

Oconee Federal Financial Corp.
Form 10-K
September 28, 2016
TABLE OF CONTENTS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the Fiscal Year Ended June 30, 2016
OR

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

For the transition period from _____ to _____
Commission File Number: 001-35033
Oconee Federal Financial Corp.
(Exact Name of Registrant as Specified in its Charter)

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

(864) 882-2765
(Registrant's Telephone Number Including Area Code)
Securities Registered Pursuant to Section 12(b) of the Act:

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

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

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

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

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

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

Edgar Filing: Oconee Federal Financial Corp. - Form 10-K

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of September 19, 2016 there were 5,812,690 shares outstanding of the registrant's common stock. The aggregate value of the voting and non-voting common stock held by non-affiliates of the registrant, computed by reference to the closing price of the common stock as of December 31, 2015 was \$22.3 million.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2016 Annual Meeting of Stockholders. (Part III)
-

TABLE OF CONTENTS

Table of Contents

PART I.

Item 1.

Business 1

Item 1A.

Risk Factors 34

Item 1B.

Unresolved Staff Comments 35

Item 2.

Properties 35

Item 3.

Legal Proceedings 35

Item 4.

Mine Safety Disclosures 35

PART II.

Item 5.

Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities 36

Item 6.

Selected Financial Data 37

Item 7.

Management’s Discussion and Analysis of Financial Condition and Results of Operations 39

Item 7A.

Quantitative and Qualitative Disclosures About Market Risk 50

Item 8.

Financial Statements and Supplementary Data 51

Item 9.

Changes in and Disagreements with Accountants on Accounting and Financial Disclosures 98

Item 9A.

Controls and Procedures 98

Item 9B.

98

Other Information

PART III.

Item 10.

Directors, Executive Officers and Corporate Governance 99

Item 11.

Executive Compensation 99

Item 12.

Security Ownership of Certain Beneficial Owners and Management and Related
Stockholder Matters 99

Item 13.

Certain Relationships and Related Transactions, and Director Independence 99

Item 14.

Principal Accounting Fees and Services 99

PART IV.

Item 15.

Exhibits and Financial Statement Schedules 100

Signatures

101

TABLE OF CONTENTS

PART I

ITEM 1. Business

Forward Looking Statements

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

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

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Annual Report.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

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

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

- changes in interest rates generally, including changes in the relative differences between short term and long term interest rates and in deposit interest rates, that may affect our net interest margin and funding sources;
- fluctuations in the demand for loans, which may be affected by the number of unsold homes, land and other properties in our market areas and by declines in the value of real estate in our market area;
- declines in the yield on our assets resulting from the current low interest rate environment;
- our ability to successfully implement our business strategies;
- risks related to a high concentration of loans secured by real estate located in our market areas;
- changes in the level of government support of housing finance;

TABLE OF CONTENTS

- the results of examinations by our regulators, including the possibility that our regulators may, among other things, require us to increase our allowance for loan losses, write down assets, change our regulatory capital position, limit our ability to borrow funds or maintain or increase deposits, or prohibit us from paying dividends, which could adversely affect our dividends and earnings;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- changes in laws or government regulations or policies affecting financial institutions, which could result in, among other things, increased deposit insurance premiums and assessments, capital requirements, regulatory fees and compliance costs and the resources we have available to address such changes;
- technological changes that may be more difficult or expensive than expected;
- our reliance on a small executive staff;
- changes in our compensation and benefit plans, and our ability to retain key members of our senior management team and to address staffing needs to implement our strategic plan;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;
- our ability to control costs and expenses, particularly those related to operating as a publicly traded company;
- other changes in our financial condition or results of operations that reduce capital available to pay dividends;
- other changes in the financial condition or future prospects of issuers of securities that we own, including our stock in the Federal Home Loan Bank (“FHLB”) of Atlanta; and
- other economic, competitive, governmental, regulatory and operational factors affecting our operations, pricing, products and services.

Oconee Federal Financial Corp.

Oconee Federal Financial Corp. (the “Company”) is a federally-chartered corporation that was incorporated in January 2011 to be the mid-tier stock holding company for Oconee Federal Savings and Loan Association in connection with the mutual holding company reorganization of Oconee Federal Savings and Loan Association.

