Since the recession and through the period of slow recovery thereafter, the housing market has slowed and real estate values in our market areas have declined. This could cause some of our mortgage and home equity loans to be inadequately collateralized, which would expose us to a greater risk of loss if we seek to recover on defaulted loans by selling the real estate collateral.

We may be adversely affected by recent changes in U.S. tax laws. The new legislation resulted in a reduction in our federal corporate tax rate from 35% to 21% in 2018, which had a favorable impact on our earnings and capital generation abilities. However, the new legislation also enacted limitations on certain deductions that will have an impact on the banking industry, borrowers and the real estate market. These limitations include: (1) a lower limit on the deductibility of mortgage interest on one- to four-family residential mortgage loans; (2) the elimination of interest deductions for home equity loans; (3) a limitation on the deductibility of business interest expense; and (4) a limitation on the deductibility of property taxes and state and local income taxes.

Changes in tax laws may have an adverse effect on the market for, and the valuation of, residential properties, and on the demand for such loans, and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, like Connecticut. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in our loan portfolio may be adversely impacted because of the changing economics of home ownership, which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

The Company’s investment portfolio may suffer reduced returns, material losses or other-than-temporary impairment losses. The value of our investment portfolio is subject to the risk that certain investments may default or become impaired due to a deterioration in the financial condition of one or more issuers of the securities held in our portfolio, or due to a deterioration in the financial condition of an issuer that guarantees an issuer’s payments of such investments. Such defaults and impairments could reduce our net investment income and result in realized investment losses.

Our investment portfolio is also subject to increased risk as the valuation of investments is more subjective when markets are illiquid, thereby increasing the risk the estimated fair value (i.e. the carrying amount) of the portion of the investment portfolio that is carried at fair value as reflected in our financial statements is not reflective of prices at which actual transactions would occur.

Because of the risks set forth above, the value of our investment portfolio could decrease, we could experience reduced net investment income, and we could recognize investment losses, which could materially and adversely affect our results of operations, financial position and liquidity.

Additionally, we review our securities portfolio at each quarter-end to determine whether the fair value is below the current carrying value. When the fair value of any of our securities has declined below its carrying value, we are required to assess whether the decline is other-than-temporary. We are required to write-down the value of that security through a charge to earnings if we conclude that the decline is other-than-temporary. In the case of debt securities, we are required to charge to earnings any decreases in value that are credit-related. As of December 31, 2018, the amortized cost and the fair value of our available for sale securities portfolio totaled $146.5 million and $143.8 million, respectively. Changes in the expected cash flows of these securities and/or prolonged price declines in future periods may result in a charge to earnings to write-down these securities. Any charges for other-than-temporary impairment would not impact cash flows, tangible capital or liquidity. For the years ended December 31, 2018 and

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2017, we recognized no other-than-temporary impairment losses on certain debt securities related to credit-related factors.

Regulatory reform may have a material impact on the Company's operations. In 2010, the Dodd-Frank Act was passed, which imposes significant regulatory and compliance changes. The key effects of the Dodd-Frank Act on our business are:

- changes to regulatory capital requirements;
- creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which oversees systemic risk, and the Consumer Financial Protection Bureau, which develops and enforces rules for bank and non-bank providers of consumer financial products);
- potential limitations on federal preemption;
- changes to deposit insurance assessments;
- regulation of debit interchange fees we earn;
- changes in retail banking regulations, including potential limitations on certain fees we may charge; and
- changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments.

Some provisions of the Dodd-Frank Act became effective immediately upon its enactment. Many provisions, however, will require regulations to be promulgated by various federal agencies to be implemented, some but not all of which have been proposed or finalized by the applicable federal agencies. The provisions of the Dodd-Frank Act may have unintended effects, which will not be clear until after implementation. Certain changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, we expect that, at a minimum, our operating and compliance costs will increase, and our interest expense could increase, as a result of these new rules and regulations.

Strong competition within the Bank’s market area could hurt its profits and slow growth. We face intense competition both in making loans and attracting deposits. This competition has made it more difficult for us to make new loans and at times has forced us to offer higher deposit rates. Competition for loans and deposits might result in our earning less on our loans and paying more on our deposits, which reduces net interest income. As of June 30, 2018, we held approximately 1.79% of the deposits in Hartford, Middlesex, New London, Tolland and Windham counties in Connecticut, which represented the 11th largest market share of deposits out of the 36 financial institutions in these counties. As of the same date, we held approximately 4.85% of the deposits in Newport and Washington counties in Rhode Island, which represented the 5th largest market share of deposits out of the 11 financial institutions in these counties. Some of the institutions with which we compete have substantially greater resources and lending limits than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to compete successfully in our market area.

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We are subject to certain capital requirements, which may adversely impact our return on equity, require us to raise additional capital, or constrain us from paying dividends or repurchasing shares. A final capital rule that became effective for financial institutions on January 1, 2015, included minimum risk-based capital and leverage ratios, and refined the definition of what constitutes “capital” for purposes of calculating these ratios. The final rule also established a “capital conservation buffer” of 2.5%, which was fully implemented as of January 1, 2019. A financial institution, such as the Bank, is subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that can be utilized for such actions.

The application of more stringent capital requirements could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets.

The Company is subject to liquidity risks. Market conditions could negatively affect the level or cost of liquidity available to us, which would affect our ongoing ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations and fund asset growth and new business transactions at a reasonable cost, in a timely manner, and without adverse consequences. Deposits and FHLB advances are our primary sources of funding. A significant decrease in our deposits, an inability to renew FHLB advances, an inability to obtain alternative funding to deposits or FHLB advances, or a substantial, unexpected, or prolonged change in the level or cost of liquidity could have a negative effect on our business and financial condition.

If the goodwill or other intangible assets recorded in connection with the Company’s acquisitions becomes impaired, it could have a negative impact on the Company’s profitability. Applicable accounting standards require the acquisition method of accounting be used for all business combinations. Under this method, if the purchase price of an acquired entity exceeds the fair value of its net assets, the excess is carried on the acquirer’s balance sheet as goodwill. At December 31, 2018, we had $11.7 million of goodwill and $4.6 million of core deposit intangible on our balance sheet. The Company evaluates goodwill for impairment at least annually or more frequently if events or changes in circumstances warrant such evaluation. Our annual review of our goodwill occurs in November. Write-downs of the amount of impairment, if necessary, are to be charged to earnings in the period in which the impairment occurs. No impairment related to goodwill or core deposit intangibles was recorded for the years ended December 31, 2018 or 2017. Future evaluations may result in findings of impairment and related write-downs, which could have a material adverse effect on our financial condition and results of operations.

We face a risk of liability and enforcement action with noncompliance with the Bank Secrecy Act and other anti-money laundering statutes and regulations. The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “PATRIOT Act”) and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. Federal and state bank regulators also focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we may acquire in the future are deficient, we would be subject to liability, including fines and restrictions on our ability to pay dividends and to obtain regulatory approvals for potential acquisitions, which would negatively impact our business, financial condition and results of operations.

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Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have a material adverse effect on us. Our business is dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of customer business, and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on us.

In addition, we provide our customers with the ability to bank remotely, including over the Internet and over the telephone. The secure transmission of confidential information over the Internet and other remote channels is a critical element of remote banking. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, regulatory scrutiny, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could materially and adversely affect us.

We are subject to a variety of operational risks, legal and compliance risks, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations. We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to attract and keep customers and can expose us to litigation and regulatory action.

If personal, non-public, confidential or proprietary information of customers in our possession were to be misappropriated, mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, erroneously providing such information to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or the interception or inappropriate acquisition of such information by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to

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fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in our diminished ability to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could adversely affect our business, financial condition or results of operations, perhaps materially.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer. In the ordinary course of our business, we collect and store sensitive data, including our proprietary business information and that of our customers, suppliers and business partners and personally identifiable information of our customers and employees. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. We, our customers, and other financial institutions with which we interact, may be subject to ongoing, repeated attempts to penetrate key systems by hackers. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such unauthorized access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information and regulatory penalties; disrupt our operations and the services we provide to customers; damage our reputation; and cause a loss of confidence in our products and services, all of which could adversely affect our business, revenues and competitive position. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses.