Edgar Filing: Oconee Federal Financial Corp. - Form 10-K

As of June 30, 2016, Oconee Federal Financial Corp. had 5,837,908 shares outstanding and a market capitalization of approximately \$114.2 million.

The executive offices of Oconee Federal Financial Corp. are located at 201 East North Second Street, Seneca, South Carolina 29678, and the telephone number is (864) 882-2765. Our website address is www.oconeefederal.com.

Information on our website should not be considered a part of this annual report. Oconee Federal Financial Corp. is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System. At June 30, 2016, we had total assets of \$485.6 million, total deposits of \$399.6 million and total equity of \$85.4 million. We recorded net income of \$5.2 million for the year ended June 30, 2016.

Oconee Federal Savings and Loan Association

Oconee Federal Savings and Loan Association is a federally chartered savings and loan association headquartered in Seneca, South Carolina. Oconee Federal Savings and Loan Association was originally chartered by the State of South Carolina in 1924 and in 1991 it converted to a federal charter.

Our principal business consists of attracting retail deposits from the general public in our market area and investing those deposits, together with funds generated from operations, in one-to-four family residential mortgage loans and, to a lesser extent, nonresidential mortgage, construction and land,

2

TABLE OF CONTENTS

agricultural and other loans. We also invest in U.S. Government and federal agency securities, mortgage-backed securities and short-term deposits. We have also used borrowed funds as a source of funds, and we borrow principally from the Federal Home Loan Bank of Atlanta. We conduct our business from our executive office and seven branch offices. Our offices are located in Oconee County, South Carolina, Stephens County, Georgia and Rabun County, Georgia. Our primary market area consists of the counties where we have offices and the nearby communities and townships in adjacent counties in South Carolina and Georgia.

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

Oconee Federal, MHC

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

Acquisition

On December 1, 2014, the Company and Oconee Federal, MHC completed the acquisition of Stephens Federal Bank (“Stephens Federal”). The acquisition was consummated in accordance with the Agreement and Plan of Merger by and among the Company, Oconee Federal MHC, Oconee Federal Savings and Loan Association and Stephens Federal dated February 26, 2014, as amended on May 6, 2014 (the “Merger Agreement”), pursuant to which Stephens Federal merged with and into the Oconee Federal Savings and Loan Association, with the Oconee Federal Savings and Loan Association as the surviving institution.

Pursuant to the terms of the Merger Agreement, Stephens Federal completed a voluntary supervisory conversion from a federally chartered mutual savings association to a federally chartered stock savings association immediately prior to the merger with Oconee Federal Savings and Loan Association. Accordingly, no consideration was paid by Oconee Federal Savings and Loan Association or the Company in connection with the acquisition of Stephens Federal; however, upon completion of the acquisition, the Company issued 36,945 shares of Company common stock to Oconee Federal, MHC, which is equal to the quotient of (i) the valuation of Stephens Federal, which was \$700, as determined by an independent third party, divided by (ii) the average closing price of the Company’s common stock as reported on the NASDAQ for the 20 consecutive trading days ending on the third trading day preceding the effective date of the acquisition, or approximately \$18.95 per share, rounded.

The acquisition expanded our market area to northeast Georgia, specifically Stephens and Rabun Counties, where we added three additional branches, two in Toccoa, Georgia of Stephens County and one in Clayton, Georgia of Rabun County. These counties and surrounding counties and townships have enhanced our ability to build our deposit base and opened up new lending markets to us. We also acquired a secondary mortgage lending platform with Freddie Mac through the acquisition that has opened new opportunities for us to reach customers with new mortgage products that we were not able to offer before.

As a result of the acquisition, we added \$140.9 million in total assets at fair value, which included goodwill of \$2.6 million and deferred tax assets of \$5.1 million.

Market Area

We conduct business through our executive office and four branches in the towns of Seneca, Walhalla, and Westminster South Carolina, and three branches in the towns of Toccoa and Clayton, Georgia. All five of our South Carolina offices are located in Oconee County, which is located on the I-85 corridor between the Charlotte and Atlanta metropolitan areas, approximately 120 miles south of Charlotte and

TABLE OF CONTENTS

approximately 120 miles north of Atlanta. Our South Carolina offices are also located approximately 40 miles south of Greenville, South Carolina, and 10 miles from Clemson, South Carolina. Two of our Georgia branches are located in Stephens County and one is located in Rabun County. Both counties border Oconee County, South Carolina. Our primary market area, which consists of Oconee County, South Carolina and Stephens and Rabun Counties, Georgia and their nearby communities and townships in adjacent counties in both South Carolina and Georgia, is mostly rural and suburban in nature. The regional economy is fairly diversified, with services, wholesale/retail trade, manufacturing and government representing the primary industries. In addition, Oconee County and nearby counties are experiencing an increase in retiree populations. Oconee County's and South Carolina's respective June 2016 unemployment rates of 5.8% and 5.4%. Rabun County and Stephens County had 5.6% and 6.0% June 2016 unemployment rates, respectively, and Georgia's overall rate was 5.1%. The national unemployment rate was 4.9% for June 2016.

The largest employers in our market area are education and health services providers; public utilities and light manufacturing companies; including the city and county school systems; Oconee Memorial Hospital; Duke Energy, an electric utility and provider of nuclear and hydroelectric energy; Schneider Electric-Square D, a manufacturer of electronic components; Itron, a manufacturer of electronic measuring devices; and BorgWarner, a supplier of motor vehicle parts and systems. Other employers include the local government, retail trade and the leisure/hospitality industry. Many residents of Oconee County are employed in nearby Greenville, South Carolina, which has major employers such as BMW Motors, Inc. and Greenville Health System, and in Pickens County, which has major employers such as Clemson University and the Pickens County school system.

Competition

Competition for making loans and attracting deposits in our primary market area is intense, particularly in light of the relatively modest population base of our primary markets and the relatively large number of institutions that maintain a presence in the area. Financial institution competitors in our primary market area include other locally-based commercial banks, thrifts and credit unions, as well as regional and super-regional banks. We also compete with depository and lending institutions not physically located in our primary market area but capable of doing business remotely, mortgage loan originators and mortgage brokers and other companies in the financial services industry, such as investment firms, mutual funds and insurance companies. Some of our competitors offer products and services that we currently do not offer, such as investment services, trust services and private banking. To meet our competition, we seek to emphasize our community orientation, local and timely decision making and superior customer service. As of June 30, 2015 the most recent date of available data, our market share of deposits represented 24.1%, 30.0%, and 9.8% of FDIC-insured deposits in Oconee County, SC, Stephens County, GA, and Rabun County, GA, respectively.

Lending Activities

The principal lending activity of Oconee Federal Savings and Loan Association is originating one-to-four family residential mortgage loans and, to a lesser extent, home equity loans and lines of credit, nonresidential real estate loans, construction and land loans, commercial loans, agricultural loans, and other loans. We increased our loan portfolio of nonresidential real estate loans, home equity loans and lines of credit, and added agricultural loans and to a much lesser extent than the other segments, commercial and industrial loans through the acquisition of Stephens Federal. We plan to continue to maintain the loans we acquired that are of sound credit quality in our portfolio and to increase our lending in nonresidential real estate loans to a modest extent in our primary market area.