Our failure to keep pace with technological change may have a material adverse effect on our competitive position and results of operations. Financial products and services have become increasingly technology-driven. Our ability to meet the needs of our customers competitively, and in a cost-efficient manner, is dependent on the ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of our competitors have greater resources to invest in technology than we do and may be better equipped to market new technology-driven products and services. The ability to keep pace with technological change is important, and the failure to do so could have a material adverse impact on our business and therefore on our financial condition and results of operations.

Item 1B. Unresolved Staff Comments.

None.

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Item 2. Properties.

The Company conducts its business through its executive office at 803 Main Street, Willimantic, Connecticut, its 18 branch offices located in Connecticut and five branch offices located in Rhode Island. Of the 23 offices, eight are owned and 15 are leased. Lease agreements expire at various dates through 2039 with renewal options of five to 50 years.

Office Locations	Number of Offices
Full-service branches:	
Connecticut:	
New London County	6
Windham County	6
Tolland County	3
Hartford County	2
Middlesex County	1
Rhode Island:	
Newport County	3
Washington County	2
Total:	23

Additionally, the Bank owns three other properties used, in part, for banking operations. The total net book value of all our properties at December 31, 2018 was $17.1 million. See Notes 6 and 12 in Item 8. Financial Statements and Supplementary Data, for more information.

Item 3. Legal Proceedings.

Periodically, there have been various claims and lawsuits against us, such as claims to enforce liens, condemnation proceedings on properties in which we hold a security interest, claims involving the making and servicing of real property loans and other issues incident to our business. At December 31, 2018, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company's financial condition, results of operations or cash flows.

On February 20, 2019, one purported SI Financial stockholder filed a putative class action lawsuit against SI Financial, Berkshire Hills and the members of the SI Financial board of directors in the Circuit Court for Baltimore County, captioned Parshall v. Mark Alliod, et al., Docket No. C-03-CV-19-000124 (the "Complaint"). The plaintiff, on behalf of himself and similarly-situated SI Financial stockholders, generally alleges that the defendants breached their fiduciary duties to SI Financial and its stockholders in connection with the Merger Agreement. The Complaint alleges that the defendants failed to secure adequate value for SI Financial stockholders in connection with the Merger and that the registration statement filed with the SEC on February 4, 2019 contains materially incomplete information regarding the Merger. The plaintiff seeks injunctive relief, rescission of the Merger or rescissory damages (if the Merger is consummated), other unspecified damages, and an award of attorneys' fees and expenses.

On March 5, 2019, one purported SI Financial stockholder filed a putative class action lawsuit against SI Financial and the members of the SI Financial board of directors in the United States District Court for the District of Connecticut, captioned Bushanksy v. SI Financial Group, Inc. et al., Case No. 3:19-cv-00321. The plaintiff, on behalf of himself and similarly-situated SI Financial stockholders, generally alleges that the Proxy Statement/Prospectus contains material misstatements and omissions in violation of Section 14(a) and Section 20(a) of the Exchange Act,

and Rule 14a-9 promulgated thereunder. The plaintiff seeks injunctive relief, rescission of the Merger or rescissory damages (if the Merger is consummated), declaratory relief, and an award of attorneys' fees and expenses.

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In addition, on March 5, 2019, one purported SI Financial stockholder filed a putative class action lawsuit against SI Financial and the members of the SI Financial board of directors in the United States District Court for the Southern District of New York, captioned Raul v. SI Financial Group, Inc. et al., Case No. 1:19-cv-02038. The plaintiff generally alleges that the Proxy Statement/Prospectus contains material and misleading statements or material misrepresentations or omissions in violation of Section 14(a) and Section 20(a) of the Exchange Act, and Rule 14a-9 promulgated thereunder. The plaintiff seeks injunctive relief, unspecified damages, a direction that SI Financial and the SI Financial board of directors disseminate a corrective amendment to the Proxy Statement/Prospectus, and an award of attorneys' fees and expenses.

Item 4. Mine Safety Disclosures.

None.

PART II.

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The market for the registrant's common equity and related shareholder matters required by this item is included in Item 7. Management's Discussion and Analysis in the section captioned "Common Stock Information" in this Form 10-K.

During the fourth quarter of 2018, the Company repurchased shares of its common stock as follows:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
October 2018 (1)	123	$ 13.36	—	397,122
November 2018	—	—	—	397,122
December 2018 (2)	138,969	12.79	—	397,122
Total	139,092	$ 12.79		

(1) Consists of shares surrendered by employees to satisfy tax withholding requirements upon vesting of stock awards. These shares were not repurchased as part of a publicly announced plan or program.
(2) Consists of shares utilized to pay the exercise price of options exercised.

Item 6. Selected Financial Data.

The following is only a summary and should be read in conjunction with the consolidated financial statements and notes contained in Item 8. Financial Statements and Supplementary Data of this Form 10-K. The Company has derived the following selected consolidated financial and other data at December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016 in part from its consolidated financial statements and notes in Item 8. The information at December 31, 2016, 2015 and 2014 and for the years ended December 31, 2015 and 2014 is derived from consolidated financial statements and notes that are not contained in this annual report.

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Selected Financial Condition Data:	At December 31,				
	2018	2017	2016	2015	2014
	(In Thousands)				
Total assets	$1,649,827	$1,580,956	$1,550,890	$1,481,834	$1,350,533
Cash and cash equivalents	87,929	83,486	73,186	40,778	39,251
Securities available for sale	143,822	154,053	159,367	175,132	173,040
Loans receivable, net	1,312,565	1,237,174	1,220,323	1,165,372	1,044,864
Deposits [1]	1,292,732	1,212,465	1,135,073	1,061,525	1,014,313
Federal Home Loan Bank advances	151,836	170,094	217,759	234,595	148,277
Junior subordinated debt owed to unconsolidated trust	8,248	8,248	8,248	8,248	8,248
Total shareholders' equity	172,128	168,481	164,727	154,330	157,739

Selected Operating Data:	Years Ended December 31,				
	2018	2017	2016	2015	2014
	(In Thousands, Except Per Share Data)				
Interest and dividend income	$58,171	$53,987	$52,911	$48,126	$47,521
Interest expense	13,048	11,081	10,083	8,901	8,243
Net interest income	45,123	42,906	42,828	39,225	39,278
Provision for loan losses	3,143	661	2,190	2,509	1,539
Net interest income after provision for loan losses	41,980	42,245	40,638	36,716	37,739
Noninterest income	11,239	11,161	15,594	10,321	10,166
Noninterest expenses	41,065	39,795	39,998	40,585	41,506
Income before income tax provision	12,154	13,611	16,234	6,452	6,399
Income tax provision	2,589	8,369	4,924	2,104	1,988
Net income	$9,565	$5,242	$11,310	$4,348	$4,411
Basic earnings per share	$0.81	$0.44	$0.96	$0.36	$0.36
Diluted earnings per share	$0.80	$0.44	$0.95	$0.36	$0.36

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Selected Operating Ratios:	At or For the Years Ended December 31,				
Performance Ratios:	2018	2017	2016	2015	2014
Return on average assets	0.60 %	0.33 %	0.75 %	0.31 %	0.33 %
Return on average equity	5.61	3.09	7.09	2.79	2.82
Interest rate spread [2]	2.76	2.69	2.85	2.82	2.97
Net interest margin [3]	3.01	2.89	3.01	2.97	3.11
Noninterest expenses to average assets	2.56	2.51	2.64	2.87	3.06
Dividend payout ratio [4]	29.67	45.25	17.29	44.02	33.44
Efficiency ratio [5]	72.86	73.60	68.53	82.16	84.05
Average interest-earning assets to average interest-bearing liabilities	127.89	126.85	123.54	121.79	122.01
Average equity to average assets	10.65	10.73	10.53	11.02	11.55
Capital Ratios: [6]					
Common equity tier 1 capital ratio	12.88	14.54	15.08	14.86	N/A
Tier 1 risk-based capital ratio	12.88	15.29	15.88	14.86	14.86
Total risk-based capital ratio	14.13	16.49	17.11	15.97	15.87
Tier 1 capital ratio	9.58	10.36	10.50	9.73	9.37
Asset Quality Ratios:					
Allowance for loan losses as a percent of total loans	1.11	0.99	0.96	0.84	0.74
Allowance for loan losses as a percent of nonperforming loans	149.54	192.60	217.56	149.83	155.88
Net charge-offs to average loans outstanding during the year	0.06	0.01	0.02	0.04	0.06

[1] Includes mortgagors' and investors' escrow accounts.
[2] Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.
[3] Represents net interest income as a percent of average interest-earning assets.
[4] Annual dividends paid divided by basic net income.
[5] Represents noninterest expenses divided by the sum of net interest income and noninterest income, excluding gains or losses on the sale of securities and other-than-temporary impairment of securities.
[6] Capital ratios for 2018 and 2014 are reported at Bank level as they were not required to be reported on a consolidated basis. All other prior year capital ratios are reported on a consolidated basis.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

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 December 31, 2018 and 2017 and the results of operations for the years ended December 31, 2018, 2017 and 2016. The information contained in this section should be read in conjunction with the consolidated financial statements and notes contained elsewhere in this annual report.

Management Strategies

The Company's mission is to operate and grow a profitable community-oriented financial institution. The Company plans to achieve this mission by continuing its strategies of:

Offering a full range of financial products and services. The Bank has a long tradition of focusing on the needs of consumers and small- and medium-sized businesses in the community and being an active corporate citizen. The Bank believes its community orientation, quicker decision-making process and customized products are attractive to its customers and distinguish it from the large regional banks that operate in its market area. The Bank serves as a financial services company offering one-stop shopping for all of its customers' financial needs. The Bank believes its broad array of product offerings deepens its relationships with its current customers and entices new customers to begin banking with them, ultimately increasing fee income and profitability.

Actively managing the balance sheet and diversifying the asset mix. The Company manages its balance sheet by: (1) prudently increasing the Bank's multi-family and commercial real estate and commercial business loan portfolios, which offer higher yields, shorter maturities and more sensitivity to interest rate fluctuations; (2) managing its interest rate risk by diversifying the type and maturity of its assets in its loan and investment portfolios and monitoring the maturities in its deposit portfolio; and (3) maintaining strong capital levels and liquidity. Multi-family and commercial real estate and commercial business loans increased $81.8 million, $46.1 million and $42.6 million for the years ended December 31, 2018, 2017 and 2016, respectively, and comprised 64.0% of total loans at December 31, 2018. The Company intends to continue to pursue the opportunities from the many multi-family and commercial properties and businesses located in its market area and areas outside its market area where lenders have specialized knowledge.

Continuing conservative underwriting practices and maintaining a high quality loan portfolio. The Bank believes strong asset quality is key to long-term financial success. The Bank has sought to maintain a high level of asset quality and moderate credit risk by using conservative underwriting standards and by diligent monitoring and collection efforts. Nonperforming loans increased from $6.4 million at December 31, 2017 to $9.8 million at December 31, 2018. At December 31, 2018, nonperforming loans were 0.74% of the total loan portfolio and 0.60% of total assets. While continuing to increase its multi-family and commercial real estate and commercial business lending, which tend to have larger loan balances than residential mortgage loans, the Bank will continue to manage these larger loan exposures by applying its philosophy of conservative loan underwriting and credit administration standards.

Increasing core deposits. The Bank's primary source of funds is retail deposit accounts. At December 31, 2018, 59.9% of the Bank's deposits were core deposits, consisting of demand, savings and money market accounts. The Bank values core deposits because they represent longer-term customer relationships and a lower cost of funding compared to certificates of deposit. We expect core deposits to continue to increase primarily due to investments the Bank has made in its branch network, new product offerings, competitive interest rates and additional transactional deposits we obtain from our growing base of commercial

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clients. The Bank intends to continue to increase its core deposits and focus on gaining market share in counties outside of Windham County in Connecticut and in Newport and Washington Counties in Rhode Island by continuing to offer exceptional customer service, cross-selling its loan, deposit, life insurance and annuity products and increasing its commercial deposits from small- and medium-sized businesses through additional business banking and cash management products.

Supplementing fee income through expanded mortgage banking operations. The Company views the changing regulatory landscape and interest rate environment as an opportunity to gain noninterest income by leveraging its expertise in originating residential mortgages and selling those loans in the secondary market. This strategy enables the Company to have a much larger lending capacity, provide a more comprehensive product offering and reduce the interest rate, prepayment and credit risks associated with originating residential loans for retention in its loan portfolio. Further, this strategy allows the Company to be more selective with the single-family residential loans that are held in portfolio.

Critical Accounting Policies

The discussion and analysis of the financial condition and results of operations are based on the Company’s consolidated financial statements, which are prepared in conformity with GAAP. The preparation of these financial statements requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of income and expenses. 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 its critical accounting policies. The Company considers the determination of allowance for loan losses, deferred income taxes and the impairment of long-lived assets to be its critical accounting policies.

Allowance for Loan Losses. Determining the amount of allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a monthly basis and establishes the provision for loan losses based on changes in the size and composition of the loan portfolio and in the level of nonperforming loans, delinquencies, classified assets, loan charge-offs and other factors related to the collectibility of the loan portfolio. A portion of the allowance is established by segregating the loans by loan category and assigning allocation percentages based on our historical loss experience, delinquency trends, economic conditions and other qualitative factors. The allocation percentages are re-evaluated quarterly to ensure their relevance in the current economic environment. Accordingly, increases in the size of the loan portfolio and the increased emphasis on multi-family and commercial real estate and commercial business loans, which carry a higher degree of risk of default and, thus, a higher allocation percentage, increases the allowance. Additionally, a portion of the allowance is established based on the impairment analysis of specific nonperforming loans, classified assets and troubled debt restructurings.

Although management believes it uses the best information available to establish the allowance for loan losses, which is based on estimates that are susceptible to change, future additions to the allowance may be necessary as a result of changes in economic conditions and other factors. Additionally, the Bank’s regulators, as a part of their examination process, periodically review the allowance for loan losses and may require the Bank to increase the allowance for loan losses by recognizing additional provisions for loan losses charged to expense, or to decrease its allowance for loan losses by recognizing loan charge-offs. See Notes 1 and 4 in Item 8. Financial Statements and Supplementary Data for additional information.

Deferred Income Taxes. The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax asset, a valuation allowance is

established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The

Company exercises significant judgment in evaluating the amount and timing of recognition of the resulting tax assets and liabilities. These judgments require the Company to make projections of future taxable income. These judgments and estimates, which are inherently subjective, are reviewed periodically as regulatory and business factors change. A reduction in estimated future taxable income may require the Company to record a valuation allowance against its deferred tax asset. A valuation allowance would result in additional income tax expense in the period, which would negatively affect earnings. See Notes 1 and 10 in Item 8. Financial Statements and Supplementary Data.

Impairment of Long-Lived Assets. The Company is required to record certain assets it has acquired, including identifiable intangible assets such as core deposit intangibles and goodwill, at fair value, which may involve making estimates based on third-party valuations, such as appraisals or internal valuations based on discounted cash flow analyses or other valuation techniques. Further, long-lived assets, including intangible assets and premises and equipment, that are held and used by the Company, are presumed to have a useful life. The determination of the useful lives of intangible assets is subjective, as is the appropriate amortization period for such intangible and long-lived assets. Additionally, long-lived assets are reviewed for impairment at least annually or whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. If impairment is indicated by that review, the asset is written down to its estimated fair value through a charge to noninterest expenses. Testing for impairment is a subjective process, the application of which could result in different evaluations of impairment. See Notes 1, 6 and 7 in Item 8. Financial Statements and Supplementary Data for additional information.

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Analysis of Net Interest Income

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.