TABLE OF CONTENTS

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

	At June 30,		2015		2014	
	2016		Amount	Percent	Amount	Percent
	Amount	Percent				
	(Dollars in thousands)					
Real estate loans:						
One-to-four family	\$ 242,067	82.56%	\$ 256,321	82.57%	\$ 214,735	92.55%
Multi-family	1,996	0.68	2,574	0.83	254	0.11
Home equity	6,433	2.19	8,198	2.64	227	0.10
Nonresidential	20,310	6.93	21,685	6.98	8,408	3.62
Agricultural	2,958	1.01	4,164	1.34	—	0.00
Construction and land	14,332	4.89	14,590	4.70	7,661	3.30
Total real estate loans	288,096	98.26	307,532	99.06	231,285	99.68
Commercial and industrial	176	0.06	184	0.06	—	0.00
Consumer and other loans	4,915	1.68	2,745	0.88	747	0.32
Total loans	\$ 293,187	100.00%	\$ 310,461	100.00%	\$ 232,032	100.00%
Net deferred loan fees	(1,124)		(1,194)		(1,246)	
Allowance for loan losses	(922)		(1,008)		(855)	
Loans, net	\$ 291,141		\$ 308,259		\$ 229,931	
	At June 30,		2012			
	2013		Amount	Percent		
	Amount	Percent				
	(Dollars in thousands)					
Real estate loans:						
One-to-four family	\$ 204,397	91.61%	\$ 234,125	92.82%		
Multi-family	258	0.12	264	0.10		
Home equity	292	0.13	395	0.16		
Nonresidential	8,521	3.82	9,226	3.66		
Construction and land	8,735	3.91	7,232	2.87		
Total real estate loans	222,203	99.59	251,242	99.61		
Consumer and other loans	925	0.41	987	0.39		
Total loans	\$ 223,128	100.00%	\$ 252,229	100.00%		
Net deferred loan fees	(1,214)		(1,540)			
Allowance for loan losses	(751)		(857)			
Loans, net	\$ 221,163		\$ 249,832			

TABLE OF CONTENTS

Contractual Maturities and Interest Rate Sensitivity. The following table summarizes the scheduled repayments of our loan portfolio at June 30, 2016. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less. Loans are presented net of loans in process.

Real Estate Loans									
	One-to-Four Family	Multi-family	Home Equity	Nonresidential	Agricultural	Construction and Land	Commercial and Industrial	Consumer and Other	Total
(Dollars in thousands)									
Amounts due in:									
One year or less	\$ 1,710	\$ —	\$ 1,455	\$ 856	\$ —	\$ 805	\$ 125	\$ 4,261	\$ 9,212
More than one to two years	1,672	—	1,661	20	39	202	51	264	3,909
More than two to three years	2,218	—	1,942	66	352	320	—	59	4,957
More than three to five years	4,948	116	262	1,691	70	997	—	74	8,158
More than five to ten years	26,890	171	945	7,709	939	5,969	—	131	42,754
More than ten to fifteen years	18,420	633	81	5,107	827	407	—	—	25,475
More than fifteen years	186,209	1,076	87	4,861	731	5,632	—	126	198,722
Total	\$ 242,067	\$ 1,996	\$ 6,433	\$ 20,310	\$ 2,958	\$ 14,332	\$ 176	\$ 4,915	\$ 293,187

The following table summarizes our fixed-rate and adjustable-rate loans that are due after June 30, 2017:

Real Estate Loans									
	One-to-Four Family	Multi-family	Home Equity	Nonresidential	Agricultural	Construction and Land	Commercial and Industrial	Consumer and Other	Total
(Dollars in thousands)									

Interest rate
terms on
amounts due
after one year:

Fixed-rate loans	\$ 216,896	\$ 665	\$ 3,193	\$ 13,095	\$ 1,758	\$ 12,962	\$ 51	\$ 654	\$ 249,271
Adjustable-rate loans	23,461	1,331	1,785	6,359	1,200	565	—	—	34,701
Total	\$ 240,357	\$ 1,996	\$ 4,978	\$ 19,454	\$ 2,958	\$ 13,527	\$ 51	\$ 654	\$ 283,972

Loan Approval Procedures and Authority. Pursuant to federal law, the aggregate amount of loans that Oconee Federal Savings and Loan Association is permitted to make to any one borrower or a group of related borrowers is generally limited to 15% of Oconee Federal Savings and Loan Association's unimpaired capital and surplus (25% if the amount in excess of 15% is secured by "readily marketable collateral" or 30% for certain residential development loans). At June 30, 2016, based on the 15% limitation, Oconee Federal Savings and Loan Association's loans-to-one-borrower limit was approximately \$12.8 million. At June 30, 2016, our largest loan relationship with one borrower was for approximately \$3.5 million secured by a brokerage account and was performing in accordance with its terms on that date.