	Years Ended December 31,											
	2018				2017				2016			
	Average Balance	Interest & Dividends	Average Yield/ Rate		Average Balance	Interest & Dividends	Average Yield/ Rate		Average Balance	Interest & Dividends	Average Yield/ Rate	
	(Dollars in Thousands)											
Interest-earning assets:												
Loans [1] [2] [3]	$1,279,076	$53,358	4.17	%	$1,242,056	$49,660	4.00	%	$1,182,072	$46,802	3.96	%
Securities [3]	163,395	3,817	2.34		185,082	3,972	2.15		196,544	4,128	2.10	
Other interest-earning assets	66,487	1,267	1.91		70,616	763	1.08		51,275	2,259	4.41	
Total interest-earning assets	1,508,958	58,442	3.87		1,497,754	54,395	3.63		1,429,891	53,189	3.72	
Noninterest-earning assets	92,305				84,611				84,788			
Total assets	$1,601,263				$1,582,365				$1,514,679			
Interest-bearing liabilities:												
Deposits:												
Business checking	$588	—	—		$1,028	—	—		$838	—	—	
NOW and money market	507,806	1,249	0.25		490,766	865	0.18		468,654	507	0.11	
Savings [4]	31,546	114	0.36		35,818	126	0.35		36,565	98	0.27	
Certificates of deposit [5]	468,886	8,187	1.75		454,380	6,506	1.43		431,732	5,975	1.38	
Total interest-bearing deposits	1,008,826	9,550	0.95		981,992	7,497	0.76		937,789	6,580	0.70	
Federal Home Loan Bank advances	162,801	3,186	1.96		190,519	3,348	1.76		211,429	3,310	1.57	
Subordinated debt	8,248	312	3.78		8,248	236	2.86		8,248	193	2.34	
Total interest-bearing liabilities	1,179,875	13,048	1.11		1,180,759	11,081	0.94		1,157,466	10,083	0.87	
	250,863				231,752				197,750			

Noninterest-bearing liabilities									
Total liabilities	1,430,738			1,412,511			1,355,216		
Total shareholders' equity	170,525			169,854			159,463		
Total liabilities and shareholders' equity	$1,601,263			$1,582,365			$1,514,679		
Net interest-earning assets	$329,083			$316,995			$272,425		
Tax equivalent net interest income[3]		45,394			43,314			43,106	
Tax equivalent interest rate spread[6]			2.76 %			2.69 %			2.85 %
Tax equivalent net interest margin as a percentage of interest-earning assets [7]			3.01 %			2.89 %			3.01 %
Average of interest-earning assets to average interest-bearing liabilities			127.89 %			126.85 %			123.54 %
Less tax equivalent adjustment [3]		(271)			(408)			(278)	
Net interest income		$45,123			$42,906			$42,828	

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(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% for the period ending December 31, 2018 and 34% for the periods ended December 31, 2017 and 2016. 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.
(7) Tax equivalent net interest margin represents tax equivalent net interest income divided by average interest-earning assets.

Rate/Volume Analysis. 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.

	2018 Compared to 2017 Increase (Decrease) Due To			2017 Compared to 2016 Increase (Decrease) Due To		
	Rate	Volume	Net	Rate	Volume	Net
	(In Thousands)					
Interest-earning assets:						
Interest and dividend income:						
Loans [1][2][3]	$2,244	$1,454	$3,698	$502	$2,356	$2,858
Securities [3]	286	(441)	(155)	81	(237)	(156)
Other interest-earning assets	547	(43)	504	(2,134)	638	(1,496)

Total interest-earning assets	3,077	970	4,047	(1,551)	2,757	1,206
Interest-bearing liabilities:						
Interest expense:						
Deposits [4]	1,837	216	2,053	590	327	917
Federal Home Loan Bank advances	294	(456)	(162)	347	(309)	38
Subordinated debt	76	—	76	43	—	43
Total interest-bearing liabilities	2,207	(240)	1,967	980	18	998
Change in net interest income [5]	$870	$1,210	$2,080	$(2,531)	$2,739	$208

[1] Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale.
[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% for the period ending December 31, 2018 and 34% for both the

periods ending December 31, 2017 and 2016. 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 and brokered deposits.

(5) Presented on a tax equivalent basis using a tax rate of 21% for the period ending December 31, 2018 and 34% for both the periods ending December 31, 2017 and 2016.

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Comparison of Financial Condition at December 31, 2018 and December 31, 2017

Assets:

Summary. Total assets increased $68.9 million, or 4.4%, to $1.65 billion at December 31, 2018, principally due to increases of $75.4 million in net loans receivable and $4.4 million in cash and cash equivalents, offset by a decrease of $10.2 million in available for sale securities. The decrease in available for sale securities was due to maturities during 2018, the proceeds of which were used to fund loan growth with the excess contributing to the increase of $4.4 million in cash and cash equivalents.

Loans Receivable, Net. Net loans receivable increased $75.4 million during 2018, which reflects increases in multi-family and commercial mortgage loans of $86.9 million, construction loans of $14.6 million, medical loans of $9.7 million, condominium association loans of $8.8 million and other commercial business loans of $8.7 million, offset by decreases in SBA and USDA guaranteed loans of $21.0 million, residential mortgage loans of $12.9 million, time share loans of $11.1 million and home equity lines of credit of $6.0 million. Compared to 2017, commercial real estate and commercial business loan originations increased $105.3 million and $6.3 million, respectively, while residential real estate and consumer loan originations both decreased $5.0 million during 2018. Changes in the loan portfolio consisted of the following:

Residential Real Estate. Residential mortgage loans comprised 29.0% of total loans at December 31, 2018. The residential mortgage portfolio decreased $12.9 million, or 3.3%, primarily due to the sale of $60.9 million of fixed-rate residential mortgage loans. Residential mortgage loan originations decreased $5.0 million during 2018 as a result of decreased activity in the housing market and less refinancing opportunities due to the rising interest rate environment.

Multi-family and Commercial Real Estate. At December 31, 2018, multi-family and commercial real estate loans represented 43.0% of the Company’s total loan portfolio and increased $86.9 million, or 18.0%, during 2018. Loan originations for multi-family and commercial real estate loans were $176.9 million during 2018, representing an increase of $105.3 million as compared to 2017.

Construction. Construction loans, which include both residential and commercial construction loans, increased $14.6 million, or 50.6%, during 2018, primarily due to increased commercial real estate activity.

Commercial Business. Commercial business loans represented 21.0% of total loans at December 31, 2018, decreasing $5.1 million during 2018 primarily due to a reduction of $21.0 million in SBA and USDA guaranteed loans and $11.1 million in time share loans, offset by increases of $9.7 million in medical loans, $8.8 million in condominium association loans and $8.7 million in other commercial business loans. Commercial business loan originations increased $6.3 million during 2018 as compared to 2017.

Consumer Loans. Consumer loans represented 3.7% of the Company’s total loan portfolio at December 31, 2018 and decreased $6.3 million, or 11.4%, during 2018. The decrease in consumer loans was primarily due to a reduction of $6.0 million and $266,000 in home equity loans and other consumer loans, respectively. Loan originations for consumer loans totaled $19.8 million for 2018, representing a decrease of $5.0 million compared to 2017.

The allowance for loan losses totaled $14.7 million at December 31, 2018 compared to $12.3 million at December 31, 2017. The ratio of the allowance for loan losses to total loans increased from 0.99% at December 31, 2017 to 1.11% at December 31, 2018, primarily due to increases in nonperforming loans, net loan charge-offs, reserves for impaired loans and an 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, and 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.

Liabilities:

Total liabilities increased $65.2 million, or 4.6%, to $1.48 billion at December 31, 2018. During 2018, deposits increased $80.0 million, or 6.6%, which included increases in certificates of deposit of $69.6 million and noninterest-bearing deposits of $29.2 million, offset by decreases in NOW and money market deposits of $10.5

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million and savings accounts of $8.3 million. The increase in deposits remained strong due to competitive products and cash management initiatives. The increase in deposits was partially offset by a decrease of $18.3 million in borrowings, from $178.3 million at December 31, 2017 to $160.1 million at December 31, 2018, resulting from repayments of Federal Home Loan Bank advances with funds from excess deposits.

Equity:
Summary. Shareholders' equity increased $3.6 million from $168.5 million at December 31, 2017 to $172.1 million at December 31, 2018. The increase in shareholders' equity was attributable to net income of $9.6 million, offset by an increase in the net unrealized loss on available for sale securities of $704,000 (net of taxes), and dividends declared of $2.8 million.

Accumulated Other Comprehensive Loss. Accumulated other comprehensive loss comprises the unrealized gains and losses on available for sale securities. At December 31, 2018, net unrealized losses on available for sale securities, net of taxes, totaled $2.1 million compared to $1.2 million at December 31, 2017. For the year ended December 31, 2017, accumulated other comprehensive loss included $236,000 of the tax effect from the change in tax law that was reclassified to retained earnings in 2017. Unrealized holding losses on available for sale securities primarily resulted from a change in the market value of mortgage-backed securities, which was recognized in accumulated other comprehensive loss on the consolidated balance sheet and a component of comprehensive income on the consolidated statements of comprehensive income.