Our lending is subject to written underwriting standards and origination procedures. Decisions on loan applications are made on the basis of detailed applications submitted by the prospective borrower, credit histories that we obtain, and property valuations (consistent with our appraisal policy) prepared by outside independent licensed appraisers approved by our board of directors as well as internal evaluations, where permitted by regulations. The loan applications are designed primarily to determine the borrower's ability to repay the requested loan, and the more significant items on the application are verified through use of credit reports, financial statements and tax returns. Under our loan policy, the loan officer processing an application is responsible for ensuring proposals and approval of any extensions of credit are in compliance with internal policies and procedures and applicable laws and regulations, and for establishing and maintaining credit files and documentation sufficient to support the loan and to perfect any collateral position.

Our lending officers do not have individual lending authority. Two members of the Management Credit Committee must jointly approve all portfolio loan applications where the total credit exposure would be up to \$500 thousand. Total credit exposure is the sum total of all loans that a customer has directly or guarantees with Oconee Federal. Three members of the Management Credit Committee must jointly approve all portfolio loan applications where the total credit exposure would be between \$500 thousand and

TABLE OF CONTENTS

\$1 million. These loan applications would be reviewed regularly by the Board Credit Committee. The Board of Directors approves all portfolio loan applications where the total credit exposure exceeds \$1 million. To ensure adequate liquidity, under our loan policy, aggregate loans outstanding should not exceed our total deposits and advances from the Federal Home Loan Bank of Atlanta.

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

One-to-four Family Residential Real Estate. The cornerstone of our lending program has long been the origination of long-term loans secured by mortgages on owner-occupied one-to-four family residences. At June 30, 2016, \$242.1 million, or 82.6% of our total loan portfolio, consisted of one-to-four family residential mortgage loans. At that date, our average outstanding one-to-four family residential mortgage loan balance was \$120 thousand and our largest outstanding residential loan had a principal balance of \$1.7 million. At June 30, 2016, our ten largest one-to-four family residential loans in our portfolio totaled \$12.3 million. Virtually all of the residential mortgage loans we originate are secured by properties located in our market area.

The repayment terms of our mortgage loans are generally up to 30 years for traditional homes and up to 15 years for manufactured or modular homes. The repayment terms of non-owner-occupied homes are generally up to 15 years for fixed-rate loans and up to 30 years for adjustable-rate loans. Due to consumer demand in the current low market interest rate environment, many of our recent originations are 15- to 30-year fixed-rate loans secured by one-to-four family residential real estate. Although we typically retain in our portfolio the loans we originate, we generally originate our fixed-rate one-to-four family residential loans in accordance with secondary market standards.

Our adjustable-rate mortgage loans have fixed rates for the first 12 months, and then carry interest rates that adjust annually at a rate based on the change, between closing of the loan and the adjustment date, of the Federal Housing Finance Agency's published contract interest rate, which represents the national average rate for purchases of previously occupied homes. Such loans carry terms to maturity of up to 30 years. The adjustable-rate mortgage loans currently offered by us generally provide for a 100 basis point annual interest rate change cap, a lifetime cap of 500 basis points over the initial rate and a lifetime floor of 200 basis points under the initial rate.

Although adjustable-rate mortgage loans may reduce our vulnerability to changes in market interest rates because they periodically reprice, as interest rates increase, the required payments due from the borrower also increase (subject to rate caps), increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustments of the contractual interest rate are also limited by the maximum periodic and lifetime rate adjustments permitted by our loan documents. At June 30, 2016, \$23.5 million, or 9.7% of our one-to-four family residential loans, had adjustable rates of interest. No adjustable-rate one-to-four family residential loans were originated during the year ended June 30, 2016.

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

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

At June 30, 2016, we had \$1.9 million of one-to-four family residential mortgage loans that were 60 days or more delinquent and \$7.1 million of one-to four-family residential mortgage loans that were 30-59

TABLE OF CONTENTS

days delinquent. Among delinquent loans past due more than 60 days, two loans exceeded \$200 thousand in outstanding principal, or 23.9%, of total loans in this category. For loans 30-59 days past due, four loans with outstanding balances greater than \$250 thousand totaled \$1.3 million, or 18.7%, of the total balance of loans in this category.

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

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

At June 30, 2016, multi-family real estate loans totaled \$2.0 million or 0.7% of the loan portfolio. All of these loans were performing in accordance with their terms at June 30, 2016.