Comparison of Operating Results for the Years Ended December 31, 2018 and 2017

General. The Company's results of operations depends 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, gains on the sale of securities, bank-owned life insurance income, 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.

The Company recorded net income of $9.6 million for 2018, an increase of $4.3 million, compared to net income of $5.2 million for 2017. Excluding pre-tax costs of $1.1 million associated with the pending merger with Berkshire, the Company would have reported net income of $10.4 million, or $0.88 diluted earnings per share, for the year ended December 31, 2018. The Company anticipates the merger with Berkshire to be completed in the second quarter of 2019, subject to regulatory and shareholder approvals and other customary closing conditions. The lower net income for the year ended December 31, 2017 was related to a charge to income tax expense of $4.0 million as a result of the revaluation of the Company's net deferred tax asset due to the passage of the Tax Cuts and Jobs Act on December 22, 2017, which reduced the corporate income tax rate from 35% to 21%. Excluding the aforementioned charge to income tax expense in 2017, the Company would have reported net income of $9.2 million, or $0.77 diluted earnings per share, for the year ended December 31, 2017.

Non-GAAP Financial Measures. We believe that certain non-GAAP financial measures provide investors with information useful in understanding our financial performance, our performance trends and financial position. Specifically, we provide measures based on what we believe are our operating earnings on a consistent basis and exclude non-core operating items which affect the GAAP reporting of results of operations. We, as well as securities analysts, investors and other interested parties, use these measures to compare peer company operating performance.

We believe our presentation and discussion, together with the accompanying reconciliations, provide a complete understanding of factors and trends affecting our business and allows investors to view performance in a manner similar to management. These non-GAAP measures should not be considered a

substitute for GAAP basis measures and results, and we strongly encourage investors to review our consolidated financial statements in their entirety and not to rely on any single financial measure. Because non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names.

The table below presents a reconciliation of net income and earnings per share to shareholders, excluding the tax-affected transaction costs related to the pending merger with Berkshire for 2018 and the revaluation of the deferred tax asset for 2017.

	Years Ended December 31,	
(Dollars in Thousands, Except Per Share Data)	2018	2017
Net Income:		
Net income - GAAP basis	$9,565	$5,242
Merger-related transaction costs (after tax)	858	—
Revaluation of deferred tax asset	—	3,969
Net income - Non-GAAP basis	$10,423	$9,211
Earnings Per Share:		
Diluted as reported - GAAP basis	$0.80	$0.44
Merger-related transaction costs (after tax)	0.08	—
Revaluation of deferred tax asset	—	0.33
Diluted adjusted - Non-GAAP basis	$0.88	$0.77

Interest and Dividend Income. Total interest and dividend income increased $4.2 million, or 7.8%, for 2018, primarily due to an increase in the average balance of loans and the average yield earned on loans and other interest-earning assets. Interest income on loans and securities reflect net accretion of $688,000 for the year ended December 31, 2018 and net amortization of $6,000 for the year ended December 31, 2017, related to fair value adjustments of loans and securities resulting from the acquisition of Newport Bancorp, Inc., and its wholly-owned subsidiary Newport Federal Savings Bank in September 2013 (the "Newport Acquisition"). Average interest-earning assets increased $11.2 million to $1.51 billion in 2018, due to a higher average balance of loans of $37.0 million, offset by a decrease of $21.7 million in investment securities and other interest-earning assets of $4.1 million. The average yield on interest-earning assets increased 24 basis points to 3.87% as a result of an increase in the average yield on other interest-earning assets of 83 basis points.

Interest Expense. Interest expense increased $2.0 million, or 17.8%, to $13.0 million for 2018 compared to $11.1 million in 2017, primarily due to an increase in the average balance and average rate paid on deposits and the average rate paid on borrowings. Higher interest expense on interest-bearing liabilities reflects net amortization of $56,000 for the year ended December 31, 2018 and net accretion of $288,000 for the year ended December 31, 2017, related to fair value adjustments of deposits and borrowings resulting from the Newport acquisition. The average balance of interest-bearing deposits increased $26.8 million to $1.01 billion and the average rate paid on interest-bearing deposits increased 19 basis points to 0.95% as a result of higher market interest rates. Contributing to the increase in the average balance of deposit accounts were increases in the average balance of NOW and money market accounts of $17.0 million and certificate of deposit accounts of $14.5 million. The average balance of FHLB advances decreased $27.7 million, while the average rate paid on FHLB advances increased 20 basis points to 1.96% for 2018. The average rate paid on subordinated debt increased 92 basis points to 3.78%, compared to the same period in 2017, due to increases in the three-month LIBOR rate.

Provision for Loan Losses. The provision for loan losses increased $2.5 million to $3.1 million in 2018 compared to $661,000 in 2017, primarily due to increases in nonperforming loans, net loan charge-offs and reserves for

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impaired loans and an increase in commercial loans, which carry a higher degree of risk than other loans held in the loan portfolio. At December 31, 2018, nonperforming loans totaled $9.8 million, compared to $6.4 million at December 31, 2017, resulting from increases in nonperforming multi-family and commercial real estate and residential real estate loans of $1.6 million and $1.3 million, respectively. For 2018, net loan charge-offs totaled $795,000, consisting primarily of commercial business loan charge-offs, compared to $147,000 for 2017.

Noninterest Income. Total noninterest income increased $78,000 in 2018. The following table shows the components of noninterest income and the dollar and percentage changes from 2017 to 2018.

	Years Ended December 31,		Change	
	2018	2017	Dollars	Percent
	(Dollars in Thousands)			
Service fees	$7,145	$6,912	$233	3.4 %
Wealth management fees	25	548	(523)	(95.4)
Increase in cash surrender value of bank-owned life insurance	907	613	294	48.0
Mortgage banking	1,061	1,519	(458)	(30.2)
Net loss on disposal of equipment	(6)	(4)	(2)	50.0
Other	2,107	1,573	534	33.9
Total noninterest income	$11,239	$11,161	$78	0.7

The increase in noninterest income was primarily due to increases in the cash surrender value of bank-owned life insurance, service fees and other noninterest income, offset by decreases in fees from mortgage banking activities and wealth management fees. The cash surrender value of bank-owned life insurance increased $294,000 in 2018, compared to 2017, as a result of new policies purchased in October 2017. Service fees increased $233,000 in 2018, compared to 2017, primarily due to a higher volume of overdraft and electronic banking charges. Other noninterest income increased $534,000 in 2018 primarily due to swap fees of $781,000 from interest rate swap agreements and profit distributions of $127,000 from the Company's investment in three small business investment companies. Other noninterest income in 2017 included a pre-tax gain of $795,000 on the sale of the Company's trust and asset management business in May 2017. As a result of the sale, wealth management fees decreased $523,000 in 2018. Fees earned from mortgage banking activities decreased $458,000 during 2018 due to lower gains on residential fixed-rate loan sales.

Noninterest Expenses. Noninterest expenses increased $1.3 million for 2018 compared to 2017. The following table shows the components of noninterest expenses and the dollar and percentage changes from 2017 to 2018.

	Years Ended December 31,		Change	
	2018	2017	Dollars	Percent
	(Dollars in Thousands)			
Salaries and employee benefits	$21,591	$20,730	$861	4.2 %
Occupancy and equipment	6,806	6,818	(12)	(0.2)
Computer and electronic banking services	5,194	5,271	(77)	(1.5)
Outside professional services	1,280	1,499	(219)	(14.6)
Marketing and advertising	917	709	208	29.3
Supplies	569	502	67	13.3
FDIC deposit insurance and regulatory assessments	695	755	(60)	(7.9)
Merger expenses	1,090	—	1,090	—
Core deposit intangible amortization	602	601	1	0.2
Other real estate operations	287	743	(456)	(61.4)
Other	2,034	2,167	(133)	(6.1)

Total noninterest expenses	$41,065	$39,795	$1,270	3.2

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Contributing to the increase in noninterest expenses for 2018 were pre-tax merger-related transaction costs of $1.1 million for 2018, associated with the pending merger with Berkshire. Salaries and employee benefits increased $861,000 for 2018, primarily attributable to an increase in salaries and related compensation, benefits and taxes. Marketing expenses increased $208,000 for 2018 due primarily to focused marketing initiatives related to commercial banking and cash management. Compared to 2017, other real estate operations decreased $456,000 for 2018 due to lower holding costs related to other real estate properties and the sale of five foreclosed properties held by the Bank during 2018. Professional services decreased $219,000 in 2018 as a result of a decrease in legal expense, partially offset by higher audit fees as compared to 2017.