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

At June 30, 2016, we had \$6.4 million of home equity loans and lines of credit outstanding, representing 2.2% of our total loan portfolio. We had \$106 thousand of home equity loans that were 60 days or more delinquent and \$94 thousand of home equity loans that were 30-59 days delinquent at June 30, 2016.

Nonresidential Real Estate. Nonresidential loans include those secured by real estate mortgages on churches, owner-occupied and non-owner occupied commercial buildings of various types, retail and office buildings, hotels, and other business and industrial properties. The nonresidential real estate loans that we originate generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of our nonresidential real estate loans is generally 75%. At June 30, 2016, we had \$20.3 million in nonresidential real estate loans, representing 6.9% of our total loan portfolio. At June 30, 2016, our average outstanding nonresidential mortgage loan balance was \$257 thousand. Our largest nonresidential real estate relationship totaled \$2.4 million, all of which was related to one loan. This loan is secured by a mortgage on a church building in Oconee County, and, at June 30, 2016, this loan was performing in accordance with its terms. At June 30, 2016, of our ten largest loans in our total portfolio, three loans totaling \$5.2 million were nonresidential real estate loans.

Set forth below is information regarding our nonresidential real estate loans at June 30, 2016:

Type of Loan	Number of Loans	Balance (Dollars in thousands)
Church	22	\$ 9,357
Office buildings	22	4,050
Other nonresidential	35	6,903

Total 79\$ 20,310

8

TABLE OF CONTENTS

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

Loans secured by nonresidential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Nonresidential real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. In addition, because a church's financial stability often depends on donations from congregation members, some of whom may not reside in our market area, rather than income from business operations, repayment may be affected by economic conditions that affect individuals located both in our market area and in other market areas with which we are not as familiar. In addition, due to the unique nature of church buildings and properties, the real estate securing church loans may be less marketable than other nonresidential real estate. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate. At June 30, 2016, we had \$990 thousand of nonresidential real estate loans that were 60 days or more delinquent. No nonresidential real estate loans were 30-59 days delinquent. Among delinquent loans past due 60 days or more, two loans exceeded \$350 thousand in outstanding principal.

Agricultural. As a result of the Stephens Federal acquisition, the Company acquired agricultural real estate loans. These loans are secured by farmland and related improvements in the Company's market area. These loans generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of these loans is generally 75%. The Company is managing a small number of these loans in our portfolio.

Loans secured by agricultural real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Agricultural real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. At June 30, 2016, we had \$2.9 million of agricultural loans outstanding, representing 1.0% of our total loan portfolio. At June 30, 2016, our average outstanding agricultural loan balance was \$246 thousand. Our largest agricultural relationship totaled \$977 thousand, of which \$938 thousand was related to one loan. This loan is secured by a mortgage on a farm in Stephens County, and, at June 30, 2016, this loan was performing in accordance with its terms. At June 30, 2016, all of our agricultural loans were performing in accordance with their terms.

Construction and Land. We generally make construction loans to individuals for the construction of their primary residences and to commercial businesses for their real estate needs. These loans generally have maximum terms of twelve months, and upon completion of construction convert to conventional amortizing mortgage loans. Residential construction loans have rates and terms comparable to one-to-four family residential mortgage loans that we originate. Commercial construction loans have rates and terms comparable to other commercial real estate loans that we originate. During the construction phase, the borrower generally pays interest only. The maximum loan-to-value ratio of our owner-occupied

TABLE OF CONTENTS

construction loans is 80%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential mortgage loans. Commercial construction loans are generally underwritten pursuant to the same guidelines used for originating other commercial real estate loans.

We make loans secured by land to complement our construction lending activities. These loans have terms of up to 10 years, and maximum loan-to-value ratios of 75% for improved lots and 65% for unimproved land. At June 30, 2016, we had \$14.3 million of construction and land loans outstanding, representing 4.9% of our total loan portfolio.