Income Tax Provision. For 2018, the Company recorded an income tax provision of $2.6 million compared to $8.4 million in 2017. The decrease in the income tax provision was primarily due to additional income tax expense of$4.0 million as a result of the revaluation of the Company's net deferred tax asset 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%. The effective tax rate was 21.3% and 61.5% for 2018 and 2017, respectively. The higher effective tax rate in 2017 was primarily due to the revaluation of the Company's net deferred tax asset. See Note 10 in Item 8 - Financial Statements and Supplementary Data for more details.

Comparison of Operating Results for the Years Ended December 31, 2017 and 2016

General. The Company recorded net income of $5.2 million for 2017, a decrease of $6.1 million, compared to net income of $11.3 million for 2016. Of the $6.1 million decrease in net income for 2017, $4.0 million related to the revaluation of the Company's net deferred tax asset due to the passage of the Tax Cuts and Jobs Act in December 2017, which reduced the corporate tax rate from 35% to 21%. Additionally, net income for 2016 included $7.3 million ($5.1 million after tax) in net proceeds from the sale of the Company's ownership interest in Vantis life Insurance Company in December 2016.

Non-GAAP Financial Measures

We believe that certain non-GAAP financial measures provide investors with information useful in understanding our financial performance, our performance trends and financial position. Specifically, we provide measures based on what we believe are our operating earnings on a consistent basis and exclude non-core operating items which affect the GAAP reporting of results of operations. We, as well as securities analysts, investors and other interested parties, use these measures to compare peer company operating performance. We believe our presentation and discussion, together with the accompanying reconciliations, provide a complete understanding of factors and trends affecting our business and allows investors to view performance in a manner similar to management. These non-GAAP measures should not be considered a substitute for GAAP basis measures and results, and we strongly encourage investors to review our consolidated financial statements in their entirety and not to rely on any single financial measure. Because non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names.

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The table below presents a reconciliation of net income and earnings per share to shareholders, excluding the revaluation of the deferred tax asset for 2017 and the tax-affected Vantis sale transaction for 2016.

	Years Ended December 31,	
(Dollars in Thousands, Except Per Share Data)	2017	2016
Net Income:		
Net income - GAAP basis	$5,242	$11,310
Net gain on sale of investment in affiliate	—	(5,060)
Revaluation of deferred tax asset	3,969	—
Net income - Non-GAAP basis	$9,211	$6,250
Earnings Per Share:		
Diluted as reported - GAAP basis	$0.44	$0.95
Net gain on sale of investment in affiliate	—	(0.42)
Revaluation of deferred tax asset	0.33	—
Diluted adjusted - Non-GAAP basis	$0.77	$0.53

Interest and Dividend Income. Total interest and dividend income increased $1.1 million, or 2.0%, for 2017, primarily due to an increase in the average balance and average rate earned on loans. Interest income on loans and securities reflect net amortization of $6,000 and $196,000 for the years ended December 31, 2017 and 2016, respectively, related to fair value adjustments of loans and securities resulting from the Newport Acquisition. Average interest-earning assets increased $67.9 million to $1.50 billion in 2017, due to a higher average balance of loans of $60.0 million and an increase in other interest-earning assets of $19.3 million, offset by a decrease in investment securities of $11.5 million. The average yield on interest-earning assets decreased nine basis points to 3.63% as a result of decreases in the average yield on other interest-earning assets of 333 basis points due to $2.0 million of dividends recognized in conjunction with the sale of the Company's ownership interest in Vantis Life Insurance Company in 2016.

Interest Expense. Interest expense increased $1.0 million, or 9.9%, to $11.1 million for 2017 compared to $10.1 million in 2016, primarily due to an increase in the average balance and average rate paid on deposits and the average rate paid on borrowings. Higher interest expense on interest-bearing liabilities reflects net accretion of $288,000 and $518,000 for the years ended December 31, 2017 and 2016, respectively, related to fair value adjustments of deposits and borrowings resulting from the Newport acquisition. The average balance of interest-bearing deposits increased $44.2 million to $982.0 million and the average rate paid on interest-bearing deposits increased six basis points to 0.76% as a result of higher market interest rates. Contributing to the increase in the average balance of deposit accounts were increases in the average balance of certificate of deposit accounts of $22.6 million and NOW and money market accounts of $22.1 million. The average balance of FHLB advances decreased $20.9 million while the average rate paid on FHLB advances increased 19 basis points to 1.76% for 2017. The average rate paid on subordinated debt increased 52 basis points to 2.86%, compared to the same period in 2016, due to increases in the three-month LIBOR rate.

Provision for Loan Losses. The provision for loan losses decreased $1.5 million to $661,000 in 2017 compared to $2.2 million in 2016, primarily due to reductions in reserves for impaired loans and net loan charge-offs. At December 31, 2017, nonperforming loans totaled $6.4 million, compared to $5.4 million at December 31, 2016, resulting from increases in nonperforming multi-family and commercial real estate loans of $2.4 million, partially offset by a decrease in nonperforming residential real estate loans of $1.0 million. For 2017, net loan charge-offs totaled $147,000, consisting primarily of residential real estate loan charge-offs, compared to $233,000 for 2016.

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Noninterest Income. Total noninterest income decreased $4.4 million to $11.2 million in 2017. The following table shows the components of noninterest income and the dollar and percentage changes from 2016 to 2017.

	Years Ended December 31,		Change	
	2017	2016	Dollars	Percent
	(Dollars in Thousands)			
Service fees	$6,912	$6,453	$459	7.1 %
Wealth management fees	548	1,209	(661)	(54.7)
Increase in cash surrender value of bank-owned life insurance	613	570	43	7.5
Net gain on sale of securities	—	55	(55)	(100.0)
Mortgage banking	1,519	1,203	316	26.3
Net gain on trading securities and derivatives	—	62	(62)	(100.0)
Net loss on disposal of equipment	(4)	(92)	88	(95.7)
Net gain on sale of investment in affiliate	—	5,263	(5,263)	(100.0)
Other	1,573	871	702	80.6
Total noninterest income	$11,161	$15,594	$(4,433)	(28.4)

The decrease in noninterest income was primarily due to the net proceeds of $5.3 million from the sale of the Company's ownership interest in Vantis Life Insurance Company in December 2016. Fees earned from mortgage banking activities increased $316,000 during 2017 due to increased volume and gains on residential fixed-rate loan sales. Service fees increased $459,000 in 2017, compared to the same period in 2016, primarily due to a higher volume of overdraft charges. Other noninterest income increased $702,000 for 2017 as a result of a pre-tax gain of $795,000 on the sale of the Company's trust and asset management business in May 2017. As a result of the sale, wealth management fees decreased $661,000 in 2017.

Noninterest Expenses. Noninterest expenses decreased $203,000 for 2017 compared to 2016. The following table shows the components of noninterest expenses and the dollar and percentage changes from 2016 to 2017.

	Years Ended December 31,		Change	
	2017	2016	Dollars	Percent
	(Dollars in Thousands)			
Salaries and employee benefits	$20,730	$20,363	$367	1.8 %
Occupancy and equipment	6,818	6,793	25	0.4
Computer and electronic banking services	5,271	5,580	(309)	(5.5)
Outside professional services	1,499	1,668	(169)	(10.1)
Marketing and advertising	709	755	(46)	(6.1)
Supplies	502	554	(52)	(9.4)
FDIC deposit insurance and regulatory assessments	755	932	(177)	(19.0)
Contribution to SI Financial Group Foundation	—	500	(500)	(100.0)
Core deposit intangible amortization	601	602	(1)	(0.2)
Other real estate operations	743	350	393	112.3
Other	2,167	1,901	266	14.0
Total noninterest expenses	$39,795	$39,998	$(203)	(0.5)

The decrease in noninterest expenses for 2017, as compared to the same period in 2016, was primarily due to a $500,000 cash contribution made in 2016 to SI Financial Group Foundation, a charitable foundation dedicated to providing assistance to charitable causes within the communities we serve. Salaries and employee benefits increased $367,000 for 2017, as a result of additional commercial lenders in 2017 and lower deferred compensation costs in

2016 because of a post-retirement benefit payout in June 2016. Computer and electronic

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banking expenses decreased $309,000 for 2017 compared to the same period in 2016 primarily due to the reconfiguration of the telecommunication infrastructure and contract renegotiations with a third party provider. Other noninterest expenses increased by $266,000 primarily due to $373,000 in fraudulent debit card transactions during the first quarter of 2017. Regulatory assessments decreased $177,000 in 2017 due to a lower FDIC assessment rate compared to 2016. Other real estate operations increased $393,000 for 2017 compared to the same period in 2016, primarily due to the foreclosure of six properties as well as holding costs related to the other real estate properties.