	Number of Loans	Loans in Process	Net Principal Balance
(Dollars in thousands)			
One-to-four family	41	\$ 9,456	\$ 7,210
Residential land	112	—	6,180
Nonresidential	5	—	942
Total construction and land loans	158	\$ 9,456	\$ 14,332

At June 30, 2016, our largest residential construction loan was for \$2.0 million, of which \$1.2 million was outstanding. This loan was performing according to its terms at June 30, 2016. At June 30, 2016, we had \$93 thousand of our residential land loans that were 30-59 days delinquent and \$25 thousand that were 60 days or more delinquent. The application process for a construction loan includes a submission to Oconee Federal Savings and Loan Association of accurate plans, specifications and costs of the project to be constructed or developed, a copy of the deed or plat survey of the real estate involved in the loan and an appraisal of the proposed collateral for the loan. Our construction loan agreements generally provide that loan proceeds are disbursed in increments as construction progresses. Outside independent licensed or certified appraisers or architects inspect the progress of the construction of the dwelling before disbursements are made.

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

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

Commercial and industrial loans and leases typically are underwritten on the basis of the borrower's or lessee's ability to make repayment from the cash flow of its business and generally are collateralized by business assets. As a result, such loans and leases involve additional complexities, variables and risks and require more thorough underwriting and servicing than other types of loans and leases. At June 30, 2016, we had \$176 thousand of commercial and industrial loans outstanding, representing 0.1% of our total loan portfolio. At June 30, 2016, all of our commercial and industrial loans were performing in accordance with their terms.

Consumer. We offer installment loans for various consumer purposes, including the purchase of automobiles, boats, and for other legitimate personal purposes. The maximum terms of consumer loans is 18 months for unsecured loans, 12 months for loans secured by marketable securities and 18 to 60 months

TABLE OF CONTENTS

for loans secured by a vehicle, depending on the age of the vehicle. The Company generally only extends consumer loans to existing customers or their immediate family members, and these loans generally have relatively low balances.

To date, our consumer lending, apart from home equity loans, has been quite limited. At June 30, 2016, we had \$4.9 million of consumer loans outstanding, representing 1.7% of our total loan portfolio. Of these loans, \$1.4 million, or 28.6%, were secured by deposits at Oconee Federal Savings and Loan Association.

Consumer loans may entail greater credit risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At June 30, 2016, all of our consumer loans were performing in accordance with their terms.

Originations, Purchases and Sales of Loans

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

With the exception of loans acquired through the Stephens Federal acquisition, we currently do not purchase whole loans or interests in loans from third parties.

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

	Years Ended June 30,	
	2016	2015
	(In thousands)	
Total loans at beginning of period	\$ 310,461	\$ 232,032
Loans originated:		
Real estate loans:		
One-to-four family	15,270	20,505
Multi-family	—	—
Home equity	178	170
Nonresidential	3,738	895
Agricultural	263	974
Construction and land	7,313	5,680
Total real estate loans	26,762	28,224
Commercial and industrial	51	131
Consumer and other loans	4,610	1,584
Total loans originated	31,423	29,939
Loans acquired through Stephens Federal Acquisition:	—	95,462
Deduct:		
Principal repayments	(43,747)	(43,393)
Sold loans that were acquired in Stephens Federal acquisition	(2,587)	(2,809)
Charge-offs	(537)	(42)
Transfers to real estate owned	(1,826)	(728)

Edgar Filing: Oconee Federal Financial Corp. - Form 10-K

Net loan activity	(17,274)	78,429
Total loans at end of period	\$ 293,187	\$ 310,461

11

TABLE OF CONTENTS

Secondary Mortgage Lending

We added the capabilities and access to the Freddie Mac secondary mortgage lending program through the acquisition of Stephens Federal. As such we originated \$4.3 million and sold \$4.6 million of conforming one-to-four residential real estate mortgage loans for the year ended June 30, 2016.

Delinquencies and Nonperforming Assets

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

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

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

At June 30,

2016

2015

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due
--	-----------------------------	-----------------------------	-----------------------------------	-------------------	-----------------------------	-----------------------------	--------------------------------	-------------------

(Dollars in thousands)

Real estate loans:

One-to-four family	\$ 7,086	\$ 1,001	\$ 863	\$ 8,950	\$ 5,871	\$ 1,243	\$ 2,311	\$ 9,425
Multi-family	—	—	—	—	—	—	—	—
Home equity	94	22	84	200	49	—	—	49
Nonresidential	—	48	942	990	229	313	1,108	1,650
Agricultural	—	—	—	—	—	—	—	—