Income Tax Provision. For 2017, the Company recorded an income tax provision of $8.4 million compared to $4.9 million in 2016. The increase in the income tax provision was primarily due to additional income tax expense of$4.0 million as a result of the revaluation of the Company's net deferred tax asset 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%. This charge was recorded as additional income tax expense in the Company's statement of income for 2017. The effective tax rate was 61.5% and 30.3% for 2017 and 2016, respectively. The higher effective tax rate in 2017 was primarily due to the revaluation of the Company's net deferred tax asset and the lower effective tax rate for 2016 was impacted by the tax-exempt gain on bank-owned life insurance proceeds and the dividend received deduction. See Note 10 in Item 8. Financial Statements and Supplementary Data, for more details.

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 regularly adjusts its investment in liquid assets based upon its assessment of (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities and (4) the objectives of the Company’s asset/liability management, funds management and liquidity policies. The Company’s policy is to maintain liquid assets less short-term liabilities within a range of 9.0% to 20.0% of total assets. Liquid assets were 9.19% of total assets at December 31, 2018. Excess liquid assets are generally invested in interest-earning deposits and short- and intermediate-term securities.

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 December 31, 2018, cash and cash equivalents totaled $87.9 million. Securities classified as available for sale, which provide additional sources of liquidity, totaled $143.8 million at December 31, 2018. On that date, the Bank had FHLB advances outstanding of $151.8 million and no overnight advances outstanding. In addition, at December 31, 2018, the Bank had the ability to borrow an additional $145.1 million from the FHLB, which includes overnight lines of credit of $10.0 million. 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 its liquid assets combined with the available lines provide adequate liquidity to meet its current financial obligations.

In addition, the Bank believes deposit inflows through its branch network, which is presently comprised of 23 full-service retail banking offices located throughout its primary market area, and the general cash flows from its existing lending and investment activities, will afford it sufficient long-term liquidity.

The Bank’s primary investing activities are the origination, purchase and sale of loans and the purchase of securities. For the year ended December 31, 2018, the Bank originated $336.1 million of loans and purchased $56.0 million of loans and $34.9 million of securities. In 2017, the Bank originated $234.5 million of loans and purchased

$36.1 million of loans and $32.0 million of securities.

At December 31, 2018, the Bank had $194.8 million in loan commitments outstanding, which included $23.4 million in commitments to grant loans, $59.3 million in unused home equity lines of credit, $67.6 million in commercial lines of credit, $42.8 million in undisbursed construction loans, $1.2 million in overdraft protection lines and $338,000 in standby letters of credit.

Financing activities consist primarily of activity in deposit accounts and in borrowed funds. The increased liquidity needed to fund asset growth has been provided through proceeds from the sale and maturity of loans and securities and increased deposits. The net increase in total deposits, including mortgagors' and investors' escrow accounts, was $80.3 million and $77.4 million for the years ended December 31, 2018 and 2017, respectively.

Certificates of deposit due within one year of December 31, 2018 totaled $244.7 million, or 19.0% 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.

FHLB advances decreased $18.3 million for the year ended December 31, 2018 and decreased $47.7 million for the year ended December 31, 2017.

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, SI Financial Group is responsible for paying any dividends declared to its shareholders and making payments on its subordinated debentures. SI Financial Group may repurchase shares of its common stock in the future. SI Financial Group'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 SI Financial Group 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. SI Financial Group believes such restriction will not have an impact on SI Financial Group's ability to meet its ongoing cash obligations. At December 31, 2018 and 2017, SI Financial Group had cash and cash equivalents of $2.2 million and $3.1 million, respectively.

The Company and the Bank have managed their capital to maintain strong protection for depositors and creditors. The Bank is subject to regulatory capital requirements promulgated by federal bank regulatory agencies, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At December 31, 2018, the Bank met all the capital adequacy requirements to which they were subject and are "well capitalized" under regulatory guidelines. See Note 14 in Item 8. Financial Statements and Supplementary Data for additional information relating to regulatory capital requirements.

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Payments Due Under Contractual Obligations

The following table presents information relating to the Company’s payments due under contractual obligations as of December 31, 2018.

	Payments Due by Period				
	Less Than One Year	One to Three Years	Three to Five Years	More Than Five Years	Total
	(In Thousands)				
Federal Home Loan Bank advances	$44,269	$75,318	$26,249	$6,000	$151,836
Operating lease obligations [1]	1,382	2,379	1,942	6,315	12,018
Purchase obligations [2]	1,428	2,964	3,114	1,479	8,985
Other long-term liabilities reflected on the balance sheet [3]	—	—	—	8,248	8,248
Total contractual obligations	$47,079	$80,661	$31,305	$22,042	$181,087

(1) Payments are for the lease of real property.
(2) Represents a seven-year agreement entered into on 11/11/2017 with Connecticut Online Computer Center, Inc. for data processing services.
(3) Represents junior subordinated debt owed to an unconsolidated trust.

Off-Balance Sheet Arrangements

As a financial services provider, we are routinely 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 December 31, 2018 and 2017 are as follows:

	December 31,	
	2018	2017
	(In Thousands)	
Commitments to extend credit:		
Commitments to originate loans	$23,441	$60,360
Undisbursed construction loans	42,848	9,027
Undisbursed home equity lines of credit	59,314	56,044
Undisbursed commercial lines of credit	67,576	50,054
Overdraft protection lines	1,249	1,306
Standby letters of credit	338	134
Total commitments	$194,766	$176,925

Commitments to originate loans at December 31, 2018 and 2017 included fixed-rate loan commitments of $13.0 million and $34.1 million, respectively, at interest rates ranging from 3.00% to 6.88% and 2.88% to 6.00%, respectively.

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

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clauses and may require payment of a fee. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include residential and commercial property, accounts receivable, inventory, property, plant and equipment, deposits and securities.

Undisbursed commitments under construction, home equity or commercial lines of credit are commitments for future extensions of credit to existing customers. Total undisbursed amounts on lines of credit may expire without being fully drawn upon and therefore, do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Letters of credit are primarily issued to support public or private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year.

The Bank is a limited partner in three small business investment corporations ("SBICs") as well as an investor in a community economic development organization. At December 31, 2018, the Bank's remaining off-balance sheet commitment for the capital investments in the SBICs was $787,000 and no further commitment in the other investment. See Note 12 in the Company's Consolidated Financial Statements.

In 2004, the Bank established an Employee Stock Ownership Plan ("ESOP") for the benefit of its eligible employees. In conjunction with the "second step" public stock offering completed in 2011, the Company provided an additional loan to the ESOP totaling $3.1 million to purchase additional common shares. As of December 31, 2018, the remaining principal balance on the ESOP debt totaled $2.6 million. At December 31, 2018, allocated shares, including shares committed to be allocated to participants, totaled 412,226 and the amount of unallocated common shares held in suspense totaled 264,611, with a fair value of $3.4 million. See Note 11 in the Company's Consolidated Financial Statements.

As of December 31, 2018, the Company did not engage in any off-balance sheet transactions reasonably likely to have a material effect on its financial condition, results of operations or cash flows. See Note 12 in the Company's Consolidated Financial Statements.

Impact of Inflation and Changes in Prices

The financial statements and financial data presented within this document have been prepared in accordance with GAAP, which require the measurement of financial condition and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation on the Company's operations is reflected in increased operating costs. Unlike many other companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Impact of Recent Accounting Standards

For information relating to new accounting pronouncements, reference Note 1 – "Nature of Business and Summary of Significant Accounting Policies – Recent Accounting Pronouncements" in the Company's Consolidated Financial Statements.

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Common Stock Information

The common stock of the Company is listed on NASDAQ Global Market ("NASDAQ") under the trading symbol "SIFI." As of March 13, 2019, there were 12,054,785 shares of common stock outstanding, which were held by approximately 1,168 shareholders of record.

The following table sets forth the market price and dividend information for the Company's common stock for the periods indicated, as reported by NASDAQ.

	Years Ended December 31,					
	2018			2017		
	Price Range		Dividends	Price Range		Dividends
	High	Low	Declared	High	Low	Declared
First Quarter	$15.15	$13.75	$ 0.06	$15.70	$13.50	$ 0.05
Second Quarter	15.60	14.05	0.06	16.25	13.95	0.05
Third Quarter	15.20	13.60	0.06	16.45	13.90	0.05
Fourth Quarter	14.40	12.26	0.06	15.70	14.25	0.05

Item 7A. 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 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 years to manage interest rate risk. The Company offers 10-year fixed-rate mortgage loans that it retains in its portfolio. 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.

In January 2012, the Company entered into an interest rate swap agreement with a third-party financial institution with a notional amount of $15.0 million, whereby the counterparty will pay a variable rate equal to three-month LIBOR and the Company will pay a fixed-rate of 1.26%. The agreement was effective January 11, 2012 and terminated on January 11, 2017. This agreement was not designated as a hedging instrument.

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 simulations. The matching of assets and liabilities may be analyzed

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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 December 31, 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 at December 31, 2018.

	Percentage Change in Estimated Net Interest Income Over	
	12 Months	24 Months
100 basis point decrease in rates	(4.68)%	(4.17)%
200 basis point increase in rates	5.85	4.11
300 basis point increase in rates	7.56	3.96

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 if rates increased 200 or 300 basis points in the 12- and 24-month periods as a result of the Company's strategy 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-rate 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 movement.

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Report of Independent Registered Public Accounting Firm
The Board of Directors and Shareholders
of SI Financial Group, Inc.

Opinion on the Financial Statements
We have audited the accompanying consolidated balance sheets of SI Financial Group, Inc. and subsidiaries (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows, for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.
We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 18, 2019 expressed an unqualified opinion.
Basis for Opinion
These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.
We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

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We have served as the Company's auditor since 2005.

/s/ Wolf & Company, P.C.

Boston, Massachusetts
March 18, 2019

Item 8. Financial Statements and Supplementary Data.

SI FINANCIAL GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)

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	December 31,	
	2018	2017
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$17,433	$16,872
Interest-bearing	70,496	66,614
Total cash and cash equivalents	87,929	83,486
Available for sale securities, at fair value	143,822	154,053
Loans held for sale	1,915	835
Loans receivable (net of allowance for loan losses of $14,682 and $12,334 at December 31, 2018 and 2017, respectively)	1,312,565	1,237,174
Federal Home Loan Bank stock, at cost	9,035	9,856
Federal Reserve Bank Stock, at cost	3,638	3,636
Bank-owned life insurance	34,633	33,726
Premises and equipment, net	19,552	19,409
Goodwill and other intangibles	16,291	16,893
Accrued interest receivable	4,921	4,784
Deferred tax asset, net	6,921	6,412
Other real estate owned, net	720	1,226
Other assets	7,885	9,466
Total assets	$1,649,827	$1,580,956
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	$250,065	$220,877
Interest-bearing	1,037,966	987,170
Total deposits	1,288,031	1,208,047
Mortgagors' and investors' escrow accounts	4,701	4,418
Federal Home Loan Bank advances	151,836	170,094
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	24,883	21,668
Total liabilities	1,477,699	1,412,475
Commitments and contingencies (Notes 6, 11 and 12)		
Shareholders' Equity:		
Preferred stock ($0.01 par value per share; 1,000,000 shares authorized; none issued)	—	—
Common stock ($0.01 par value per share; 35,000,000 shares authorized; 12,054,785 shares and 12,242,434 shares issued and outstanding at December 31, 2018 and 2017, respectively)	121	122
Additional paid-in capital	126,153	126,540
Unallocated common shares held by ESOP	(2,208)	(2,688)
Unearned restricted shares	(226)	(235)
Retained earnings	50,426	46,176
Accumulated other comprehensive loss	(2,138)	(1,434)
Total shareholders' equity	172,128	168,481

Total liabilities and shareholders' equity	$1,649,827	$1,580,956

See accompanying notes to consolidated financial statements.

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

	Years Ended December 31,		
	2018	2017	2016
Interest and dividend income:			
Loans, including fees	$53,098	$49,272	$46,544
Securities:			
Taxable interest	2,990	3,183	3,376
Tax-exempt interest	54	56	56
Dividends	762	713	676
Other	1,267	763	2,259
Total interest and dividend income	58,171	53,987	52,911
Interest expense:			
Deposits	9,550	7,497	6,580
Federal Home Loan Bank advances	3,186	3,348	3,310
Subordinated debt and other borrowings	312	236	193
Total interest expense	13,048	11,081	10,083
Net interest income	45,123	42,906	42,828
Provision for loan losses	3,143	661	2,190
Net interest income after provision for loan losses	41,980	42,245	40,638
Noninterest income:			
Service fees	7,145	6,912	6,453
Wealth management fees	25	548	1,209
Increase in cash surrender value of bank-owned life insurance	907	613	570
Net gain on sale of securities	—	—	55
Mortgage banking	1,061	1,519	1,203
Net gain on derivatives	—	—	62
Net gain on sale of investment in affiliate	—	—	5,263
Net loss on disposal of equipment	(6)	(4)	(92)
Other	2,107	1,573	871
Total noninterest income	11,239	11,161	15,594
Noninterest expenses:			
Salaries and employee benefits	21,591	20,730	20,363
Occupancy and equipment	6,806	6,818	6,793
Computer and electronic banking services	5,194	5,271	5,580
Outside professional services	1,280	1,499	1,668
Marketing and advertising	917	709	755
Supplies	569	502	554
FDIC deposit insurance and regulatory assessments	695	755	932
Contribution to SI Financial Group Foundation	—	—	500
Merger expenses	1,090	—	—
Core deposit intangible amortization	602	601	602

Other real estate operations	287	743	350
Other	2,034	2,167	1,901
Total noninterest expenses	41,065	39,795	39,998
Income before income tax provision	12,154	13,611	16,234
Income tax provision	2,589	8,369	4,924
Net income	$9,565	$5,242	$11,310
Earnings per share:			
Basic	$0.81	$0.44	$0.96
Diluted	$0.80	$0.44	$0.95

See accompanying notes to consolidated financial statements.

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

	Years Ended December 31,		
	2018	2017	2016
Net income	$9,565	$5,242	$11,310
Other comprehensive loss, net of tax:			
Available for sale securities:			
Net unrealized holding losses	(704)	(517)	(455)
Reclassification adjustment for gains recognized in net income[1]	—	—	(36)
Net unrealized holding losses on available for sale securities	(704)	(517)	(491)
Other comprehensive loss	(704)	(517)	(491)
Comprehensive income	$8,861	$4,725	$10,819

[1] Pre-tax amounts are included in net gain on the sale of securities in noninterest income on the consolidated statements of income. Income tax expense associated with the reclassification adjustment for the years ended December 31, 2018, 2017 and 2016 was $0, $0 and $19,000, respectively.

See accompanying notes to consolidated financial statements.

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SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016
(In Thousands, Except Share Amounts)

	Common Stock			Unallocated				
	Shares	Dollars	Additional Paid-in Capital	Common Shares Held by ESOP	Unearned Restricted Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at December 31, 2015	12,218,818	$ 122	$ 124,997	$ (3,648)	$ (815)	$ 33,864	$ (190)	$ 154,330
Comprehensive income	—	—	—	—	—	11,310	(491)	10,819
Cash dividends declared ($0.16 per share)	—	—	—	—	—	(1,889)	—	(1,889)
Equity incentive plan compensation	—	—	408	—	474	—	—	882
Allocation of 48,638 ESOP shares	—	—	188	480	—	—	—	668
Tax benefit from share-based compensation	—	—	28	—	—	—	—	28
Stock options exercised	7,892	—	67	—	—	—	—	67
Common shares repurchased	(13,806)	—	(60)	—	—	(118)	—	(178)
Balance at December 31, 2016	12,212,904	122	125,628	(3,168)	(341			